



Securities Lending and Short Selling – Quo Vadis?

Thursday, 28 August 2008

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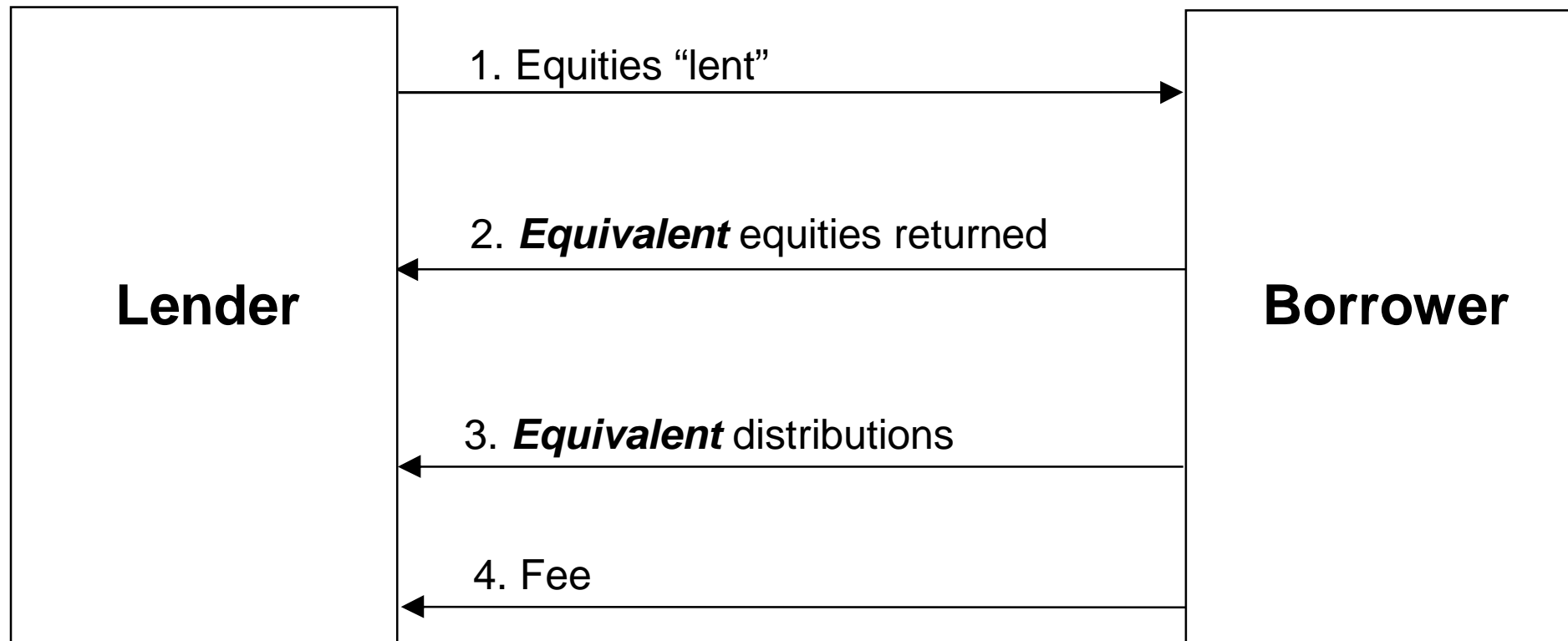
Where are they going? Back to (close to) normal

- § Normal, or standard, “securities driven” securities lending should continue to provide a means for beneficial owners to earn extra income, for a low risk.
- § “Cash driven” securities lending transactions are OK too, but only if you know what you are doing.
- § The new short selling disclosure amendments to the Corporations Act may be an overreaction, and a less than optimum response, to a questionable need.

