



ASIC

Australian Securities & Investments Commission

REGULATION IMPACT STATEMENT

Repeal of Short Sale Tagging

July 2014

About this Regulation Impact Statement

This Regulation Impact Statement (RIS) addresses ASIC's proposal to repeal the ASIC market integrity rule requiring a market participant of the ASX, Chi-X and APX markets to specify the quantity of a sell order that is short at the time the sale order is placed or at the time the trade is reported.

What this Regulation Impact Statement is about

- 1 This Regulation Impact Statement (RIS) concerns the disclosure of short selling on licensed markets. It addresses ASIC's proposal to repeal the requirement for a market participant to specify the quantity of financial products that are “short” at the time a sale order is placed or at the time the trade is reported. This requirement is known as ‘real-time short sale tagging’.
- 2 This proposal will affect market participants trading in section 1020B products, as defined in the *Corporations Act 2001* (Corporations Act), on:
 - the “ASX market” operated by ASX Limited;
 - the “Chi-X Australia market” operated by Chi-X Australia Pty Limited; and
 - the “APX market” operated by Asia Pacific Exchange Limited.

“Section 1020B products” include securities, managed investment products and certain other financial products.
- 3 In developing our final position, we have considered the regulatory and financial impact of our proposals. We are aiming to strike an appropriate balance between:
 - accurate disclosure of short sale activity both to the market and to ASIC as a regulator;
 - efficiencies in the reporting and publication of short sale activity by market participants, market operators and ASIC;
 - ensuring that the burden placed on the financial, human resources and IT systems of market participants and market operators is appropriate and commensurate with the expected benefits of the Short Sale Tagging Obligation;
 - ensuring that the financial markets are fair and efficient including through the detection and addressing of market misconduct;
 - compliance with international standards for the effective regulation of short selling.
- 4 This RIS sets out our assessment of the regulatory and financial impacts of our proposed policy and our achievement of this balance.

Contents

A	Introduction	4
	Background.....	4
	RIS Question 1: What is the problem ASIC is trying to solve?.....	7
	RIS Question 2: Why is ASIC action needed?	13
B	Options and impact analysis	14
	RIS Question 3: What policy options is ASIC considering?	14
	RIS Question 4: What is the likely net benefit of each option?.....	15
C	Consultation	24
	RIS Question 5: Who has ASIC consulted and how has ASIC consulted them	24
D	Conclusion and recommended option	27
	RIS Question 6: What is the best option from those ASIC has considered ?	27
E	Implementation and review.....	29
	RIS Question 7: How will ASIC implement and evaluate its chosen option?	29
F	Regulatory Burden and Cost Offset (RBCO) Estimate Table	30

A Introduction

Background

- 5 “Short selling” is the sale of financial products that the seller does not own at the time of the sale. “Covered short selling” is when the seller relies on a securities lending arrangement to “borrow” the financial products in order to ensure that they can be delivered to the buyer when settlement is due. This proposal relates primarily to covered short selling which is permitted in Australia.

Disclosure of short selling in Australia

- 6 Short selling is regulated by the Corporations Act and the *Corporations Regulations 2001* (Corporations Regulations). Division 5B of Part 7.9 of the Corporations Act and Division 15 of Part 7.9 of the Corporations Regulations set out the reporting and disclosure requirements for persons making covered short sales on a licensed market.
- 7 There are two separate short selling reporting requirements under the Corporations Act and the Corporations Regulations:
- (a) “short sale transaction reporting” is the reporting of daily volumes of section 1020B products that are short sold in the market; and
 - (b) “short position reporting” is the reporting of instances where the quantity of a product that a person has is less than the quantity of the product that the person has an obligation to deliver.
- 8 These obligations apply to short sales of section 1020B products made on a licensed market.
- 9 This RIS relates to short sale transaction reporting. It does not relate to short position reporting.

Current regime of short sale transaction reporting for market participants

- 10 Short sale transaction reporting is the reporting by market participants of daily volumes of section 1020B products that are short sold in the market.
- 11 The requirements for disclosure by market participants is imposed by the Corporations Act and the Corporations Regulations. These include requirements with respect to the particulars of the information to be disclosed and the timing and manner of disclosure. Currently, the particulars required to be disclosed include:
- (a) the number of products that are short sold;

- (b) the description of the product; and
 - (c) the name of the entity that issued the product.
- 12 The market participant must provide these particulars to the market operator at or before 9 am on the next trading day after it receives this information from the seller, or after it makes the sale on its own behalf. If the market participant makes the sale or receives the information after 7pm on the trading day, the market participant must provide the particulars on the second trading day after the sale or receipt of the information.
- 13 Currently, market participants manually record the number of products that they short sell for each transaction and aggregate this number at the end of each trading day (End of Day Reporting). The daily volume of short sales by product is sent to the market operator.
- 14 The volumes provided by participants are further aggregated by the market operator. The total volume is published and provides an indication of the overall short selling activity that takes place on the market each day. This information may be of assistance to investors and companies in explaining share price movements.
- 15 A RIS released in July 2012 recommending the introduction of real time short sale tagging, discussed some difficulties with the End of Day Reporting that were identified at that time. These include:
- (a) the process is time-consuming for market participants requiring one to two hours each day;
 - (b) the information is aggregate and does not provide any detail at the transactional level; and
 - (c) market participants had difficulties complying with their transactional reporting obligations in respect to about 60% of total orders sent to the market because these orders were generated by algorithms rather than the traditional manual method of a broker entering an order into the market.

