



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

5 May 2008

Malcolm Starr
General Manager, Regulatory and Public Policy
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By email: regulatorypolicy@asx.com.au

Dear Mr Starr

Short selling

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. Our members have primary responsibility in listed companies to deal with the Australian Securities Exchange (ASX) and interpret and implement the Listing Rules. Our members deal on a day-to-day basis with ASX and have a thorough working knowledge of the operations of the markets, the needs of investors and the Listing Rules, as well as compliance with the Corporations Act (the Act). We have drawn on their experience in our submission on short selling.

CSA recommendations

CSA notes that there are two risks which need to be addressed by the regulatory framework for short-selling:

1. the risk of settlement failing
2. the risk of an uninformed market and potentially market manipulation.

CSA recommends that:

- with respect to market disclosure, the same regulations should apply to covered short selling as to naked short selling
- naked short selling should continue to be allowed subject to existing regulations to address the risk of settlement failure
- any regulatory response in relation to short selling should not be undertaken in isolation, but should include appropriate regulatory attention to the disclosure of margin loans to executives and directors who individually or collectively are substantial shareholders and stock lending.

These recommendations are dealt with in greater detail below.

1. Applying the same disclosure regulation to covered short selling as to naked short selling

CSA agrees with the ASX that a key objective of the regulatory framework must be to limit the risk of failure of settlement.

However, CSA notes that failure of settlement is not the only risk that is entailed in short selling. There is also a real risk that short-selling may create an uninformed market with investors unaware of the reasons behind significant movements in share prices. An uninformed market can, in combination with undisclosed margin loans to executives or directors who are individually or collectively substantial shareholders or market capitalisation covenants in a company's borrowing arrangements, give rise to a real risk of market manipulation.

CSA considers that the risk of settlement failure is well covered by existing regulation, whereas the second risk of creating an uninformed market and market manipulation needs to be addressed by more comprehensive market disclosure of short selling as well as stock lending, margin loans to executives and directors who are individually or collectively substantial shareholders and market capitalisation covenants in borrowing arrangements.

CSA notes that disclosure failures concerning covered short selling results in companies being unaware of and unable to explain to the ASX, investors and the media the reasons behind movements in share prices that can be generated by short selling activity.

CSA believes that, currently, there is a discrepancy between the ASX Market Rules and the Corporations Act in relation to the regulation of short selling. At present, the ASX regulates naked short selling — brokers must disclose any naked short sales to the extent that they are aware of them — but does not regulate covered short selling.

CSA notes that higher levels of information to ASX concerning covered short sales would assist in keeping the market informed. CSA also notes that more vigorous and rigorous enforcement of the substantial shareholder notice requirements would also assist in ensuring the market is kept informed.

CSA recommends that the same disclosure regulation should apply to covered short selling as to naked short selling.

2. Naked short selling should continue to be allowed, subject to existing regulations to address the risk of settlement failure

CSA believes on balance that there is value in the market having the capacity to continue to engage in naked short selling. It can improve liquidity in the market. However, CSA believes that this must be balanced with the need to keep the market informed, to restrict market manipulation.

3. Consideration of the disclosure of margin loans and stock lending

CSA does not believe that any consideration of the regulatory framework in relation to short selling can be undertaken without consideration of the regulatory framework in relation to the disclosure of margin loans, covenants in loan agreements and stock lending. CSA believes that a holistic solution is required, given the degree to which these issues are meshed.

CSA intends to lodge a separate submission with ASX on the issue of the disclosure of margin loans and stock lending.

Concern about potential effect on voting outcomes at general meetings

CSA would also like to note our concern that, due to the non-disclosure of covered short selling when allied with stock lending, there is potential for voting outcomes at annual general meetings (AGMs) to be manipulated. The ASX consultation paper notes, on page 15, that:

When 'lending' beneficial ownership transfers from the lender to the borrower, meaning that the borrower has the right to all dividends and votes attached to the securities for the term of the loan.

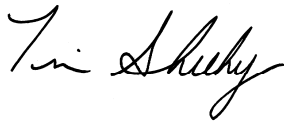
The commercial terms of the loan agreement will generally require the borrower to reimburse the lender for all 'economic' rights of ownership, such as any dividends or corporate events that may occur during the loan period. The lender usually has a right to recall the securities if they want to vote at a company meeting.

CSA notes that permitting the lending of securities prior to an AGM can result in a distortion of voting outcomes or, worse, a manipulation of voting outcomes, making full disclosure essential.

Conclusion

When preparing this submission, CSA drew in particular on the expertise of its national Legislation Review Committee, comprising members working in listed companies with the responsibility to interpret the Listing Rules and ensure that continuous disclosure obligations are met.

Yours sincerely

A handwritten signature in black ink, appearing to read "Tim Sheehy". The signature is written in a cursive, flowing style.

Tim Sheehy
CHIEF EXECUTIVE