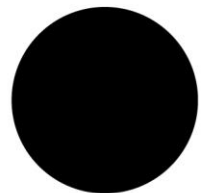




**DISCUSSION PAPER ON THE  
IMPLEMENTATION OF A SHORT SALE  
REPORTING AND DISCLOSURE  
FRAMEWORK**

**DATE OF ISSUE: 19 NOVEMBER 2018**



**TABLE OF CONTENTS**

<b>NOTICE INVITING SUBMISSIONS</b>	<b>3</b>
<b>DEFINITIONS</b>	<b>4</b>
<b>CHAPTER 1: INTRODUCTION AND PURPOSE OF THIS PAPER</b>	<b>5</b>
1.1 INTRODUCTION	5
1.2 PURPOSE OF THE DISCUSSION PAPER	5
<b>CHAPTER 2: BACKGROUND</b>	<b>6</b>
<b>CHAPTER 3: BENEFITS AND RISKS ASSOCIATED WITH SHORT SALES</b>	<b>7</b>
3.1 BENEFITS OF SHORT SALES	7
3.2 RISKS ASSOCIATED WITH SHORT SALES	7
<b>CHAPTER 4: SHORT SALE REPORTING AND DISCLOSURE</b>	<b>9</b>
4.1 MODELS FOR SHORT SALE REPORTING AND PUBLIC DISCLOSURE	9
4.2 MECHANICS OF SHORT SALE REPORTING AND PUBLIC DISCLOSURE	9
MODELS	
<b>CHAPTER 5: INTERNATIONAL PRACTICE</b>	<b>13</b>
5.1 SUMMARY OF REGULATORY APPROACHES IN FOREIGN JURISDICTIONS	13
<b>CHAPTER 6: PROPOSED SHORT SALE REPORTING AND DISCLOSURE</b>	<b>19</b>
<b>FRAMEWORK IN SOUTH AFRICA</b>	
6.1 PROPOSED MODELS FOR SHORT SALE REPORTING AND DISCLOSURE	19
6.2 POSSIBLE EXEMPTIONS FOR POSITIONAL AND TRANSACTIONAL	22
SHORT SALE REPORTING	
<b>CHAPTER 7: IMPACT ASSESSMENT</b>	<b>23</b>
<b>CHAPTER 8: CONCLUSION</b>	<b>26</b>
<b>ANNEXURE A: SUBMISSION TEMPLATE</b>	<b>27</b>

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## NOTICE INVITING SUBMISSIONS

Comments are invited on the proposals in this discussion paper on the proposed introduction of an appropriate reporting and disclosure framework for short sale transactions within the South African financial markets.

Comments from the financial industry will assist the Financial Sector Conduct Authority ("FSCA") to develop and implement the most appropriate reporting and disclosure framework for short sale transactions in South Africa.

### **Making a submission**

The discussion paper is available on the FSCA website ([www.fsca.co.za](http://www.fsca.co.za)).

Enquiries may be directed to Ms Elmarie Hamman ([elmarie.hamman@fsca.co.za](mailto:elmarie.hamman@fsca.co.za) or direct telephone line: 012-428 8019). Comments should be sent, not later than 15 January 2019, to the following e-mail address: [shotselling@fsca.co.za](mailto:shotselling@fsca.co.za); or

By physical address: 41 Matroosberg Road, Ashlea Gardens, Pretoria, 0002; or

By postal address: PO Box 35655, Menlo Park, 0102.

## DEFINITIONS

“**Act**” means the Financial Markets Act, 2012 (Act No. 19 of 2012) and any word or expression to which a meaning has been assigned in the Act bears the meaning so assigned to it, unless the content otherwise indicates -

“**authorised user**” means an authorised user as defined in the Act;

“**client**” means client as defined in the Act;

“**covered short sale**” means a transaction where a person executes a short sale and relies on an existing securities lending arrangement to have a presently exercisable and unconditional right to vest the securities in the buyer at the time of the sale;

“**issued share capital**” in relation to a company, means the total of ordinary and any preference shares issued by the company, but does not include convertible debt securities;

“**naked short sale**” means the practice of a short sale in securities without a securities lending arrangement;

“**net short position**” means the position that remains after deducting any long position a person holds from any short position a person holds in relation to a company’s issued share capital;

“**regulated person**” means a regulated person as defined in the Act;

“**securities**” means securities as defined in the Act;

“**securities services**” means securities services as defined in the Act;

“**short position**” means the quantity of the securities that a person has is less than the quantity of the securities that a person has an obligation to deliver;

“**short sale**” means a transaction in which a person sells securities which the person does not own and which, at the point of sale, the person has not entered into an agreement to purchase such securities;

“**T**” means transaction date.

