



Position Paper

Transparency of Short Selling and Securities Lending

This paper sets out ASX's recommendations in response to the Government's Exposure Draft of the Corporations Amendment (Short Selling) Bill 2008.

2 October 2008

Summary

This paper sets out ASX's response to two issues:

- What should be the content of the reporting framework to be reflected in regulations to be made under the draft Corporations Amendment (Short Selling) Bill 2008; and
- How to transition from the current prohibition on most forms of short selling to the situation envisaged by the draft legislation, where covered short selling is again permitted but with an effective reporting framework in place.

ASX supports the Government's proposal to legislate to close the gaps that have been apparent in the existing law that saw very little covered short selling activity being reported.

However, ASX believes that the definition of covered short sales in the legislation needs to be broadened somewhat to be consistent with that contained in ASIC's class order of 19 September 2008. The Government should also consider whether the application of the up-tick rule (which currently applies in only very limited circumstances) should be retained. In addition, the Government could consider legislating to remove the ability of a market operator to determine whether, and in what form, naked short selling could occur.

This paper predominantly constitutes a contribution to public debate as to the way in which the Government, with the advice of ASIC, may wish to consider addressing issues around short selling transparency in the foreshadowed regulations, rather than a statement of how ASX will be dealing with those issues.

The paper also identifies the need to allow financial intermediaries adequate time to implement the systems and process changes that are pre-conditions to successful introduction of the three additional strands of financial market transparency proposed by ASX in this paper.

Those three strands involve:

- Real-time identification or 'tagging' (by clients to brokers and brokers to ASX) of those orders that involve covered short sales;
- End of day reporting by brokers to ASX of their net short sale position to enable publication by ASX the next day of the aggregated data on a per security basis; and
- Identification by custodians and other CHESS settlement system participants to the relevant ASX subsidiary of details of CHESS transactions facilitating stock borrowing and lending so as to enable publication by ASX of the aggregated data on a per security basis.

In ASX's view, there will need to be a transitional phase during which the ability to undertake covered short selling, at least in non-financial stocks and preferably (in time) in all stocks, is restored before any or all of the three new strands of financial market transparency are completely in place and the regulations are in operation.

Comments

Any comments or questions on this submission should be directed to:

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Introduction

Appropriately regulated short selling can enhance market liquidity and price discovery. Liquid markets lower the cost of capital for firms and lower transaction costs for investors buying and selling securities by minimising the market impact of trades. The price signals short selling can provide, when appropriate transparency is in place, can often deliver valuable information to investors on market perceptions of the appropriate value of securities. Knowing the level of short selling in a stock is a relevant factor which assists market users in their own buying and selling decisions.

To some extent, the legislative provisions dealing with short selling which have existed in Australia for many years evidence an implicit acknowledgment of both the net benefits of short selling, notwithstanding some significant risks, and the advantages of transparency as to the level of permitted short selling.

However, as is now widely acknowledged, the legislative provisions did not achieve their evident objectives. The consultation process initiated by ASX in March 2008 was designed to take forward the public debate about overcoming the legislative deficiencies whilst retaining the commitment to short selling as providing a net public benefit.

The task of implementing that broad thrust of improved legislation directed at achieving effective reporting was interrupted, for understandable reasons, by ASIC's decision taken with effect from 22 September 2008 to introduce a temporary prohibition on short selling subject to limited exceptions or carve-outs. An explanation of the short selling arrangements prior to and after 22 September is at Appendix A.

The process of refining the initial prohibitions, whilst creating great difficulties for the operation of the market, highlighted the fact that short selling is not simply undertaken in order to effect a view that a stock may be over-priced. Short selling also facilitates a raft of hedging, arbitrage and other risk management activities, including underwriting of capital raisings.

In the absence of the temporary prohibition, the public policy debate had focussed on addressing the problem that the legislative provision dealing with reporting of short sales potentially had no application to many covered short sales in which the short seller may not technically be short but may actually be the beneficial owner by the time that it effected the short sale. This is because the definitions that were needed to impose reporting obligations on relevant transactions did not apply to transactions in which the seller had, at the time of the sale 'a presently exercisable and unconditional right to vest the products in the buyer'. The draft legislation currently has this focus.