Introduction of Short Sale Tagging Obligation

- 16 On 12 July 2012, ASIC made the *ASIC Market Integrity Rules (ASX Market) Amendment 2012 (No. 2)* and the *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2012 (No. 2)*. These instruments amended the *ASIC Market Integrity Rules (ASX Market) 2010* and the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* to insert Part 5.12. On 26 May 2013, ASIC made the *ASIC Market Integrity Rules (APX Market) 2013* which includes Part 5.12.
- 17 Part 5.12 imposes the “Short Sale Tagging Obligation”. In general terms the Short Sale Tagging Obligation applies to a market participant that places a

short order for (or reports a short sale of) section 1020B products on the relevant market. The obligation requires the participant to include an electronic 'tag' in the sell order (or report) which specifies the quantity of products that is short at the time the order is placed.

- 18 The Short Sale Tagging Obligation would not change the existing short sale transaction reporting obligations under the Corporations Act. Instead, it specifies the timing and the method of reporting required by market participants. The Short Sale Tagging Obligation would replace End of Day Reporting as the specified method of short sale transaction reporting.
- 19 The Short Sale Tagging Obligation was intended to:
- (a) improve the accuracy of short sale transaction reporting including by addressing the difficulties of reporting algorithmic trading;
 - (b) enable more efficient collection of short selling information from sellers and market participants; and
 - (c) provide better, more timely data for ASIC and in particular data on a transactional (not aggregated) basis.

Delay of implementation of Short Sale Tagging

- 20 Part 5.12 was originally due to commence on 10 March 2014. Market participants requested that ASIC delay the commencement of this obligation to provide them with additional time to make the necessary system changes. ASIC consulted market operators and market participants on a proposed delay of the commencement date. There was broad support for this proposal.
- 21 On 7 February 2014 ASIC made the *ASIC Market Integrity Rules (ASX Market) Amendment 2014 (No. 1)* and the *ASIC Market Integrity Rules (Chi-X Australia Market) Amendment 2014 (No. 1)*. These instruments amended the *ASIC Market Integrity Rules (ASX) 2010* and the *ASIC Market Integrity Rules (Chi-X Australia) 2011* to delay the commencement of the Short Sale Tagging Obligation from 10 March 2014 to 28 July 2014.
- 22 The delay of implementation of Short Sale Tagging Obligation was not applied to the *ASIC Market Integrity Rules (APX Market) 2013* because:
- (a) the APX operating rules and procedures require a participant to obtain consent from the market operator to short sell on the APX market; and
 - (b) APX confirmed it does not intend to consent to short selling on its market.

We note that APX has recently advised that there has been no change in this position.

Recent developments and the proposed repeal of the Short Sale Tagging Obligation

- 23 During the months prior to the scheduled commencement of the Short Sale Tagging Obligation, industry bodies and market participants raised a number of issues with ASIC. These issues are discussed in detail below (see paragraphs 42 to 49). Upon consideration of these issues and following further consultation and discussion, ASIC has determined that the commencement of the Short Sale Tagging Obligation at this time is unlikely to result in many of the expected benefits including the more efficient reporting of more accurate information. Further, ASIC considers that there is an appreciable risk that the introduction of the Short Sale Tagging Obligation may be counter-productive in that it may result in impaired efficiency and less accurate information.
- 24 The main benefit which is still likely to be realised is the provision of more timely and detailed data to ASIC. However, since the Short Sale Tagging Obligation was introduced in 2012, ASIC's ability to monitor the level of short selling activity in the market has improved through the introduction of its new market surveillance system and other regulatory developments. These developments and their effects are discussed in more detail below (see paragraphs 36 to 39).
- 25 ASIC therefore proposes to repeal the Short Sale Tagging Obligation. ASIC proposes to have the repeal in place prior to the scheduled commencement of the Short Sale Tagging Obligation. Accordingly, it is proposed that the Short Sale Tagging Obligation would not commence.

RIS Question 1: What is the problem ASIC is trying to solve?

Identifying the most appropriate mechanism for short sale transaction reporting

- 26 As explained in paragraphs 6 and 7 above, the Corporations Act and the Corporations Regulations set out the statutory requirements for disclosure of short sale activity.
- 27 The objective of this disclosure is to improve market confidence and integrity by providing greater transparency to both investors and regulatory bodies about the short selling activity on Australian financial markets. In particular, the effective and timely disclosure of short selling activity:
- (a) indicates the level of short selling in particular stocks;
 - (b) explains certain share price movements;
 - (c) provides an early signal that individual securities may be overvalued;

- (d) indicates that a proportion of the sales in an individual security will need to be reversed by new purchases (to cover the short seller's settlement obligations);
 - (e) enhances investors' willingness to participate in the market by removing uncertainty surrounding the level of short selling; and
 - (f) deters market abuse, or reduces the opportunities for market abuse, by enabling the market regulator to better identify instances of market manipulation.
- 28 These objectives are met not only through short sale transaction reporting but also through short position reporting. None of these objectives can be achieved if the information reported is not sufficiently accurate.
- 29 The Short Sale Tagging Obligation does not substantially alter the statutory obligations. However, it is intended to change the timing and the method by which short sale transaction reporting occurs.
- 30 Through both the introduction of the Short Sale Tagging Obligation, and this proposed repeal, the “problem” that ASIC seeks to solve is to identify the most appropriate mechanism for short sale transaction reporting. In seeking to identify the most appropriate mechanism, ASIC aims to balance the following considerations:
- (a) accurate disclosure of short sale activity both to the market and to ASIC as a regulator;
 - (b) efficiencies in the reporting and publication of short sale activity by market participants, market operators and ASIC;
 - (c) ensuring that the burden placed on the financial, human resources and IT systems of market participants and market operators is appropriate and commensurate with the expected benefits of the Short Sale Tagging Obligation;
 - (d) ensuring that the financial markets are fair and efficient including through the detection and addressing of market misconduct; and
 - (e) compliance with international standards for the effective regulation of short selling.
- 31 Further to the final factor above, on 19 June 2009, the International Organization of Securities Commissions released a report¹ on the regulation of short selling which identified four general principles for the effective regulation of short selling. These include the principle that short selling should be subject to a reporting regime that provides timely information to

¹ ‘Regulation of short selling’, IOSCO, June 2009, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf>

the market or to market authorities. This overlaps with (b) and (d) of ASIC's list of considerations above. Factor (b) refers to the efficiency of reporting and publication. Factor (d) refers to the aim of ensuring fair and efficient markets including through the detecting and addressing of misconduct. Ensuring that ASIC, as the regulator, receives the data it needs in a timely way is important for maintaining fair and efficient markets.