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CHAPTER 1: INTRODUCTION AND PURPOSE

**1.1 PURPOSE OF THE DISCUSSION PAPER**

1.1.1 This discussion paper sets out the FSCA's proposals for a short sale reporting and disclosure framework which consists of the following:

- (a) flagging of short sale orders on an exchange trading system and the public disclosure of aggregated short sale transactions across authorised users of the exchange per security ("transaction reporting");
- (b) a two-tier system for the reporting and disclosure of significant short positions held in shares admitted to trading on a regulated market ("position reporting"), comprising of -
  - i. a requirement to report to the regulator (private disclosure) once a net short position has reached a specified first trigger threshold;
  - ii. if the short position then reaches a second, higher threshold, an obligation on the regulator to make a public disclosure to the market.

1.1.2 The Financial Sector Assessment Programme review, conducted by the International Monetary Fund (IMF) in 2014, concluded that South Africa does not have a reporting framework in place for short sales, thus failing to meet principle 37<sup>1</sup> of the objectives and principles of securities regulation issued by the International Organisation of Securities Commissions (IOSCO) in 2010.

1.1.3 The FSCA is of the view that improving the transparency of short sale transactions would have distinct benefits which would outweigh the associated costs. Greater disclosure would both help deter market abuse and reduce the risks of disorderly markets posed by short sales. It would provide early warning signs of a build-up of large short positions, thereby alerting regulators to potentially abusive behaviour and enabling them to monitor and take action more effectively. Public access to information on short sales would also provide informational benefits to the market, improving insight into market dynamics and making available important information to assist price discovery.

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<sup>1</sup> Principle 37 stipulates that regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

## CHAPTER 2: BACKGROUND

- 2.1 During the 2008 global financial crisis, several countries implemented emergency measures on short sales as a result of concerns that this activity was aggravating the downward spiral in share prices, thereby posing a threat to individual financial institutions and wider financial stability. Various measures were taken, ranging from restricting short sales to temporarily banning short sales in certain sectors. Other measures included introducing a requirement to flag every short sale on the exchange trading system and the reporting and disclosure of net short positions at certain thresholds.
- 2.2 In view of the financial crisis, IOSCO's Technical Committee set up a Task Force on Short Sales ("Task Force"), the purpose being to work on eliminating gaps in various regulatory approaches to naked short sales, including requirements and disclosure of short positions. In fulfilling its mandate, the Task Force developed high-level principles for the effective regulation of short sales which were documented in the June 2009 IOSCO Report on the regulation of short sales. These principles are designed to assist regulators in their consideration of a regulatory regime for short sales. The Task Force recommended that effective regulation of short sales comprises four requirements as outlined in Principle 37 of the IOSCO's principles of securities regulation. The requirements are as follows:
- 2.2.1 Short sales should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets;
- 2.2.2 Short sales should be subject to a reporting regime that provides timely information to the market or to market authorities;
- 2.2.3 Short sales should be subject to an effective compliance and enforcement system;
- 2.2.4 Short sales regulation should allow appropriate exceptions/exemptions for certain types of transactions for efficient market functioning and development.

## CHAPTER 3: BENEFITS AND RISKS ASSOCIATED WITH SHORT SALES

### 3.1 BENEFITS OF SHORT SALES

- 3.1.1 Even where regulators consider that some aspects of short sales require regulation, they normally recognise that short sales can contribute to market efficiency.
- 3.1.2 Short sales play an important role in financial markets and are undertaken by a variety of market participants. It contributes to efficient price discovery, increases market liquidity, and facilitates hedging and other risk management activities.