However, now there is an additional significant public policy issue: how to transition from an interim ban on short selling (with limited exceptions) to an environment in which the legislative provisions directed at transparency of permitted short selling are effective, without again creating market disruption because of legitimate impediments to speedy implementation of an optimal transparency regime.

In order to put in context the recommendations made in this paper, it is necessary to recognise that:

- in order to impose the temporary prohibitions, ASIC addressed in its various instruments, the definitional ambiguities and legislative gaps to which ASX and others had been drawing attention for some time; and
- more importantly, a number of these solutions will need to be carried over into legislative amendments in order to properly effect the completely different objective, once the temporary prohibitions have been removed, of appropriately regulating permitted short selling activity.

The rationale for permitting short selling subject to increased transparency

When ASX released its short selling consultation paper in March 2008, there was no unanimous view as to either the rationale for increasing transparency as to the extent of short selling or the reason why legislative amendment was the key to addressing existing opacity.

Some stakeholders believed that increased transparency would reduce the overall level of short selling activity and supported it on this basis. Others believed it would enhance the price discovery mechanism by providing information to assist investors in making investment decisions and supported increased transparency on this subtly different basis.

With regards to the need for legislative amendments, some were under the impression that ASX could unilaterally provide a solution through amendments to the ASX Market Rules without appreciating that these rules can only apply to ASX participants and cannot effectively extend to customers of brokers. Others supported the need for legislative amendment, recognising the impracticality of ASX creating obligations that are unenforceable by purporting to impose contractual terms (market rules) on organisations (brokers' clients) that are not a party to that multilateral contract (ASX's rules).

ASX received over 40 submissions to its March 2008 consultation paper. There was support in most of the submissions for reporting of covered short sales. ASX agrees that increased transparency, via the proposed legislative amendments, will enhance price discovery and should be enacted, especially if the increased transparency involves the three strands to financial market transparency identified in this paper.

The submissions generally (but not universally) reflected an understanding that if there was to be more information made available to market users about covered short sales:

- The assessment of whether the increased information was beneficial should be primarily based on whether it contributed to price discovery (and not based primarily on whether it would cause short sellers to lessen their involvement in the market); and
- That the assessment of the costs of delivering this potential benefit would potentially need to incorporate extensive changes to brokers' systems if a broader concept of the 'net' level of short selling (than is currently captured by the ASX reporting system) were to be introduced (e.g. if the end of day report needed to capture the eventual closing-out of the short economic position).

We note that these views are broadly consistent with the objectives expressed in the Regulation Impact Statement (RIS) issued with the draft Bill recently issued by the Government to encourage comment as to how it should be fleshed out. Those stated objectives were: to increase transparency of covered short sales to aid price discovery, to remove uncertainty surrounding the level of short selling, and to reduce the potential opportunities for market abuse. The RIS also focuses on meeting these objectives in a manner that does not impose excessive compliance costs on market participants.

More effective disclosure of covered short sales (some time after the temporary ban is lifted) should not be construed as a measure primarily designed to continue impeding short selling activity or even a response to short sellers who may seek to engage in market manipulation. As noted previously, short selling remains a legitimate activity that facilitates a number of important strategies such as market making, arbitrage, and the underwriting of capital raisings.

As the Reserve Bank of Australia (RBA) has stated, short selling adds to market liquidity and to the efficiency of pricing, contributing to lower bid-offer spreads and helping to ensure that prices reflect the views of both bullish and bearish investors.¹ Notwithstanding these clear benefits, there have been concerns that short selling may have been used, by a small group of investors, as a vehicle through which breaches of other legislative provisions occur.

Increased transparency is primarily intended to assist with pricing efficiency. However, the extreme price volatility and its implications for certain financial stocks of systemically important institutions, has seen the imposition of temporary prohibitions on short selling activities by regulators around the world. A sustainable long-term improvement to the regulation of short selling will generally centre around providing reliable and timely information on short selling to potential buyers from which they can more confidently determine whether and when to buy or sell.