Developments since the creation of the Short Sale Tagging Obligation and their effect on the problem

- 32 Generally, since 2012, there have been important positive developments in the relevant regulatory landscape. This has made the introduction of the Short Sale Tagging Obligation less critical for market efficiency and market regulation.
- 33 A primary concern at the time of the creation of the Short Sale Tagging Obligation was the significant proportion of trades that were not subject to short sale transaction reporting at that time. ASIC had previously acknowledged the difficulties experienced by market participants in providing short sale transaction reporting of algorithmic trades. ASIC adopted a no-action position in relation to the failure by some market participants to comply with their obligation to provide short sale transaction reporting of algorithmic trades. The no-action position was taken on 19 November 2008 for an initial period and extended on a number of occasions. ASIC's no-action position expired on 31 December 2011. ASIC has not received any further applications for relief or a no-action position since that time.
- 34 ASIC expects that, since that time, market participants have been complying with their statutory reporting obligations in respect of all short sales including those generated by algorithmic trades. Therefore, ASIC's expectation is that the level of short sale transaction reporting, and accordingly the accuracy of reporting to the market has substantially improved since the decision was made to introduce the Short Sale Tagging Obligation.
- 35 End of Day Reporting still imposes a substantial compliance requirement on market participants. However, in discussions with ASIC, market participants have indicated that they anticipate that the Short Sale Tagging Obligation will pose a greater compliance burden. Details of market participant concerns are set out below in paragraphs 42 to 49. Details of previous and more recent consultation on this issue are set out in Part C below and include details of ASIC's public announcement of its intention to repeal the Short Sale Tagging Obligation. ASIC has not received any objection to this proposal. In particular, ASIC has received no objection on the basis of the compliance burden of End of Day Reporting. By contrast, ASIC has received

numerous and detailed representations about the burdens of the Short Sale Tagging Obligation.

- 36 Since the Short Sale Tagging Obligation was created in 2012, ASIC has increased its ability to monitor the level of short selling activity in the market, including in times of market volatility due to:
- (a) the introduction of a new market surveillance system (MAI); and
 - (b) the commencement, on 28 July 2014, of Chapter 5A of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011* which requires market participants to provide regulatory data, including the origin of an order or transaction.
- 37 In ASIC's assessment, these developments have constituted a more substantial improvement to its ability to ensure that the markets are fair and efficient than the Short Sale Tagging Obligations is likely to achieve.
- 38 In particular, the introduction of the regulatory data obligation is likely to reduce the need for the type of complex data-mining activities which were previously required in order for ASIC to isolate short trades of interest. Like the Short Sale Tagging Obligation, regulatory data will be provided to ASIC in real time. The ability to identify the origin of an order is particularly significant. Although the formal requirement to provide this information has not yet commenced, ASIC is already receiving this type of information with respect to some trading. ASIC's experience is that this information enables ASIC to identify individual trading patterns without data-mining. This makes the access to transactional (rather than aggregated data) through the Short Sale Tagging Obligation less critical. If necessary, ASIC's analysts can generally deduce from the overall trading pattern whether a particular trader has engaged in short selling during the course of the day. This deduction can be supplemented or confirmed through short position reporting.
- 39 Furthermore, ASIC has the capability to integrate short position data and the data from End of Day Reporting into its MAI system should that prove beneficial. This contrasts with the situation in 2012 where short sale data needed to be incorporated into ASIC's system manually.
- 40 ASIC already receives, and will continue to receive, some short sale tags. Many market participants already obtain and receive electronic short sale tags from their clients. These tags are transmitted to the market operators and, in some cases, are in turn relayed to ASIC. Accordingly, some short sale tagging is available to ASIC if required. However, as noted above, we do not consider that it is likely to be as valuable to ASIC as some of the other newly available information and resources.
- 41 Accordingly, as a result of developments in the regulatory landscape since the creation of the Short Sale Tagging Obligation:

- (a) ASIC expects that the accuracy of reporting under the current End of Day regime has improved as participants have made the necessary changes to their algorithmic systems;
- (b) ASIC's assessment of the relative compliance burdens of End of Day Reporting and the Short Sale Tagging Obligation has changed due to ongoing discussions with market participants in preparation for the commencement of the Short Sale Tagging Obligation. Specifically, it is doubtful that the Short Sale Tagging Obligation will be less burdensome and there is a risk that it will prove more burdensome; and
- (c) new resources and information available to ASIC (or shortly to be so) have made the additional information expected from the Short Sale Tagging Obligation less critical for ASIC's regulatory function.

Issues with the implementation of Short Sale Tagging Obligation

- 42 In the lead - up to the commencement of the Short Sale Tagging Obligation on 28 July 2014, industry raised concerns about the Short Sale Tagging Obligation. In particular, market participants raised concerns about the complexities of categorising certain types of orders on a real time basis. These complexities particularly arise for market participants trading as principal who operate multiple desks and have a central department with responsibility for determining if there are sufficient financial products for a sale to occur. In this environment, it is not always practicable for traders to determine in real time whether a particular sale is long or a covered short sale. The majority of large market participants have indicated to ASIC that they would have difficulty in determining whether their principal accounts are "short" or "long" on a real-time basis, primarily because their business model includes a central stock lending desk arrangement.
- 43 Concerns about a breach occurring as a result of a technical failure or an inadvertent failure of categorisation are heightened by the maximum penalty for breach of the Short Sale Tagging Obligation, which is \$1,000,000.
- 44 At the request of market participants, ASIC explored the option of assisting to resolve these complexities with the provision of further guidance. ASIC had already published "*Information Sheet 158: Short Sale Tagging*" in July 2012 but more recently ASIC has considered the supplementation of that guidance. However, ASIC found that the issues raised were of such variety and complexity that it proved impracticable to address them with additional guidance.
- 45 These complexities pose the risk of undermining some of the expected benefits of the Short Sale Tagging Obligation.
- 46 The primary risk for both market participants and the broader regulatory objective is the risk that the reported data will be inaccurate due to the

