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Potential short selling reporting obligations in Singapore

In February, the Monetary Authority of Singapore (MAS) and the Singapore Exchange Limited (SGX) jointly issued a consultation paper proposing, among other things, short position reporting requirements (the 'Joint Proposal').¹ The Joint Proposal followed the conclusion of an 'extensive review' by both organisations of the Singaporean securities market.² That review was undertaken after 'unusual trading activities' in three companies listed on the SGX Mainboard. The conclusion of the joint review was that the market's regulatory structure 'continues to facilitate fair, orderly and transparent trading'.³ Roughly contemporaneously with the MAS/SGX review, the International Monetary Fund (IMF) concluded its own review of Singapore's securities market. At the conclusion of that undertaking, the IMF team determined that Singapore's securities market generally complies with international standards, including the market structure and other regulatory standards established by the International Organization of Securities Commissions (IOSCO).

Through these reviews, the MAS and SGX identified the following three conceptual areas in which regulatory structures could be enhanced:

- 'Measures to promote orderly trading and responsible investing;
- Enhancements to improve transparency of market intervention measures; and
- Framework to strengthen the process for admitting new listings and enforcing against listing rule breaches.'⁴

Within the scope of the first conceptual enhancement referenced above, the MAS and SGX have proposed the introduction of a new short selling reporting regime. If enacted, this regime would 'complement' the short selling marking requirement which was introduced in March 2013, by which market-participants must ensure that orders which partly or wholly involve short sales are marked as 'short' before submission to the SGX. The MAS and SGX asked market participants to provide their views on the Joint Proposal by 2

May 2014. That deadline has now passed, and market participants' responses and feedback are currently under review by the MAS and SGX.

The short-selling proposal

Short selling involves the sale of securities that the seller does not own at the time that the sale order is placed. A short seller may believe that the price of shares in a listed company will decline, or may seek to hedge the risk of an economic long position in the same security or in a related security. In any case, to deliver the security to the purchaser, the short seller often borrows the security, typically from a broker-dealer or institutional investor. The short seller later 'closes out' the position by purchasing equivalent securities on the open market, or by using an equivalent security it already owns, and returning the security to the lender. If the short seller 'covers' the short position by purchasing the relevant shares in the market at a price below the sale price (that is, because the price of the security has declined), then the short sale results in a profit. If, on the other hand, the price of the security has increased after the seller sold the shares short, then the cost of covering the short position results in a loss for the trader.

Regulators in numerous jurisdictions allow short selling, principally on the grounds that the practice aids in 'price discovery' in trading the securities of listed companies, and adds liquidity in the market. In the Joint Proposal, the MAS and SGX note that without short selling, the prices of listed company shares 'could be systematically biased upwards,' as market prices arguably would reflect only 'positive or neutral views' of the shares.⁵ For this and related reasons, the MAS and SGX make clear that, consistent with IOSCO policy standards, they have no intention of prohibiting short selling, and instead have proposed the short selling reporting regime only to 'further improve transparency' in trading of listed company shares.⁶

The objective of the regime is to provide relevant short position information promptly to the relevant regulatory bodies, and, under certain circumstances, to other market participants. Each of the recipients of the information would potentially benefit from this regime: regulators would have a more accurate and timely view of significant short positions in listed companies; and market participants would have access to additional information with which to analyse market sentiment regarding particular issuers. Importantly, the objective of the proposed short selling reporting regime is not necessarily to address the risks of market disruptions from short selling. As the Joint Proposal states, those types of risks are addressed through other regulatory mechanisms. For example, as aforementioned, the 'marking regime' introduced last year requires market participants to mark as 'short' any order that in whole or in part involves shorting the securities of a company listed on the SGX. Another risk-mitigation mechanism is the SGX's 'buy-in' procedure, through which the Central Depository (Pte) Limited, a centralised counterparty, engages in one or more open-market purchases of shares to be delivered on behalf of short sellers who fail to make delivery of those shares; the costs and expenses from the 'buy-in' transaction(s) are assessed against the defaulted short sellers.

The Joint Proposal has two parts. Under the first part, a short seller would be required to report to the MAS and SGX any 'net short position': (1) equal to or greater than 0.05 per cent of the issued shares of a company listed on the SGX Mainboard or Catalist (focused on growth companies); or (2) with a market value of at least S\$100,000, whichever is lower. The term 'net short position' would mean, in the case of (3), the difference between the total number of shares held long and the total number of shares of the same security held short; and in the case of (b), the total Singapore dollar value of the relevant long position(s) minus the total Singapore dollar value of the short position(s) in the same security. In calculating the 'net short position', the first part of the Joint Proposal would require market participants to take into account any positions in derivative securities which could be converted into shares of the relevant listed company, or which could require that the market participant deliver such shares. The information reported to the MAS and SGX under the first part of the

Joint Proposal would be aggregated with short selling information reported by other market participants, and published by the agencies once a week without identifying the market participants who reported the information.