In this regard, as flagged in ASX's earlier public statements including our March 2008 consultation paper, ASX believed legislative clarity was needed in this area and we welcome the Government's draft Bill. We look forward to the opportunity to comment on the draft regulations that are prepared with the benefit of the comments in this paper and those of other stakeholders. It is those regulations that will provide the practical details on how the reporting regime will work. Until the legislation/regulations are in place, ASX will continue to publish the short selling data received from participants under the interim ASIC arrangements, with whatever limitations exist as to the comprehensiveness of that data, due to matters beyond ASX's control.

¹ See the RBA's May 2008 Review of Settlement Practices for Australian Equities, at http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/review_stllmt_prac_aus_equities_052008.pdf

Future framework for short selling transparency within the Corporations Amendment (Short Selling) Bill 2008

This paper outlines what ASX believes would be an appropriate framework for achieving:

- in the short-term – a transition towards greater transparency upon lifting of the current ban (subject to carve-outs) on covered short selling;
- via the passage of legislation and the making of regulations ('the medium-term') – an even more robust reporting framework involving (a) real-time tagging of short sales (by clients to brokers and brokers to ASX), and (b) new transparency of stock lending activities; and
- in both the short and longer term, a continuing prohibition on naked short selling (with the possibility of very limited exceptions, e.g. related to exercise of an Options Market Contract).

Under both the short-term and later stages, the new arrangements will potentially require significant systems enhancements (by both participants and market operators) to capture the broader class of covered short selling transactions and stock lending transactions. (In this context we welcome ASIC's "AD08-22 Update on ASIC's Response to Short Selling" where it has recognised, in relation to direct market access providers, the need to be responsive to various difficult systems / process change issues).

Ideally, at some stage after lifting of the current ban but preferably prior to the entirety of the regulations being made (presumably in the first half of 2009), brokers would progressively be in a position to increase the comprehensiveness of the data that they lodge with ASX, at the end of each day, reporting covered short sale activity by security (in respect of their clients and on their own behalf). This would be in the same form as the end of day reports that executing brokers are currently submitting pursuant to the ASIC instruments relating to reporting of activity that has been carved out from the otherwise total ban on short selling. In practice this data is often restricted to 'in-house' trading by participants, where systems already exist to capture the information. Extending the reporting requirement to all covered short sales, as defined in ASIC's announcement of 19 September, will likely require participants to develop new systems to capture this data from clients and collate it to report to the market operator.

At some stage this level of transparency would be supplemented by additional information derived from real-time tagging of orders that involve covered short sales and reporting of stock borrowing and lending by direct users of ASX's settlement system.

It would be unfortunate if the lifting of the current temporary ban on covered short selling was to be delayed beyond the time that this ban has been deemed necessary for financial stability purposes. The fact that desirable new financial market transparency initiatives could not be operational by that time should not delay any partial or complete lifting of the temporary ban, subject to broader (public policy) systemic risk considerations.

ASX's views as to the optimal content of the regulations in the medium-term (i.e. when all stages described above are in place) were predominantly formed after ASX's own consultation process earlier this year. In this context, ASX sees it as particularly important:

- to ensure that more comprehensive disclosure of permitted covered short selling activity is in place; and
- comprehensive disclosure of stock lending activity is also in place.

The legislation and supporting regulations may rely on ASX infrastructure to receive relevant short selling data, aggregate it and re-distribute it to the market. However, ASX will not be determining the content of the data to be reported to it. This will be set out in legislative amendments and regulations.

By contrast, if, as ASX has proposed, it receives a direction from the RBA to mandate that direct users of CHES (participants in ASX's settlement facility, ASTC) supply ASTC with borrowing/lending data, ASX will arrange for the re-distribution of that data to the market.