practical difficulties of ascertaining whether the market participant is short or long in real time. Accurate reporting to the market is a key objective not just for the Short Sale Tagging Obligation but for the broader regime for reporting of short sale activity. In our discussions with market participants, they indicated that End of Day Reporting gave them the necessary further time to reconcile their overall trading position to ensure that their reporting was correct. This suggests that there is a risk that reporting under the Short Sale Tagging Obligation may be less accurate than reporting under End of Day Reporting.

- 47 A second and counteracting risk is the risk to market efficiency. Market participants expressed a concern that resolving the complexity in the way certain orders are treated will increase the latency of trading and therefore affect a market participant's ability to obtain the best outcome.
- 48 Another risk is that the Short Sale Tagging Obligation may not result in the expected benefit of efficiency in reporting for market participants. ASIC had always acknowledged that the Short Sale Tagging Obligation would require system changes for market participants and market operators. A substantial transition period was incorporated into Part 5.12 on this basis and this was further extended at the request of market participants. However, ASIC expected that, once these changes were made, reporting would be more efficient for market participants when done on a real time basis. Through our discussions with market participants about the delays that may occur in resolving the complexities of real time reporting, it is now apparent that these expected efficiencies are unlikely to materialise. In our discussions with industry, ASIC has also identified a risk that these issues will render the Short Sale Tagging Obligation less efficient than End of Day Reporting.
- 49 The implementation issues identified during recent discussions with industry therefore pose the following risks in relation to the expected benefits of the Short Sale Tagging Obligation:
- (a) A significant risk that the expected benefit of more accurate information may not materialise and an appreciable risk that the difficulties in categorising trades in real time will lead to less accurate data;
 - (b) A risk that the efficiency of trading will be effected by the need to determine the correct category of trades in real time;
 - (c) A significant risk that the overall efficiency of reporting for market participants will not be improved by the Short Sale Tagging Obligation relative to End of Day Reporting coupled with a risk that the Short Sale Tagging Obligation will actually be less efficient.

The primary benefit that may still be manifest is the provision of more detailed data to ASIC in real time. However, as noted in paragraphs 36 to 39

above, ASIC's reliance on that data will be less than expected due to other regulatory improvements.

RIS Question 2: Why is ASIC action needed?

- 50 ASIC has already acted in this area through the original creation of the Short Sale Tagging Obligation. As a responsible regulator, ASIC has continued to monitor the likely usefulness of the Short Sale Tagging Obligation and has been open to considering industry representations in this regard.
- 51 Since the creation of the Short Sale Tagging Obligation in July 2012, changes in the regulatory landscape (analysed in paragraphs 32 to 41 above) have made the introduction of the Short Sale Tagging Obligation less critical.
- 52 Implementation issues raised with ASIC in the preparatory period for the commencement of the Short Sale Tagging Obligation (analysed in paragraphs 42 to 49 above) pose risks that the expected benefits of the Short Sale Tagging Obligation may not be realised. There are some risks that the introduction of the Short Sale Tagging Obligation at this time may, in fact, be counter-productive.
- 53 The Short Sale Tagging Obligation will impose a cost upon market participants and require them to make changes to their systems in a time of rapid technological change and frequent demands on IT resources.
- 54 In light of the above, ASIC is no longer convinced that the benefits of the Short Sale Tagging Obligation outweigh the costs.

B Options and impact analysis

RIS Question 3: What policy options is ASIC considering?

Option 1– Repeal the Short Sale Tagging Obligation (preferred option)

- 55 Under this option, ASIC would repeal Part 5.12 of the *ASIC Market Integrity Rules (ASX Market) 2010*, the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* and *ASIC Market Integrity Rules (APX Market) 2013*. Accordingly, Part 5.12 will not commence as scheduled on 28 July 2014 and the Short Sale Tagging Obligation will not be imposed. Instead, market participants will be required to continue with EOD Reporting under the current law. That is, market participants will continue to be required to manually record the number of products that they short sell for each transaction, aggregate this number at the end of each trading day and report this number to the market operator.
- 56 ASIC may consider a re-introduction of the Short Sale Tagging Obligation (or similar requirement) in the future after further appropriate consultation.

Option 2 – Class waiver

- 57 Under this option, ASIC would grant a class waiver from the Short Sale Tagging Obligation under Rule 1.2.1 of the *ASIC Market Integrity Rules (ASX Market) 2010* and the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011*.
- 58 Under a waiver, participants could choose to comply with their statutory obligation to provide short sale transaction reporting through:
- (a) real time short sale tagging;
 - (b) the current system of EOD Reporting; or
 - (c) a combination of both depending on the transaction or line of business.

Option 3 – Amend the Short Sale Tagging Obligation

- 59 Under this option, Part 5.12 of the *ASIC Market Integrity Rules (ASX Market) 2010*, the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* and the *ASIC Market Integrity Rules (APX Market) 2013* would be amended to require market participants to report by either short sale tagging or EOD Reporting but not both.

Option 4 – Retain the Short Sale Tagging Obligation (Status quo)

- 60 The Short Sale Tagging Obligation is due to commence on 28 July 2014. As explained in paragraph 17, the Short Sale Tagging Obligation requires the market participant to transmit with a sell order (or report) an electronic “tag” specifying the quantity of products that is short at the time the order is placed (or the report is made).
- 61 As this is a proposal to repeal an existing obligation (which is yet to commence), the status quo in this case would constitute the imposition of a regulatory obligation upon market participants and market operators.