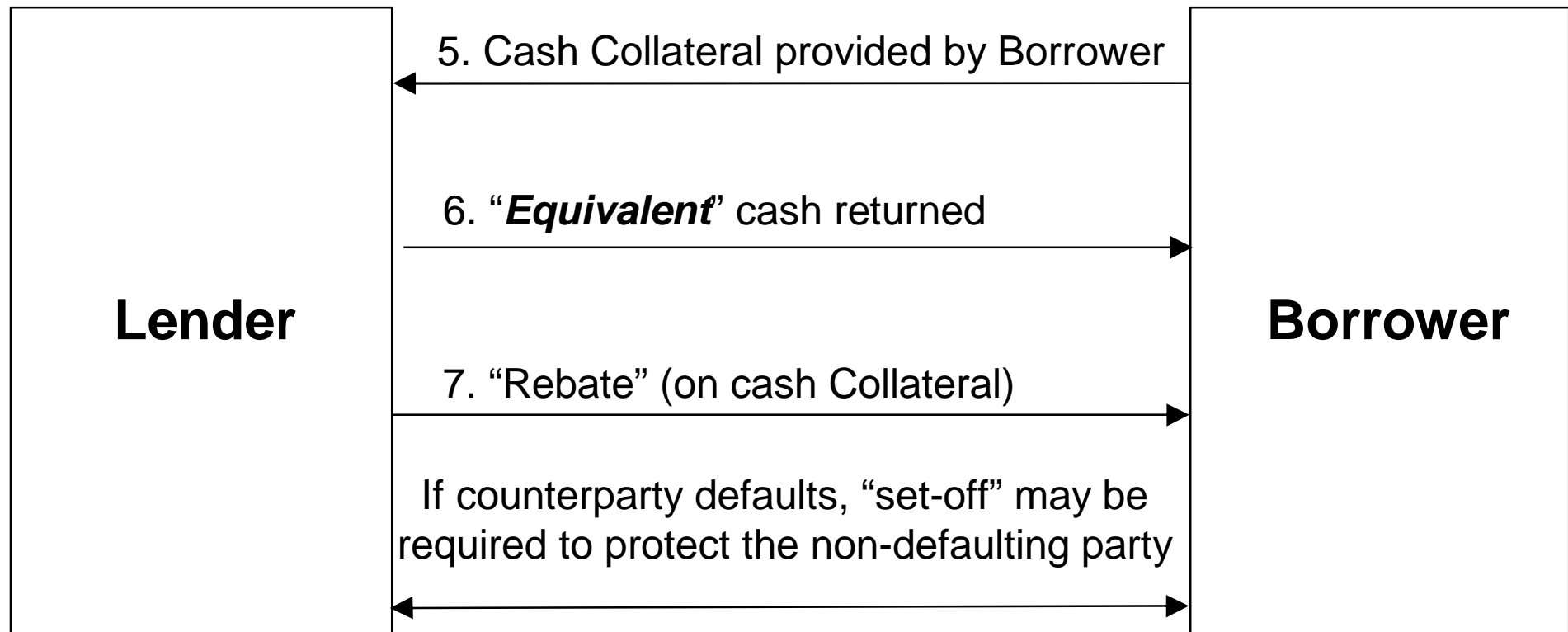
Why normal securities lending will continue

- § There is a huge demand for it throughout the developed world, for a variety of proper reasons.
- § There is plenty of supply/liquidity.
- § Australia is no exception.
- § Generally, participants know what they are doing.
- § The relatively unusual “cash driven” transactions revealed in Australia in 2008 generally appear to have involved people who did not know what they were doing.

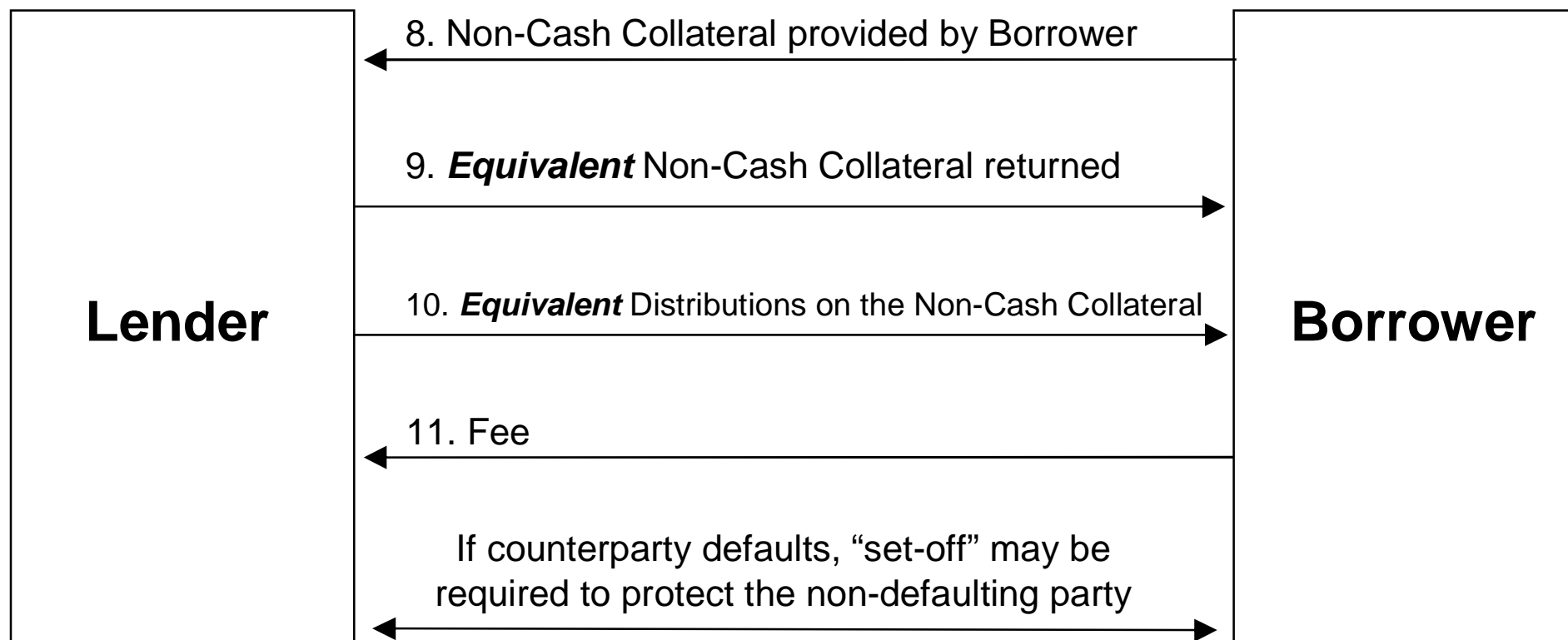
Attachment 1: What is Securities Lending – basic steps?