Key ASX positions on issues raised in the Government's Draft Bill

ASX recommends incorporation of the following approach into the legislative amendments and associated regulations foreshadowed by the Government (i.e. when the necessary systems changes have been made to enable all the strands set out below to be achieved):

Covered short selling

- Covered short selling to be permitted in circumstances where:
 - Brokers (and other 'participants' of ASX) are required to notify ASX in real-time of all short sale orders ('real time tagging of trades');
 - These ASX participants are also required to submit end of day reports to ASX of their client's (and their own) net short sale position. For this purpose, 'net short sale position' would include:
 - Naked short sales in an underlying financial product resulting from the exercise of an Options Market Contract;
 - Covered short sales where at the time of sale the seller has either borrowed the stock or entered into a borrowing arrangement which enables the seller to deliver the stock sold at settlement; and
 - Covered short sales as described in ASIC Class Order 08/751 (assuming these sales are included in the Government's legislative amendments);
 - Participants in ASTC (a group that overlaps with, but is not synonymous with, executing brokers) are also required to submit daily reports to ASTC of such details of their borrowing and lending as is directed by the RBA ('stock lending data')

Naked short selling

- Continuation indefinitely of the temporary ban on naked short selling.
 - ASX announced on 19 September 2008 that it was effectively prohibiting naked short selling under the ASX Market Rules, by removing all securities from the Approved Short Sale Product List. This decision was taken to complement ASIC's announcements on the same day. It was also consistent with feedback received from a number of stakeholders as part of ASX's earlier consultation process that indicated the provisions allowing naked short selling could be removed without adversely affecting the operation of the market.
- The means by which ASIC modified the Corporations Act on 19 September 2008 and released a Regulatory Guide on Short Selling, has reinforced the desirability of decisions on naked short selling being made in conjunction with decisions about covered short selling.
 - Such decisions could either continue to be exercised by ASX, in close consultation with ASIC, or could be taken by ASIC. For its part, ASX would have no difficulty with removal from the Corporations Act of the capacity for a market operator to permit naked short selling. This step would facilitate integrated decision-making relating to naked and covered short-selling by the one organisation (ASIC). In the event of multiple market operators, it would be even more important to centralise decision-making, and not encourage regulatory arbitrage.

- If carve-outs from the naked short selling prohibition were considered necessary for certain participants and/or activities, it would be best handled through an ASIC Class Order or through changes to the Corporations Act.
- If ASX's capacity to determine the conditions under which naked short selling can occur is not removed in the foreshadowed legislative amendments, ASX's current inclination is to continue indefinitely the ban on naked short selling which came into effect from the opening of the market on 22 September 2008.
 - ASX will review its position when the regulations made under the legislation takes effect if the Government has not amended the draft legislation to remove ASX's role in determining the availability of naked short selling.

This means that ASX is supportive of a modified version (see next para) of the Government's preferred Option 2, which merely involves clients being required by law to advise their broker of covered short sales so that all such information in relation to each security can be aggregated (along with comparable data from executing brokers as to 'in-house' activity) and disseminated to market users to assist with pricing efficiency.

Stock Lending

- If the Government is to achieve its objective of providing greater transparency on the extent of directional short selling in a cost effective and efficient manner, ASX believes that the short selling data supplied under Option 2 should be supplemented with the reporting of securities lending data (Option 4) and the real-time identification of short sales through tagging of relevant orders by brokers.
 - ASX has been discussing with the RBA how reporting of securities lending data might be achieved via ASX's settlement facility, CHESS, operated by ASX Settlement and Transfer Corporation ('ASTC'). ASTC has indicated that it will be able to move to aggregate and publish securities lending data daily on the basis of ASTC and technology service providers to the reporting institutions having sufficient time to make the necessary systems adjustments. This would also require changes to the ASTC rules.
 - Collecting real-time data on short selling transactions will be important for market regulators (ASIC) and supervisors (ASX) in tracing covered short selling activity. ASX would be in a position to publish an aggregation of such data by the next trading day. ASX is aware that some fund managers have questioned whether even aggregated data that does not reveal the identity of a broker's clients may, if published with little time lag, provide commercially sensitive information on trading strategies that other market users may exploit.

