



RiskMetrics (Australia) Pty Ltd  
Level 4, 190 Queen Street  
Melbourne VIC 3000  
ABN: 88 081 368 327 AFSL Licence No. 297008

Head of Payments Policy Department  
Reserve Bank of Australia  
GPO Box 3947  
SYDNEY NSW 2001

By email: [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)

21 November 2008

Dear Sir

Thank you for the opportunity to comment on the Reserve Bank of Australia's paper, "Consultation on Variation of the Financial Stability Standard for Securities Settlement Facilities: Disclosure of Equities Securities Lending". RiskMetrics (formerly Institutional Shareholder Services) is the world's largest proxy voting advisory firm, providing governance research to more than 1700 institutional investors in Australia and around the world.

#### **Amendment of Financial Stability Standard**

RiskMetrics strongly supports the proposal to amend the Financial Stability Standard with reference to securities settlement facilities for the purpose of requiring the Australian Securities Exchange to collect and publish data on securities lending activity. We note that the ASX has publicly announced its support for such a measure (in its position paper, "Transparency of Short Selling and Securities Lending" (2 October 2008)).

We also note that the Reserve Bank's proposal would effectively lead to the implementation of "option four: disclosure of stock lending transactions" in Treasury's Commentary on the Exposure Draft of the Corporations Amendment (Short Selling) Bill, a course of action that RiskMetrics supports.

#### **Disclosure of securities loans**

The disclosure of securities lending activity will make dealings in shares more transparent since, as the Reserve Bank notes, the publication of information about securities loans by the ASX will mean that that information will be available to all market participants, not just those who lend and borrow shares or who are otherwise subscribers to proprietary information services. This will contribute positively to price discovery and market liquidity.

Disclosure will also assist market participants in assessing settlement risks. The inability of one market participant (Tricom Securities) being unable to fulfil its settlement obligations (due to an unspecified error in an associated securities lending programme) led to significant delays in settlement on 29 January 2008. As the Reserve Bank notes, high levels of securities lending activity in shares compared to the market capitalisation of the issuer or the average daily turnover of those shares can be important indicators of the increased potential for settlement delays or failure. RiskMetrics agrees with the view expressed by the Reserve Bank, both in this consultation paper and in its earlier Review of Settlement Practices for Australian Equities, that transparency in relation to securities lending activity could be best addressed by modifying CHES to identify whether settlement instructions entered into CHES are related to securities loans. We note that this real-time capture and timely publication of securities lending data is supported by both the ASX as well as key industry groups (including the Australian Securities Lending Association).

We accept that the proposed variation to the Financial Stability Standard must necessarily be expressed in broad terms. This is sufficient so long as the CHES rules incorporate the amendments necessary to implement the level of disclosure of securities loans envisaged by the Reserve Bank in its consultation paper. Accordingly, we would expect to see changes to the ASTC Settlement Rules along the following lines:

- CHES participants should be required to advise ASTC whether a transaction giving rise to a transfer of securities is a securities loan - to enable transfer volumes in relation to securities loans to be disaggregated, on a share-by-share basis, from total transfer volumes;
- The transfer information provided should also allow ASTC to differentiate between (i) transfers to initiate securities loans and (ii) transfers to close out securities loans, including the early recall of shares for the purposes of voting - to enable aggregate net open securities loan positions to be published (this will avoid the double-counting of securities loan-transfers that would be the case with the reporting of gross securities loan positions); and
- The above information should be aggregated by ASTC after the close of each trading day - with no time lag - to enable the ASX, in line with the Reserve Bank's expectations, to publish, the next trading day, aggregate open securities loan positions and net daily movements in open securities loans on a share-by-share basis.

Also, as the Reserve Bank notes in its consultation paper, the ASX will need to put in place mechanisms to enable (i) the initial collection of information from CHES participants about aggregate open securities loans and (ii) the ASX to audit the information that it holds about securities loans. In terms of the latter point, we note that the Reserve Bank has suggested that participants might be requested to supply information about their aggregate open securities loans on a semi-annual basis. We would suggest, instead, that this information be provided on a quarterly or even monthly basis. This should not prove to be significantly burdensome (in the context of the disclosure requirements discussed above) and would have the benefit of enabling the ASX to undertake a more regular reconciliation of the information about securities loans held - and published - by it.

In addition, while securities loans play an important role in facilitating short sales of shares, they are not used exclusively for that purpose. The timely disclosure of information about securities loans will also provide valuable information to market participants that cannot be obtained from observing the level of covered short sales in the market.

One of the key other uses of securities loans is to gain temporary access to the voting rights attached to the shares being borrowed. This is, in effect, vote buying: eg Hu and Black, 'The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership' (2006) 79 Southern California Law Review 811; Christoffersen, Geczy, Musto and Reed, 'Vote Trading and Information Aggregation' (2007) 62 Journal of Finance 2897; and Hu and Black, 'Equity and Debt Decoupling and Empty Voting II: Importance and Extensions' (2008) 156 University of Pennsylvania Law Review 625.

Making data about lending activity available to all market participants will enable investors and listed companies to assess the extent to which shares are being borrowed, on or about the announced cut-off date for the determination by companies of voting entitlements at upcoming general meetings, for the purpose of obtaining votes to cast at those meetings.

Securities loans can be used to distort the results of shareholder voting and may even determine the outcome of a meeting where the matter under consideration is controversial or one on which the views of shareholders are finely balanced. A voting result that has been secured using votes attaching to shares, that have been borrowed for the purpose of gaining access to those votes, may not necessarily reflect the views of the majority of the company's other shareholders.

This is of particular concern in the context of matters that affect the control of Australian companies. Securities loans, when used to obtain access to votes, can also have an effect beyond the shares actually borrowed. Even if not voted, those shares are no longer available to the lender (unless recalled) nor do they form part of the free float of shares of the company. This has the potential to influence the outcome of a close contest by withdrawing votes from, for example, the opposition to a proposed transaction with control implications. Moreover, where the borrowed shares are actually voted in favour of a change of control transaction, the impact on the opposition is effectively doubled (the votes are not available to them or their potential supporters and have, instead, been voted against them).

RiskMetrics therefore strongly supports the proposed amendment to the Financial Stability Standard as an efficient and effective way of ensuring that information about securities lending activity in the Australian market is available to all market participants.

Please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail. Thank you once again for the opportunity to comment on your consultation paper.

Yours sincerely

A handwritten signature in blue ink that reads "Dean Paatsch".

Dean Paatsch  
RiskMetrics Australia  
03 9642 2062  
[dean.paatsch@riskmetrics.com](mailto:dean.paatsch@riskmetrics.com)