### 3.2 RISKS ASSOCIATED WITH SHORT SALES

- 3.2.1 There are some concerns that short sales can be used in an abusive fashion to drive down the price of securities to a distorted level, contribute to disorderly markets (especially in extreme market conditions), and can otherwise have an adverse impact on financial stability:
- (a) **Market abuse:** The first regulatory concern relates to the way in which short sales may be used to contribute to market abuse. That does not make short sales abusive. However, its ability to add incremental weight to a downtrend, or to support insider trading by those with adverse information about an issuer, clearly makes it a potentially useful tool for those who are intent on abusing a market. Short sales can be used abusively to create misleading signals about the real supply, or the correct valuation of a security. Behaviours designed to position prices, distort markets or mislead investors normally constitute market abuse.
  - (b) **Disorderly markets:** As mentioned above, short sales can convey a signal to the market that a firm is overvalued. If investors act appropriately on this signal, this may improve the accuracy of the valuation of the security in question. However, if investors over-react the price decline may be excessive. Such volatility reduces the ability of a firm to raise equity capital or to borrow money and makes it very difficult for banks to attract deposits.
  - (c) **Settlement risk:** Short sales may also raise regulatory concerns in the area of settlement. Naked short sales gives rise to the risk that the seller is unable to deliver securities to the buyer, i.e. there is the risk of settlement failure. This may impair the proper functioning of the market resulting in enhanced transaction costs and sub-optimal levels of trading.

**QUESTIONS**

- 1. Do you agree that enhanced transparency of short sales by way of the implementation of a reporting and disclosure regime should be pursued?**
- 2. Do you agree with the analysis of the benefits and risks of short sale transactions?**



## CHAPTER 4: SHORT SALE REPORTING AND DISCLOSURE

### 4.1 MODELS FOR SHORT SALE REPORTING AND PUBLIC DISCLOSURE

Broadly speaking, there are two types of reporting frameworks that are commonly used for short sale reporting, namely:

4.1.1 Flagging of short sale transactions and public disclosure (transaction reporting)

4.1.2 Short sale position reporting

### 4.2 MECHANICS OF SHORT SALE REPORTING AND PUBLIC DISCLOSURE MODELS

It is important to note that each of the above-mentioned reporting models is a standalone and therefore will follow different reporting and public disclosure methods. The reporting processes to be followed for each reporting model are detailed below:

**4.2.1 Short sale transaction reporting (flagging of short sales):** This approach involves ‘flagging’ or ‘marking’ of all individual short sales by authorised users on the exchange trading system so that they can be aggregated across authorised users by exchanges. It requires a marker or flag to be put on each individual short sale<sup>2</sup> or short sale order that an authorised user sends to an exchange for execution. The calculation of short sales should be done at the legal entity (authorised user) level in order to determine short sales, and therefore short sales should also be disclosed in transaction reports at the legal entity level<sup>3</sup>.

Daily volumes or number of securities that are short sold in the market (otherwise known as gross short sales) are disclosed to the public by the exchange. This report provides an indication of the proportion of trades in a particular security that are sold short and the overall level of short sales that takes place on the market each day across authorised users.

#### (a) Advantages of “flagging”

- (i) The flagging of short sales by an authorised user on an exchange trading system provides market authorities, investors and companies

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<sup>2</sup> The determination of a short sale should be calculated using the date and time of the final execution.

<sup>3</sup> MiFIR requires the determination to be made on a legal entity basis rather than on a trader by trader basis, at the time of submission of the order to sell and on an individual portfolio basis instead of the global position of the entity.

with real time information of short sales, including intra-day activity, which may particularly be useful in a fast moving market.

- (ii) Transactional reporting or flagging is necessary for regulatory and market surveillance purposes because it provides an audit trail that enables regulatory bodies to identify which transactions are short sales. This can assist in the investigation of any possible market abuse.
- (iii) The data collected from 'flagging' can also be used, to some extent, in monitoring compliance of the short position reporting.
- (iv) Flagging also provides information about the aggregate short position in a single share which could help the market judge the extent to which short sales is driving down the price of that share.

**(b) Disadvantages of “flagging”**

- (i) It should be noted, that flagging of short sales does not provide regulators with information that enables them to identify any large short positions.
- (ii) In terms of the regulatory costs associated with transaction reporting, some changes to existing systems are required, especially for authorised users to facilitate communication of this information to the exchange concerned.