Other changes

ASX agrees that Option 1 (retaining the status quo) and Option 3 (direct disclosure of covered short sales to the market operator by customers of ASX participants (brokers)) would not meet the Government's announced objectives for increasing transparency in an efficient manner.

ASX would support Option 5, a review by Treasury or ASIC of the existing short selling regime, if it was considered necessary, although we do not see the need for significant change once the transparency issues have been addressed. One issue that might be included in such a review would be whether the legislative provisions precluding short selling at a price lower than the previous sale price (variously referred to as either the 'up-tick' rule or the 'down-tick' rule) should be removed. ASX believes it should be removed.

In ASX's view, the 'up-tick' rule as it applies to covered short sales has virtually no practical operation (for the reasons outlined later in this paper) and it would be unfortunate if public policy decisions to retain the rule were made on the basis of erroneous assumptions that such a rule actually contributes to a slowing down of the velocity of share price movements in a falling market.

Transitional arrangements

The interim measures announced by ASIC on 19 September 2008 (prior to the complete prohibition announced on 21 September 2008 and modified over subsequent days) did not alter the current means by which ASX receives net short sale information from brokers, namely in the form of an end of day report of short sales which have yet to be settled. This reflects the fact that the collection of data for naked short sales was, in large part, designed to provide information to manage settlement risks rather than providing information that could assist in price discovery. Such risks do not exist with covered short selling in circumstances where the seller has the right to vest the securities in the buyer because of the securities borrowing arrangement which it has in place.

ASX's rules require a participant to report all outstanding net short sale positions at the end of the day. These net positions do not capture intra-day positions which have been closed-out (other than pursuant to a borrowing arrangement) by the end of that day. As noted in the earlier ASX consultation paper, the concept of a 'net' position does not mean that a short position of one client or the participant as principal is netted against a long position of the participant as principal or another client of that participant for reporting purposes.

If the Government pursues the option of requiring a participant to lodge a daily 'net' short sale report, it would be important for the regulations accompanying the legislation to clearly indicate how such net positions should be calculated by participants. As noted above, the effective extension of the class of covered short sales to be reported under the new ASIC requirements (to be made permanent through the proposed legislation), will likely capture a significantly greater volume of activity than has been captured to date. This may involve significant systems change for participants to capture, collate, and report such data.

Since the interim prohibition was put in place, subject to a limited number of exemptions, ASX has been collecting daily covered short sale data from executing brokers, predominantly related to market making activities, on the basis that it involves short sales that have yet to settle (noting that settlement is completed three days after the trade is conducted).

As such, the report does not claim to provide information that would enable the market to determine what short positions are still outstanding at a point in time. The net 'economic' short position is only closed when the short seller borrower eventually repurchases securities to enable them to be returned to the lender.

Once the interim prohibition on most covered short sales is lifted, the reporting arrangements will continue to reflect these arrangements unless the Government finalises the details of the regulations to accompany the new Act and indicates that reporting should be on a different basis.

The 'Up-tick' rule

In the course of imposing a temporary ban on short selling (subject to exceptions), ASIC distinguished between 2 types of covered short selling which had previously been permitted:

- those 'covered' by specifically allocated borrowings – these are the ones referred to in ASIC Class Order 08/751 as covered short sales where the seller of the stock has a 'presently exercisable and unconditional right to vest' the stock in the buyer because of a firm pre-existing securities borrowing capacity involving specifically allocated stock being set aside by the lender to cover the particular sale;
- those that are less securely 'covered' by virtue of a looser stock borrowing arrangement (e.g. whereby a general ability to borrow has been established prior to the short sale but certainty that the stock is still available for borrowing is only confirmed after the short sale order is placed).

Quite apart from the different settlement risk profiles implicit in these two types of covered short sale, they are also distinguishable (for no sound reason) by whether or not they are subject to the legislative prohibition on selling at a price lower than the previous sale price (the up-tick or down-tick rule).