RIS Question 4: What is the likely net benefit of each option?

Option 1– Repeal the Short Sale Tagging Obligation (preferred option)

Benefits

For market participants

- 62 The Australian Financial Markets Association (AFMA) has provided an estimate of the cost savings for market participants if the proposal is implemented. The estimate is based on a survey of AFMA members and extrapolated to cover an assumed 85 trading participants. For the purpose of the estimate, firms were categorised as either small (55 firms), medium (22 firms) or large (8 firms) in size. Deductions were made to allow for estimated costs already incurred by firms who had put systems in place to comply with the Short Sale Tagging Obligation so this estimate covers future costs only. AFMA’s estimate is that these costs will comprise:
- (a) one-off implementation savings of approximately \$42.3 million being the total of:
 - (i) \$7,800,000 for large firms;
 - (ii) \$15,015,000 for medium firms; and
 - (iii) \$21,450,000 for small firms,
 less \$1,950,000 already committed.
 - (b) ongoing cost savings of approximately \$10.3 million per year being the total of:
 - (i) \$1,823,360 for large firms;
 - (ii) \$3,509,968 for medium firms; and
 - (iii) \$5,014,240 for small firms.

63 AFMA has provided a further breakdown of its cost estimates for medium firms as follows:

- (a) Implementation costs on a “per firm” basis of \$682,500 comprise of :
 - (i) \$525,000 in IT costs (staffing and technical resources including changes to market participant’s technical systems to record and transmit a tag, client education about changes to the electronic order system and staff training);
 - (ii) \$105,000 in compliance costs (staff time allocation including regular compliance or quality assurance audits); and
 - (iii) \$52,500 in management costs (staff time allocation including management oversight and review).
- (b) Ongoing costs on a “per firm” basis of \$159,544 comprise of:
 - (i) \$107,800 in IT costs (staffing and technical resources);
 - (ii) \$43,120 in compliance costs (staff time allocation); and
 - (iii) \$8,624 in management costs (staff time allocation).

Under this option, market participants will be required to continue with EOD Reporting under the current law. That is, market participants will continue to be required to manually record the number of products that they short sell for each transaction, aggregate this number at the end of each trading day and report this number to the market operator. As noted at paragraph 15(a), EOD reporting requires manual processing of one to two hours each day (approximately 260 to 520 hours per year). This represents a cost to industry of approximately \$1m to \$2m per year.

64 Paragraphs 42 to 49 above describe and analyse concerns raised by market participants in the preparatory period for the commencement of the Short Sale Tagging Obligation. As noted in that analysis, this includes the risk that the efficiency of trading may be affected by the requirement to categorise trades in real time. It also includes a risk that reporting may be less efficient under the Short Sale Tagging Obligation. This option addresses those concerns.

For users of the information

65 Under this option, the information available to the market (including market participants) will be the same as the information that is currently available. That is, it will be the same information currently provided by market participants through EOD Reporting and published by market operators.

66 Paragraphs 42 to 49 above describe and analyse concerns raised by market participants in the preparatory period for the commencement of the Short Sale Tagging Obligation. As noted in that analysis, this includes an appreciable risk that the accuracy of the published data may be further

compromised by the commencement of the Short Sale Tagging Obligation. This option will remove that risk.

For ASIC

- 67 Like other users of reported information regarding short sale activity, ASIC has an interest in being assured that the information is accurate. Concerns about the accuracy of the available data will have an effect on ASIC as much as other users. This option removes the risk that the accuracy of the available data will be diminished.

For other stakeholders

- 68 If this option is adopted, market operators would not expend further resources on adapting its system to receive short sale tags.

Costs and Risks

For market participants

- 69 Some participants have already incurred costs in preparing their systems for the Short Sale Tagging Obligation. These changes will not be utilised under this option. However, we have been informed that, in some cases, these system changes can be utilised for other purposes.
- 70 We also understand that expenditure on market participants systems has been contained. AFMA's estimate of total costs incurred to date is \$1,950,000 which is low compared to the overall estimate of required costs. ASIC has been in ongoing discussion with participants for many months given the number and nature of the concerns raised by participants (discussed in paragraphs 42 to 49 above). Many participants have indicated that some of the issues concerning the categorisation of sell orders would need to be resolved before they could finalise changes to their system. Practical resolutions have not been identified for all of these complex issues. Accordingly, it has been clear for some time to both ASIC and the industry that the industry is not ready for the Short Sale Tagging Obligation to commence and that some mechanism to delay the commencement would be required. On this basis, and given the many demands on participants' IT resources, some participants have not proceeded with all the necessary changes to their systems.

For users of the information

- 71 Information available under this option is the same as information currently available. The accuracy of that information may still not be ideal. However, under this option, that level of accuracy will at least be maintained.

For ASIC

- 72 Some data which will be available in real time to ASIC under the Short Sale Tagging Obligation will not be available to ASIC under this option. However, as explained in detail in paragraphs 36 to 39 above, ASIC is less reliant on that data than it might have expected in July 2012. Under this option, ASIC will still have access to short position reports and to short sale transaction reporting under End of Day Reporting. Some short sale tags are also received by the market operators and by ASIC even though this obligation is not mandatory.

Conclusion

- 73 This option:
- (a) achieves substantial cost savings to industry and removes the risk that reporting will become more burdensome;
 - (b) prevents potential trading inefficiencies which may be the unintended result of the Short Sale Tagging Obligation and
 - (c) maintains the quality of the short sale information provided to the public without further compromise to the integrity of that data.
- 74 This option will result in some expenditure by market participants not being used for its intended purpose. However, these costs have been contained and ASIC understands that some of them may be utilised in other ways.
- 75 A consequence of this option is that some data that would otherwise be available to ASIC will not be fully available. However recent regulatory information have rendered that information far less critical. Furthermore, some information of this nature is still received by ASIC.