**4.2.2 Short position reporting**

Short position reporting entails the practice of a two-tier system. The system is a mixture of private reporting to the regulator (at a lower threshold) and public disclosures by the regulator (at a higher threshold) and based on the net short position, expressed as a percentage of a company's issued share capital. This approach involves a requirement to report to the regulator (private disclosure) once a net short position has reached a specified first trigger threshold. If the short position then reaches a second, higher threshold, an obligation to make a public disclosure to the market, in addition to the regulator, as a whole would be triggered.

Identifying disclosure thresholds that would generate meaningful information is crucial. If the thresholds are set too high, then disclosures may be rarely triggered so that regulators may not receive sufficient advance warning of possible market abuse or impending disorderly markets and the market may not receive enough information to help it make informed investment decisions.

If the thresholds are set too low, then the 'warnings' sounded to regulators may be of little value and the compliance costs for market participants may be high and not justifiable. In addition, large numbers of disclosures of positions that are not considered by the market to be meaningful are of questionable value. In particular, the initial public disclosure threshold needs to be set at a level which provides to the market meaningful information about the size of positions and the identities of short sellers, whilst minimising the degree to which trading strategies which may not risk creating disorderly markets are deterred.

In determining the reporting threshold due consideration should be given to the liquidity, market capitalisation, etc. of the security in that particular market. The threshold is set at a level intended to relieve sellers with small short positions from having to report those positions, while giving a reasonable representation of the market's overall short positions in securities markets.

**(a) Advantages of short position reporting**

IOSCO also notes that both models have their own merits and each could serve the regulatory objectives, being to harmonise regulation thereby conforming to international best practices and as well as to enhance transparency within the securities markets.

An enhanced transparency of short sales has informational benefits for the market which would outweigh the associated costs. It would help deter and constrain particularly aggressive large-scale short sales which may threaten the maintenance of orderly markets or pose the risk of market abuse and provide early warning signs of a build-up of large short sales, thereby alerting regulators to potentially abusive behaviour and enabling them to monitor and take action more effectively. Facilitating ready access to information on short sales would provide informational benefits to the market, improving insight into market dynamics and making available important information to assist price discovery.

**(b) Disadvantages of short position reporting**

There are some downsides to a position reporting regime. First, there are costs to those market participants that have to comply with such a regime. The bulk of these would appear to be incurred in calculating participants' positions in order to determine whether there is a disclosure obligation.

However, on the basis of the information available so far, it appears that the compliance costs are considerably lower than for a flagging regime. It is important to note that a position reporting regime cannot aspire to capture real-time data. It is, in effect, a "snapshot" of a person's position taken at a pre-determined time. As a result, intra-day positions will not be captured.

Finally, even when position data is aggregated, it cannot provide a complete picture of the overall levels of shorting in particular securities because it relies on threshold triggers for disclosure and, by definition, will not include those positions held beneath the disclosure thresholds.

## CHAPTER 5: INTERNATIONAL PRACTICE

### 5.1 SUMMARY OF REGULATORY APPROACHES IN FOREIGN JURISDICTIONS

5.1.1 Regulatory responses to the risks posed by short sales vary across jurisdictions. Some countries have not adopted specific controls over short sales, however address some of the risks through settlement disciplines, margin requirements, general volatility halts and other similar measures. Other jurisdictions permit short sales but impose varying degrees of controls on the process. There is no single reason why these different approaches have evolved.

5.1.2 More details are provided below regarding short sale requirements imposed by foreign jurisdictions:

#### (a) Short sale transaction reporting and disclosure requirements

All seven<sup>4</sup> foreign jurisdictions reviewed have short sale order marking/flagging requirements. In all jurisdictions, the short seller (client) has the obligation to inform the broker (called authorised user in terms of the Act) of the details of their short sale. The broker has the obligation to mark/flag the short sale transaction on the trading system.

The “flagging” model applies, where the broker, before or when executing a transaction, is required to indicate by way of marking/flagging its short sales on the trading system.

