

26 November 2008

CORPORATIONS AMENDMENT (SHORT SELLING) BILL 2008

Second Reading

Mr BRADBURY (Lindsay) (6.49 p.m.) — I rise in support of the Corporations Amendment (Short Selling) Bill 2008 and in support of all three schedules of the bill. Clearly, schedule 3 is the schedule that is providing the contention as far as the opposition is concerned. I will come to elements of schedule 3 in a moment, but I would like to reflect more generally on some of the comments made by the member for Fadden, who preceded me in this debate. His contribution, in his usual colourful and flowery manner, sought to portray the actions of the Rudd government in responding to the global financial crisis as having made the problem worse—I think that was the sentiment expressed by the previous speaker.

Clearly that is not a view that is shared by an overwhelming majority of Australians, who have acknowledged and recognised that the early and decisive action that the government has taken has ensured that Australia has responded not only in a timely fashion but in an appropriate and proportionate way to the massive challenges that we face globally at the moment. It is important to understand the extent of the challenges we face in managing the national economy in what is a very difficult international economic environment. That is particularly important in the implementation of government policy in relation to the bill that is before the House today.

Against the backdrop of the global financial crisis and the credit crunch, we all have increasingly become aware of the significance of what commenced with difficulties in the subprime mortgage market in the US just over a year ago. We have all become familiar with the reverberations that have extended to shores as far afield as those of ours here in Australia. We have seen tremendous uncertainty in the global economy. We have seen massive tightening in credit markets. The credit crunch, combined with the other aspects of the global financial crisis, has ensured that the challenges that we face in managing the economy have been amplified.

In recent times we have seen our share markets cop an absolute battering. That is something that, right across this country, people have taken great interest in observing, whether it be self-funded retirees who are seeing those declines in share values on our stock market whittle away the hard earned savings that they have put aside to fund their own retirement or whether it be those whose employment is affected by the impact of what we are seeing on share markets right across the globe. Clearly the factors at play here are global in their nature. The responses can be national and inevitably will be, but we need to be responding in an international way. That is why the efforts of the Prime Minister, the Treasurer and this government in working cooperatively with countries right across the globe have been an important part of our response to the global financial crisis.

In net terms we have seen US equity prices fall by around 30 per cent since the Lehman Brothers collapse, which was only back on 15 September 2008. Over that same period the Australian market has been down by 25 per cent. So clearly there has been considerable difficulty faced not just in our share

market but in share markets right across the globe. If you take Australian shares from their 2007 peak, the US Standard and Poor's 500 index is down by around 40 per cent and Australia's ASX 200 index is down by almost 50 per cent. The position is not a particularly optimistic one and it is not one that has been observed with any great relish by anyone throughout the community, but it is important to understand and recognise that this is the background to the proposals being brought forward.

The proposals in this bill deal with the practice of short selling. As previous speakers to this debate have commented, short selling of its nature is not necessarily a problem, although there have been examples of the way in which these practices have been employed that have added to the volatility in the market place and contributed at least in part—it is always difficult to determine the extent of the contribution—to the fall in share prices, particularly in relation to certain stocks as opposed to some others. This has obviously given rise to some scrutiny of the way in which the Corporations Act seeks to deal with these matters and indeed the way in which our regulators are equipped to deal with these matters. Essentially a short sale involves an investor, quite often a hedge fund or an investment bank, forming a view that shares in a particular company are set to fall. The investor then borrows the shares from someone who owns them—often that will be a large pension fund or insurance company—and then the investor sells the shares in the market place. Having done that, the investor then buys the shares back. It would be the investor's hope to do so at a price lower than what they sold them for, and then they will return them to the original owner.

It is important in the area of short selling to understand and appreciate the distinction between covered short selling and naked short selling. I think it is almost an article of faith that, when you introduce a bit of nudity into the debate, it spices up the discussion. I acknowledge and recognise that the notion of naked short selling has certainly turned a few heads in recent months and has perhaps given this issue—one that might otherwise be particularly dry—something of a more retail flavour. It would have been rather unusual a few months ago to have people visiting me at my mobile office of a weekend talking about short selling, but naked short selling has been getting a pretty good run of late as I get around the community in my mobile office. Largely these issues have been raised with me by self-funded retirees, who, as I stated earlier, are very clearly concerned about the impact that the global financial crisis and the decline in share values on our stock exchange have had on their retirement savings.

The distinction, of course, between covered short selling and naked short selling largely relates to whether or not, prior to entering into the sale, the investor has an arrangement in place whereby they have secured the ability to get their hands on the security that they are seeking to sell. The terminology that we rely upon is that, if they are exercising a covered short sale, they must have a presently exercisable and unconditional right to vest the product in the seller at the time of the sale. So arrangements have to be undertaken or put in place prior to entering into the sale in order to ensure that the seller at least has a pathway towards securing the underlying security that they are promising to sell.

I mentioned earlier that many people have come to talk to me about this at my mobile office. This is one aspect of this particular discussion that does perplex a lot of people. I think that for the layperson it is difficult to understand how this could occur—how someone could enter into a contract to sell a security that they do not own, nor do they necessarily have any secure means by which they can get their hands on that security in order to deliver on the key points of action that are set out in that particular contractual arrangement.