Option 2 – Class waiver**Benefits***For market participants*

- 76 ASIC publicly proposed a class waiver on the basis that it would provide market participants with flexibility to choose the method of compliance with the short sale transaction reporting obligation in the Corporations Act and the Corporations Regulations. This would improve efficiency of reporting by market participants. Certain orders, such as client orders which already carry real time tags, can be more easily reported through short sale tagging. Principal orders are more likely to be subject to the complexities of categorisation on a real time basis and might therefore more easily be reported through End of Day Reporting.

- 77 Market participants would not be required to change their IT systems if they did not choose to, leading to costs savings similar to Option 1.

For users of the information (including ASIC)

- 78 No specific benefits of this option have been identified for information users including ASIC.

- 79 It is unlikely that ASIC will receive significant additional information as a result of this option since many trades are likely to continue to be reported through End of Day Reporting.

Costs and risks

For users of the information (including market participants and ASIC)

- 80 Our consultation with market participants have identified a number of significant issues which cannot be resolved under a class waiver. In particular, the short sale information available to the market is likely to be compromised under a waiver due to
- (a) double counting of short sales; and
 - (b) inaccuracies arising from the aggregation of
 - (i) information relating to **orders** under the Short Sale Tagging Obligation; and
 - (ii) information relating to **transactions** under the current regime.

- 81 The issues are set out below.

Issue 1: Duplication of short sale reporting

- 82 If market participants regularly report a particular short order/transaction by both short sale tagging and EOD Reporting, there is a significant risk that the order/transaction will be double-counted. This will compromise the accuracy of the data on short selling published by the market operators which is based on the data reported by market participants.
- 83 Many market participants have reported that it will be difficult for them to ensure that each individual short order/transaction is only reported once - that is either by Short Sale Tagging or EOD Reporting but not both. We understand that this is particularly acute for those market participants who have been providing short sale tags to the market operators for some time.
- 84 Some market participants have long been receiving short sale tags from their client's electronic interface which they then forward to ASX and Chi-X. Where this occurs, the short sale tags are not currently relied upon to comply with the short sale transaction reporting under the Corporations Act and the

Corporations Regulations. At present, that obligation must be fulfilled by EOD Reporting.

85 Accordingly, these market participants already have a system of reporting certain orders/transactions twice. That is, they report through EOD Reporting which is currently mandatory but also provide short sale tags notwithstanding that they are currently not required. We understand that, for these participants it will be time-consuming and expensive to re-configure their systems to ensure that an individual order/transaction is reported only once.

86 The market operators have indicated it is not possible to determine whether the aggregate number provided by participants under EOD Reporting includes any transactions which have already been the subject of short sale tagging. This is because the EOD Reporting does not provide further detail on the individual orders or transactions.

Issue 2: Reporting on an order basis versus reporting on a transaction basis

87 The short sale transaction reporting obligation under the Corporations Act applies to actual sales and accordingly EOD Reporting is conducted on the basis of sales that have occurred on each trading day. EOD Reporting does not include orders that have been placed in the market but subsequently cancelled or amended.

88 The Short Sale Tagging Obligation applies to orders, including those that may ultimately be executed but also including those that may ultimately be cancelled or amended.

89 Allowing participants the option of reporting through either short sale tagging or EOD Reporting will result in two sets of data published to the market that will be reported on different bases. This data would have to be viewed together to provide an overall picture of short selling activity. We are concerned that this is likely to result in unreliable or misleading representation of short sale activity.

Issue 3: Aggregation of reports

90 Under a class waiver, ASX (at least) would be required to maintain systems for both short sale tagging and EOD Reporting. Our understanding is that up to three reports would be provided to the market as follows:

- (a) short sale tagging report published by ASX (reporting on the basis of short orders);
- (b) short sale tagging report published by Chi-X (reporting on the basis of short orders); and
- (c) consolidated EOD Reporting for both markets published by ASX in accordance with the current arrangements between ASX and Chi-X (reported on the basis of short sales).

- 91 All three reports would need to be combined to provide any useful short sale information to the market. This would create an extra layer of complexity and inefficiencies for users of the reports. The different bases in reporting (orders versus actual sales) may also cause difficulties for merging the reports and for their interpretation by the market.

Conclusion

- 92 This option provides flexibility and efficiencies to participants with respect to the method of reporting. It may result in some cost savings to participants who elect to make no changes to their systems.
- 93 However, in ASIC's assessment, this option provides the least benefit for users of the report. For market participants, the benefits and efficiencies of flexibility of reporting are likely to be outweighed by the compromise of the available data (which is also used by ASIC) and by the inefficiencies in interpreting that data due to the aggregation of reporting conducted on different bases.

Option 3 – Amend the Short Sale Tagging Obligation

Benefits

For market participants

- 94 This would provide flexibility in the mechanism of reporting and consequent efficiencies in the same manner as Option 2.
- 95 The potential cost savings for market participants under this option would be similar to those under Option 1.

For users of the information (including ASIC)

- 96 No specific benefits of this option have been identified for information users including ASIC.
- 97 As with Option 2, it is unlikely that ASIC will receive significant additional information as a result of this option since many trades are likely to continue to be reported through End of Day Reporting.

Costs and Risks

For market participants

- 98 Those market participants (referred to in paragraphs 83 to 85) who currently provide double- reporting of some orders – that is transmitting short sale tags as well as providing EOD Reporting - would need sufficient time to re-configure their systems before the rule amendment commences to ensure

double-reporting is avoided. This re-configuration of systems would impose further costs on these market participants..

For users of the information (including ASIC)

99 Under this option, the issue of duplicate reporting (referred to in paragraphs 82 to 86 above) would be resolved.

100 However, the issues of reporting on different bases (referred in paragraphs 87 to 89) and the issue of the aggregation of reports (referred to in paragraphs 90 to 91) would be ongoing.