The second part of the Joint Proposal is an alternative reporting requirement. Under the second part, a market participant who holds a net short position exceeding 0.5 per cent of a listed company's shares would be required to report its position to the MAS and SGX. The market participant would also be required to report any increase or decrease of 0.1 per cent or more in the market participant's position. The initial report by the market participant, and any subsequent report of any change of 0.1 per cent or more in that position, would be required no later than two days after the date of the relevant trade (ie, T+2). The MAS and SGX have proposed that the information reported under the second part of the Joint Proposal, including the identity of the short position holder and the extent of the person's holdings, would be published 'on an ongoing basis.'⁷

At present, it is not clear what penalties failure to comply with these reporting requirements would incur. The MAS and SGX are authorised to pursue enforcement of their respective regulations, and presumably they would be authorised to impose a civil penalty and pursue other remedies against market participants who do not comply with the final version of the short selling reporting regime. It is also possible that the final version of the short selling reporting regime will clarify, or expand, the regulators' enforcement authority.

There are several substantial differences between the Joint Proposal and short selling reporting requirements in the United States and the European Union. In the US, there is no direct requirement for a market participant to report short positions comparable to either of the alternatives proposed by the MAS and SGX. Instead, brokers and dealers in the US are required to report short transactions to the relevant regulatory organisations, which then aggregate and publicly report 'short interest' data.⁸ However, under Rule 200(g) of Regulation SHO, US market participants must mark orders as 'long', 'short' or 'short exempt', similar to the short position marking requirements introduced by Singapore in 2013.

The EU's short selling regulation (SSR) took effect in November 2012.⁹ The SSR

introduced three requirements applicable to firms and individuals trading relevant securities in markets subject to the jurisdiction of an EU Member State regulator: (1) notification to the relevant regulator and, in certain cases, public disclosure of net short positions in shares admitted to trading on a venue in the EU (eg, the London Stock Exchange); (2) restrictions on entering into uncovered short sales involving listed equity securities; and (3) restrictions on entering into uncovered trades in credit default swaps related to debt instruments issued by a sovereign EU member state government. With respect to trading listed equities, the threshold to report short positions to the relevant regulator is 0.2 per cent, and hence higher in the EU harmonisation law than the comparable alternative proposal in Singapore. But the SSR's additional requirement to report publicly short positions in listed equity securities is similar to that established under the Joint Proposal: 0.5 per cent. In fact, the MAS and SGX acknowledged in the Joint Proposal that they considered the EU's 'two-tiered' reporting thresholds, but are presently considering only whether to adopt a single short selling reporting requirement (as between the two proposed) for Singapore.¹⁰

Next steps for market participants

As aforementioned, the MAS and SGX sought the views of market-participants on the proposed short selling reporting regime. More specifically, the MAS and SGX asked, in a relatively open-ended manner, for market-participants to provide their opinions on 'the proposal to introduce short positions reporting to complement the current short-selling marking regime.'¹¹ In a more pointed form, the MAS and SGX asked market participants to opine on the 'pros and cons' of each of the 'two proposed reporting options'. In addition, the MAS and SGX stated in the Joint Proposal that they may seek further information from market-

participants based on the regulators' analysis of the comments and opinions they received by the 2 May deadline. Accordingly, there may be further consultations before publication of a final version of the short selling reporting regime. It is also possible, on the other hand, that the MAS and SGX will incorporate the substance of market participants' responses and publish a modified short position reporting requirement, or simply elect to implement one of the two options in the form in which it was proposed in February. In any case, market participants, particularly investment managers registered with the US Securities and Exchange Commission that trade securities of companies listed in Singapore, should be prepared to develop processes (or direct that the relevant external vendors to whom trade-reporting, recordkeeping and other systems have been outsourced develop processes) to report timely and accurately to the MAS and SGX the information required under the final version of any rule(s) that comprise the short selling reporting regime.

Notes

- 1 Monetary Authority of Singapore and Singapore Exchange Limited, 'Review of Securities Market Structure and Practices', P001-2014 (February 2014), available at www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/Review%20of%20Securities%20Market%20Structure%20and%20Practices.pdf.
- 2 *Ibid* at 1.
- 3 *Ibid* at s 1.2.
- 4 *Ibid* at s 1.4.
- 5 *Ibid* at s 4.1.
- 6 *Ibid* at s 4.5.
- 7 *Ibid* at 4.6(b).
- 8 Note that under US Securities and Exchange Commission Rule 200(g) of Regulation SHO, US market-participants must mark orders as 'long', 'short' or 'short exempt', similar to the short position marking requirements introduced by Singapore in 2013.
- 9 EU Regulation No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:086:0001:0024:en:PDF>.
- 10 Joint Proposal at footnote 18.
- 11 *Ibid* at 16.