The bill, primarily through schedule 2, seeks to repeal those existing sections in the Corporations Act that allow for naked short sales. I have to say that in keeping with the response of all the regulators—all of those members of the Council of Financial Regulators in this country—ASIC did move very quickly and demonstrate leadership in this area in order to ensure that, at a time when market turbulence was beginning to escalate, they were able to intervene and, through the use of their class orders, to ensure that greater stability and certainty were returned to trading at a time when things could certainly have got out of hand. So I think credit should be given there. I take this opportunity to restate the view that I have put to this House on many occasions: that right across the spectrum of our financial regulators we have some of the finest regulators that can be seen anywhere in the world economy and that the strength of our economy is in no small part a result of the great contribution of our regulators. That is why the government works very closely with those regulators and takes their advice very seriously. It is worth noting that the proposals that are contained in this bill—and in particular I will come shortly to schedule 3—are very much in keeping with the advice that has been provided by the regulators to the government, and that is appropriate. Given the commentary that we have heard from those on the other side on various occasions, I would have thought that they would be prepared to concede that that is a good thing, notwithstanding that we now see that they are determined to oppose schedule 3.

Schedule 1, of course, provides greater clarification and certainty in relation to the powers of ASIC, and specifically the powers that ASIC has to regulate in respect of short selling. That is a matter that I think did require some clarification, and certainly the amendments contained within schedule 1 have the effect of ratifying, if you like, those actions that were previously taken by ASIC in acting swiftly and decisively to put restrictions on short selling at a time when urgent and immediate action needed to be taken. Certainly the effect of schedule 1 will be to avoid any doubt in that respect. Those amendments provide ASIC and the industry with certainty in relation to the scope of the regulators' powers, specifically in relation to short selling. It is necessary to ensure the effective regulation of short selling in Australia, and I think that that is a given.

I thought it might be timely to comment on some of the comments from third parties in the marketplace in relation to the actions that had been taken by ASIC previously in banning short selling and, indeed, extending that ban. I note the comments of Paul Fiani, managing director of Integrity Asset Management, who was quoted in the Australian on 22 October this year. He supported the extension of the ban back then. He made the following comment:

What's the point of spending trillions of taxpayers' money to restore confidence and then let the shorters back in to destroy the confidence?

I think it is important to see these measures in the broader context of the government's overall strategy to respond to the global financial crisis. The point he makes, I think, is a good one: that we need to ensure that there is certainty and integrity in the way in which our share markets operate at a time when the government is going to great lengths and investing significant amounts of money in trying to provide the fiscal stimulus that the economy needs. It would be counterproductive to allow, through a lack of regulation, activities and practices such as some of the more dangerous examples of short selling to jeopardise and undermine those efforts, so it is certainly good to see that endorsement there from the managing director of Integrity Asset Management.

I note also that these measures in respect of the banning of short selling were welcomed by the

Australian Shareholders Association CEO, Stuart Wilson, who in the Australian on 30 September this year expressed his support for the ban, saying:

THE temporary ban on short sales is working so well right now that it is hard to find an argument against adopting it permanently.

... ..

Globally, market watchdogs took action, forcing our hand. For Australia, regulatory docility was not an option.

I do not think that there was ever going to be any suggestion of docility on the part of our regulators, nor is there to be an allegation of that sort leveled against this government. Whilst those on the other side may wish to try and slow down the process of securing passage of this legislation, which will provide that certainty, we on this side are determined to ensure that that certainty is delivered.

I now turn my attention to schedule 3, which is clearly the schedule that has attracted the most criticism. I think the member for Fadden was getting a little bit carried away with himself when he said it should be thrown in the bin. I suggest that perhaps he would want to have a look at it and read it before he makes such a throwaway comment, if I can use that expression. Schedule 3 establishes the disclosure regime in relation to covered short sales. It is a very important and fundamental part of this legislative package that is before the House. In respect of covered short sales—as I indicated before, covered short sales are those supported by securities that are obtained under a legally binding securities lending agreement, so there has to be a means in place that provides the seller of the security with a presently exercisable and unconditional right to vest the product in the seller at the time of the sale—schedule 3 sets out the disclosure regime, or at least the architecture and framework of that regime.

Under the proposed regime, the seller will be required to disclose covered short sales to their broker and the broker will, in turn, be required to disclose this information to the market operator. Brokers who are out there trading on their own behalf will be required to disclose any instances of covered short selling directly to the market operator. The market operator will be obligated to publicly release details relating to this information. It will be an offence if a seller or broker does not disclose details of a covered short sale.

It is important to understand the significance of this particular aspect of schedule 3 and that is that it imposes the penalties. I hear from those on the other side that there is some comfort with allowing the existing temporary regime to continue to apply. But I suggest that those on the other side who scrutinise this amendment and the schedule more closely will have their sense of comfort shattered when they understand and recognise that under the current regime, which is only temporary, there is no effective penalty or enforcement regime in place. That is the big and fundamental difference between what is currently in place and what is proposed in terms of the disclosure regime that is set out in schedule 3.

Every day that we continue to wait, every day that this parliament fails to act and to pass this legislation, this bill, in full will be another day where the regime that is in existence, for all of the good that it has done, will effectively still be a regime operating without the ability to impose any penalties on those who are in breach of the very fundamental principles that are sought to be achieved through that regime. Clearly, this regime that we are proposing will strengthen compliance in respect of the disclosure



requirements.

There are many commentators throughout the industry that have supported the government's position in relation to schedule 3. I note that the Association of Superannuation Funds of Australia, ASFA, have stated that they support the disclosure model as outlined in the bill. They are the peak representative body of all of the APRA regulated superannuation entities and I certainly do not take their view lightly.

I should say that the ASX is on record as acknowledging and supporting the regime set forward in schedule 3 and, of course, the government is acting on the advice of ASIC in this regard. Any regulations that are to be made can be made—(Time expired)