Conclusion

101 This option would provide some flexibility to market participants without the risk of duplicate reporting compromising the accuracy of the data. Costs savings are also available.

102 However, the issues of reporting on different bases and the aggregation of reports would remain. This would lead to difficulties and inefficiencies in interpreting the published data.

Option 4 – Retain the Short Sale Tagging Obligation (Status quo)

Benefits

For market participants

103 As noted above, some market participants have already incurred expenditure on preparing their systems for the Short Sale Tagging Obligation. Proceeding with the obligation will ensure that these costs are utilised.

For users of the information

104 No specific benefits of this option have been identified for information users.

For ASIC

105 Under this option, some data will be available to ASIC in real time that will not be otherwise available. However, as explained in paragraphs 36 to 39, recent improvements in the information and tools available to ASIC mean that ASIC will be less reliant on this data in the performance of its regulatory functions.

Costs and Risks

For market participants

- 106 The costs incurred for the Short Sale Tagging Obligation would be equivalent to the cost savings specified under Option 1.
- 107 As discussed in paragraphs 42 to 49, industry have raised concerns about the complexities of categorising certain types of orders on a real time basis. These concerns include the risk that the efficiency of trading will be affected by the need to categorise trades in real time. They also include a risk that reporting may be less efficient under the Short Sale Tagging Obligation
- 108 While, End of Day Reporting continues to impose a compliance burden, market participants have indicated that they expect the Short Sale Tagging Obligation to be more burdensome.

For users of the information (including ASIC)

- 109 The implementation issues identified during recent discussions with industry (discussed and analysed in paragraphs 42 to 49) pose a significant risk that the expected benefit of more accurate information may not materialise and an additional risk that the difficulties in categorising trades in real time will lead to less accurate data;

Conclusion

- 110 As discussed throughout this RIS, it is now considered that the benefits that were expected from the Short Sale Tagging Obligation may not be realised and there is a risk that, in some respects, the Short Sale Tagging Obligation will be counter-productive. The Short Sale Tagging Obligation is likely to prove an expensive and burdensome option for participants.
- 111 The most likely significant remaining benefit is the provision of some additional information to ASIC in real time. However, for the reasons explained in paragraphs 36 to 40 above, ASIC expects to be less reliant on that information due to other, more significant, regulatory developments.
- 112 Since the risks of this approach now appear to be greater than anticipated and the benefits have become less important due to other developments, ASIC no longer considers this to be the preferred option.

C Consultation

RIS Question 5: Who has ASIC consulted and how has ASIC consulted them

Historical consultation

- 113 ASIC engaged in targeted consultation with stakeholder groups in relation to short sale disclosure for some years prior to the introduction of the Short Sale Tagging Obligation. Initially, this was in the context of wider discussions with industry about the general short selling disclosure regime.
- 114 Subsequently, ASIC continued to engage in targeted consultation with stakeholder groups about the possible introduction of real time short sale tagging. This included a range of market participants, industry associations (such as AFMA and the then Securities and Derivatives Industry Association (now the Stockbrokers Association of Australia)) and ASX. Taking into account industry comments, it was decided during 2009 to further delay implementation of the proposal to enable the industry to manage other changes in the market (e.g. the transfer of market supervision from domestic financial markets to ASIC on 1 August 2010) and to align the system changes with those required for the introduction of competition in exchange markets.
- 115 An industry advisory group to the Commission, the Markets Supervision Advisory Panel, has been in place since before the transfer of supervision in 2010 and throughout the entirety of the project to introduce competition in exchange markets. We discussed with the advisory group our intentions to introduce a real-time tagging requirement.

CP 145 consultation

- We formally consulted publicly on the real-time tagging proposal as part of the consultation package on enhancing the regulation of Australia's equity markets, including the introduction of competition in exchange markets. The consultation package was released publicly on 4 November 2010 and included a detailed consultation paper—Consultation Paper 145 *Australian equity market structure: Proposals* (CP 145).
- 116 We received 16 written responses about the real-time tagging proposal in CP 145 from a broad range of stakeholders, including market operators, industry associations, market participants, high-frequency trading firms and others from the data vendor and technology sectors.

- 117 There was mixed feedback on the proposal, generally corresponding to the capability of the respondents' systems to implement such a proposal:²
- (a) Several respondents were supportive of our proposal to eliminate manual reporting.
 - (b) Concerns were raised by some respondents around implementation difficulties and costs. However, several respondents recognised that the obligation to disclose short sales already existed and that the capability for real-time tagging was already available to the market. Generally, respondents stated that implementation was achievable if sufficient time was provided.
 - (c) One association submitted that the existing short sale requirements were in line with IOSCO principles on short sale reporting, and that any change should be made through amendments to existing regulations, rather than through new market integrity rules.
 - (d) Some clarification was sought around the application of the rule.
- 118 A primary concern raised in the feedback was the timing of implementation and the use of finite resources for a number of other impending changes required by industry. In response, we allowed market participants a transitional period, until 10 March 2014, to allow for systems and process changes and the education of traders and clients. As noted above, that transitional period was subsequently extended to 28 July 2014.
- 119 Implementation difficulties have been raised by at least some participants since the early stages of consultation. However the precise nature, magnitude and complexity of these difficulties has become clearer since participants commenced their preparations for the Short Sale Tagging Obligation.

Targeted consultation during 2014

- 120 ASIC engaged in further targeted consultation and ongoing discussions with AFMA, market participants and market operators during 2014. These discussions focused on:
- (a) concerns raised by industry including concerns about the complexity of categorising orders in real time as set out in paragraphs 42 to 49 above;
 - (b) working with industry to overcome these concerns and provide market participants with ongoing certainty; and
 - (c) costs and compliance burdens for industry.
- 121 As part of this targeted consultation, ASIC raised the matter with its Markets Supervisory Advisory Panel. The Panel:

- (a) raised concerns about the implementation and practical implications for trading of the Short Sale Tagging Obligation;
- (b) noted the substantial penalties imposed for breaching the Short Sale Tagging Obligation;
- (c) raised concerns relating to the accuracy of reporting under the Short Sale Tagging Obligation on trading; and
- (d) questioned the marginal benefit of the Short Sale Tagging Obligation for surveillance purposes.