For no apparent reason, the existing legislation:

- imposes the up-tick rule on covered short selling effected through the looser stock borrowing arrangements described above (see Corporations Act s.1020B(4)(d));

- but does not impose the up-tick rule on the way that covered short selling is usually effected through more secure covering arrangements involving short sales being covered by specifically allocated borrowings.

The up-tick rule has never applied in practice to covered short sales (and only ever applied to the insignificant amount of short selling that was naked) because the law has always provided an alternative avenue: covering one's short sales with specifically allocated borrowings. The result is that, to date, derivatives hedging activity has not been impeded by the inclusion in the legislation and ASX rules of alternative ways of effecting short sales, only some of which prohibit selling at a lower price than the previous sale. It would become even more important that any theoretical up-tick rule not have any practical application if ASX's suggested introduction of real-time tagging of trades were to be introduced. The systems complexities inherent in having to have the capacity to distinguish between covered short sales to which the up-tick rule did not apply and those to which it did apply, would be very significant and yet achieve nothing.

The simple solution is to recognise that any comfort which may be taken from the assumed operation of an up-tick rule is illusory. The legislative provisions purporting to impose this as a condition of undertaking some types of short selling could be deleted without having any adverse consequences.

The medium-term – the making of regulations

As part of the medium-term solution to be provided by the legislative amendments, ASX believes the Government should confirm through the proposed regulations that the existing ASIC instrument definition of what constitutes a net short sale should continue to apply to the reporting requirement of brokers.

This net short sale data, which is currently collected and published by ASX, serves a useful purpose, particularly as a tool in managing systemic settlement risks, but is probably less useful as an accurate measure of the amount of short selling in a day, and hence a provider of insight into the efficiency and transparency of price discovery.

The practical difficulties of expanding the definition of net reporting obligations, whereby brokers would be obliged to track both the short sale and the corresponding long trade to close out the short position make this not a feasible solution. Submissions to ASX indicated such an extension would be extremely costly and practically difficult to implement, particularly where clients trade through various brokers or where a broker uses a third party clearing and settlement service provider which is becoming more common.

ASX also believes there may be merit in the Government imposing a real-time gross short sale reporting requirement on participants. The oversight by regulators of short selling would be enhanced by requiring real-time tagging of all covered short sales in ASX's ITS trading platform. It would provide a useful audit trail of short sales for the purpose of identifying and investigating potential instances of market manipulation conducted through short selling.

More problematic would be the question of whether gross real-time data should be aggregated and released publicly, either before trading the following day or at a later time. While gross data would provide a daily indicator of the aggregate level of short sales in a particular stock, particular caution would need to be exercised in interpreting such data, given it may overstate the amount of directional short selling undertaken². There may also be a real concern by fund managers that publication may disclose commercially sensitive information on trading strategies that could be exploited by other market users. We believe market users are best placed to provide insights on the pros and cons of publishing the gross data, and if so, under what conditions.

In ASX's view, the price discovery benefit provided by gross covered short sale data would be greatly enhanced if data on the level of securities borrowing was also published daily. These two sources of information – gross short selling data and securities lending data - could provide the market with a more complete picture of short selling activity than either data source published in isolation. ASX notes that caution would still need to be exercised in interpreting the data for price discovery purposes; investors would be encouraged to refer to both short selling and securities lending data and to draw any conclusions from changes in the relationship between these two sources of information, rather than relying solely on either source.

² For example, it would not capture intra-day short selling (where the short position is closed by the end of the trading day) but it would capture short selling associated with activities (such as market making, arbitrage, underwriting capital raisings) which do not provide information that is useful for price discovery.

ASX position on securities lending

ASX agrees with the RBA that an increase in the transparency of securities lending activity will, among other things, improve the robustness of the equity settlement process and improve equity market functioning.³

ASX has been discussing with the RBA how the CHES system may be able to provide a mechanism for facilitating the collection and publication of securities lending information; although this would likely require potentially significant systems changes to both CHES and in ASTC participant IT systems to implement.