Attachment 2: What if Cash Collateral is provided re a Securities Lending transaction?



Attachment 3: What if Non-Cash Collateral is provided re a Securities Lending transaction?



There is a huge demand [plus plenty of supply] for normal securities lending

- § Anecdotal evidence – 40% to 50% of stock borrowing is used to meet delivery obligations under short sales. [Balance is used for other purposes – eg hedging, arbitrage etc.]
- § No gross short selling figures for ASX.
- § But estimates are:
 - For NYSE, 24% by volume is short selling.
 - For NASDAQ, 31% by volume.
- § Globally:
 - > A\$12 trillion available.
 - > A\$6 trillion on loan.
- § In Australia:
 - A\$345 billion available.
 - A\$95 – 185 billion on loan.

Normal securities lending is well understood by participants

- § Standard form, well developed (and periodically updated) industry agreements and User's Guides.
- § Mostly by institutional owners, global custodians, investment banks, prime brokers and other specialist intermediaries.
- § Sophisticated principal or agency programmes.
- § Risks are well known and generally well managed by (or on behalf of) lenders.
- § Understood and accepted by regulators.
- § Even ANZ found no material problems in this part of its business.

“Cash driven” securities lending (or “equity finance”) was not well understood by participants. How to tell the difference?

§ These types of transaction are relatively uncommon.

§ But they resulted in huge exposures for some participants:

Tricom: peaked at about \$2.4 billion in mid 2008.

ANZ Bank: \$2 billion in August 2007.

Merrill Lynch and Credit Suisse also had some large exposures.

“Cash driven” securities lending (or “equity finance”) was not well understood by participants. How to tell the difference? (cont/d)

- § Apparently, many clients of Opes Prime and Primebroker who lent their securities did not understand the agreements they signed, despite publicly available information about securities lending. This has resulted in reputational risk to ANZ Bank.
- § Most relevant ANZ Bank staff did not understand and appreciate the risks involved as the provider of the “equity finance” cash (per its Securities Lending Review, 22 August 2008).
- § The risks include re reporting obligations and thresholds.

Short selling – the problem of “covered” short sales

- § Longstanding ambiguity re “covered” short sales in CA, recognised in ASC 1994 Discussion Paper.
- § Overlap between CA and ASX Market Rules.
- § Possible disconnect between market practice and the law.
- § Problem re enforcement against offshore sellers.
- § The blame game – does “covered” short selling actually increase volatility in a declining market?

Short selling – 2008 developments

- § Overseas: UK and US.
- § Federal government announcement of intention to legislate.
- § ASX 28 March 2008 Discussion Paper.
- § What is rationale for reporting or other restrictions?
- § Corporations Amendment (Short Selling) Bill 2008 due for introduction in current sittings of Parliament. Likely to require reporting of sales where borrowing is used to meet delivery obligations.
- § Implementation issues.
- § If one is required, is there a simpler solution – eg just requiring disclosure of stock loans by a flag in CHES?



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