122 Some members of the panel indicated that they would support a decision not to implement the Short Sale Tagging Obligation.

123 ASIC responded to industry concerns by consulting on a proposed class waiver which would relieve market participants of the Short Sale Tagging Obligation. Industry feedback on this proposal identified the significant issues set out in paragraphs 82 to 91 above which could not be resolved under the waiver option.

124 ASIC has subsequently publicly announced its decision to seek the Minister's consent to repeal the Short Sale Tagging Obligation. This was announced in ASIC's *Market Supervision Update – Issue 47 June 2014*. ASIC has discussed the proposed repeal with market operators, individual market participants, AFMA and the Stockbrokers Association of Australia. These discussions have revealed general support for the proposed repeal. ASIC has received no representations arguing against the repeal.

D Conclusion and recommended option

RIS Question 6: What is the best option from those ASIC has considered ?

- 125 In paragraph 30 above, the following factors were identified for solving the problem of identifying the most appropriate mechanism for short sale transaction reporting:
- (a) accurate disclosure of short sale activity both to the market and to ASIC as a regulator;
 - (b) efficiencies in the reporting and publication of short sale activity by market participants, market operators and ASIC;
 - (c) ensuring that the burden placed on the financial, human resources and IT systems of market participants and market operators is appropriate and commensurate with the expected benefits of reporting;
 - (d) ensuring that the financial markets are fair and efficient including through the detection and addressing of market misconduct: and
 - (e) compliance with international standards for the effective regulation of short selling.
- 126 Taking into account these considerations, ASIC considers that Option 1 is the best Option.
- 127 Option 1 offers certainty in maintaining the current levels of accuracy of the information and efficiency in reporting and publication. This is relevant to factors (a) and (b) above. Option 1 is the only option that does not pose a risk of deterioration of factors (a) and (b).
- 128 Factor (c) requires the balancing of the compliance burden placed upon market participants with the expected benefits of reporting. Since the Short Sale Tagging Obligation was created in 2012, ASIC's assessment of the compliance burden of the Short Sale Tagging Obligation has changed due to ongoing discussions with stakeholders. ASIC now considers that the Short Sale Tagging Obligation may be more burdensome than End of Day Reporting and is unlikely to be less burdensome. On the other side of this equation, developments in the regulatory landscape (set out in paragraphs 32 to 41 above) have made the benefits of the Short Sale Tagging less critical for ASIC. In addition, there is a real risk that expected benefits for market participants and other users of the information will not materialise as expected. The cumulative effect of these developments is to make Option 4 less preferable and Option 1 more appropriate.

129 The additional tools and resources available to ASIC and described in paragraphs 36 to 39 above make factor (d) above a less relevant consideration. ASIC has more sophisticated resources for detecting and responding to market misconduct than it did in 2012. This has made the timely and more detailed data available under the Short Sale Tagging Obligation less important to ASIC than it might otherwise have been. This is also a consideration for factor (e) as the most relevant IOSCO principle also refers to the timeliness of data. Other data, which will also be available to ASIC in real time, will provide greater assistance to ASIC in detecting and responding to market misconduct.

Costs and risks of Option 1

130 Some participants have already incurred costs in preparation for the commencement of the Short Sale Tagging Obligation and there is a risk that these may now be wasted if Option 1 is adopted. However, the costs were contained, as explained in paragraph 70 above and ASIC understands that, at least in some cases, the new system functionality can be used for other purposes.

131 Option 1 will also require ASIC to forgo some additional data which would otherwise be provided in real time. However, this data is now less useful to ASIC.

E Implementation and review

RIS Question 7: How will ASIC implement and evaluate its chosen option?

- 132 Option 1 requires Ministerial consent. If consent is granted, ASIC will make market integrity rules to repeal Part 5.12 of:
- (a) *ASIC Market Integrity Rules (ASX Market) 2010*;
 - (b) *ASIC Market Integrity Rules (Chi-X Australia Market) 2011*; and
 - (c) *ASIC Market Integrity Rules (APX Market) 2013*
- 133 Market integrity rules must be registered on the Federal Register of Legislative Instruments. If the Minister consents to ASIC's proposal, ASIC aims to have the market integrity rules registered in sufficient time for the repeal to commence before 28 July 2014. This would ensure that the Short Sale Tagging Obligation does not commence.
- 134 Once the repeal is made, market participants will not be required to comply with the Short Sale Tagging Obligation. Market Participants will still be required to provide EOD Reporting to comply with the short sale transaction reporting requirement under the Corporations Act and the Corporations Regulations. As this is already required, no transitional arrangements will be necessary.
- 135 ASIC may consider a re-introduction of the Short Sale Obligation in the future after further appropriate consultation.
- 136 ASIC will continue to monitor the efficiency and usefulness of short sale disclosure in close consultation with its stakeholders.

F Regulatory Burden and Cost Offset (RBCO) Estimate Table

Average annual compliance costs (from business as usual) – Option 1

Costs (\$m)	Business	Community Organisations	Individuals	Total cost
Total by sector	- \$13,130,413	\$0	\$0	- \$13,130,413
Cost offset (\$m)	Business	Community Organisations	Individuals	Total by source
Agency	\$0	\$0	\$0	\$0
Within portfolio	\$0	\$0	\$0	\$0
Outside portfolio	\$0	\$0	\$0	\$0
Total by sector	\$0	\$0	\$0	\$0
Proposal is cost neutral? no				
Proposal is deregulatory? yes				
Balance of cost offsets \$				