The publication of new CHES data for individual securities by ASTC to provide information that may enhance the fair, orderly and transparent nature of cash equity market trading would be a new development in the Australian market, and goes beyond ASTC's traditional licence requirement to provide a fair and effective settlement facility. As such, ASX considered that before imposing a new requirement on ASTC participants mandating the provision of additional data on securities lending there needed to be a clear indication from Government and/or regulators as to whether, and in what form, this information should be made publicly available. On the basis that the Government has apparently chosen not to include coverage of stock lending transparency in the legislation, notwithstanding the desirability of this transparency being achieved, ASX would be supportive of the RBA amending the Financial Stability Standard for Securities Settlement Facilities to provide a clear policy rationale for the amendments to the ASTC rules.

Securities lending plays an important role in ensuring that the vast majority of trades settle on time. The securities lending market allows participants to borrow securities to prevent a failure to deliver at the due time of settlement. The rate of failed settlements in Australia (at less than 1% of all trades) is relatively low by international standards. It may be somewhat higher if it were not for the active securities lending market.

According to the RBA, benefits from the publication of securities lending data may include better understanding of potential risk inherent in securities lending positions; equal access to market data for all market users; better 'ex post' analysis of market events; better understanding of the functioning of markets; and a proxy for short selling (noting limitations on the usefulness of data on securities lending for this purpose).

A number of submissions to ASX's short selling consultation paper also expressed strong support for the publication of securities lending information for use as a proxy for the level of short selling. As noted above, ASX would be prepared to introduce rules that required reporting of securities lending information by custodians through the CHES infrastructure, with such data to be aggregated and made available to market users. No such reporting requirement currently exists.

ASX reiterates its view that securities lending data alone is not a good proxy for short selling data, and should **not** be considered a replacement for short selling data. There are many factors independent of short selling activity which may impact securities lending (such as dividend payments and potential settlement failures). Similarly, short sale positions may be closed-out by means other than securities lending (such as on-market purchase of securities or exercise of a derivative). For these reasons, securities lending information should be considered to be supplementary to, and not a substitute for, improved short sale disclosures.

³ The RBA's May 2008 Review of Settlement Practices for Australian Equities can be accessed at http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/review_stllmt_prac_australian_equities_052008.pdf

APPENDIX A

Recent changes to the regulation of short selling in Australia

Short selling arrangements prior to 22 September 2008

- Naked short selling was prohibited unless covered by exceptions contained in s1020B of the Corporations Act.
- The one exception was for naked short sales of stocks on ASX's Approved Short Sale Product List.
- Covered short sales were allowed.
- Trading Participants were required to report to ASX each day their 'net' short sale position for each stock.
- The 'net' short sale position included naked short sales and short sales of stocks where at the time of sale the seller had either borrowed the stock or had entered into a borrowing arrangement which enabled the seller to deliver the stock sold at settlement (but without necessarily having a 'presently exercisable and unconditional right to vest' the stock in the buyer because of that securities lending arrangement).

Short selling arrangements from 22 September 2008

- Naked short selling is prohibited for all stocks including Exchange Traded Funds (except naked shorts in an underlying financial product resulting from the exercise of an Options Market Contract) – this prohibition occurred as a result of ASX action announced on Friday 19 September 2008 to remove all stocks from its Approved Short Sale Product List.
- Covered short sales of all listed stocks are not permitted (subject to a limited number of exceptions).
- Trading participants are required to continue to report to ASX each day their net short sale position for each stock (but this reporting requirement has negligible application to the client business that is a significant focus of any medium-term solution because the carve-outs primarily relate to proprietary business).
- Net short sale position includes:
 - Naked short sales in an underlying financial product resulting from the exercise of an Options Market Contract; and
 - Covered short sales made by a trading participant who is exempt from, or otherwise not subject to, the prohibition of covered short selling as per ASIC Class Order 08/751.

The current short selling position is to remain in place for 30 days, at which time, or at some later time, ASIC will review its decision to ban covered short sales of non-financial stocks. In the meantime, the Government has released the Draft Corporations Amendment (Short Selling) Bill 2008.