In the jurisdictions reviewed, it was noted that only two jurisdictions (Australia and Singapore) make provision for the exchanges to publicly disclose the short sale transactions flagged on the trading system. Practices in these jurisdictions are discussed below:

#### i. AUSTRALIA

If a person (short seller) engages an Australian Financial Services licensee (broker/authorised user) to make a sale on their behalf, the person must give the particulars of their short sales to the AFS licensee on or before the time of entering into an agreement to sell.

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<sup>4</sup> The European Union, United States of America, Australia, Canada, Hong Kong, Japan and Singapore

The AFS licensee must not make a short sale on a licensed market on behalf of a seller unless, before making the sale, the AFS licensee has asked the seller whether the requested sale is a short sale and has recorded in writing the seller's answer.

If an AFS licensee is given short sale transaction particulars by a short seller after the start of the trading day but before 7 pm, the AFS licensee must give the information to the market operator on or before 9 am on the next trading day after the information is given.

The market operator (the exchange) therefore has the obligation to publicly disclose the total number of securities that have been short sold on a particular day and disclosed to the market operator. The public disclosure is made on the day the sales are reported to the market operator.

**ii. SINGAPORE**

The Exchange has the obligation to publish short sale information on aggregate short sales volume and value for each counter on its website at the start of each trading day, based on orders marked as short sell executed the previous trading day.

**(b) The short position reporting and disclosure requirement**

This model is triggered once the short sale position of each investor crosses the relevant thresholds as set in each jurisdiction. Highlights of short sale position reporting and disclosure from the studied jurisdictions are discussed below:

- i. In Europe, a natural or legal person (investor or broker - trading in its own capacity) who has a net short position in relation to the issued share capital of a company that has shares admitted to trading on a trading venue is responsible for reporting and disclosing their net short position to the regulator and to the public. The short seller is required to privately report short positions to the regulator at a net short position of 0.2% of the issued share capital and at each successive 0.1 % threshold thereafter, and is also required to do a public disclosure once reaching 0.5% threshold of the issued share capital, and each 0.1% threshold thereafter. The short seller posts the information on a central website operated or supervised by the relevant competent authority;

- ii. In the US, short interest reporting is a form of aggregated position reporting. Pursuant to the Financial Industry Regulation Authority (FINRA) Rule 4560, member firms are required to report total short positions in all customer and proprietary firm accounts in all equity securities to FINRA on a bi-monthly basis. These filings are made online using the Short Interest reporting system accessible via Firm Gateway at firms.finra.org. All firms that report short interest to FINRA are responsible for maintaining current and previous cycle short interest reports pursuant to the U.S. Securities and Exchange Commission (SEC)'s record-keeping requirements. The web-based system is the only method for reporting the firm's proprietary and customer short positions in NASDAQ, New York Stock Exchange (NYSE), NYSE American, NYSE Arca, Bats and OTC equity securities.

FINRA computes short interest using information it receives from its broker-dealer members reflecting all trades cleared through clearing broker-dealers. FINRA Rule 4560 requires generally that broker-dealers that are FINRA members report "short positions" in customer and proprietary firm accounts in all equity securities twice a month through FINRA's web-based Regulation Filing Applications (RFA) system. FINRA defines "short positions" simply as those resulting from "short sales" as defined in Rule 200(a) of Regulation SHO under the Exchange Act. Member firms must report their short positions to FINRA regardless of position size. In a process that takes approximately eleven days after the settlement date used for calculations, or two weeks after the last trading date for the captured short positions, FINRA validates and aggregates the information by security and, along with NYSE and NASDAQ, releases it to the public.

- iii. In Australia, a short seller (be it the investor or the broker trading in its own capacity) with a short position above the reporting threshold must report details of this position to the Australian Securities & Investment Commission (ASIC) within three reporting days (T+3). The thresholds are \$100,000 and 0.01% of the total quantity of securities. ASIC will publicly disclose the total of short positions in a security issued by a listed entity that were disclosed to them the previous trading day. That is, the total short positions held in a security on day T will be published on T+4;

- iv. In Canada, participants<sup>5</sup> and access persons<sup>6</sup> are required to file a report of the aggregate short position of each separate account in each listed and quoted security as of the 15th day and the last day of each month in a form as required by the Investment Industry Regulatory Organization of Canada (IIROC). An access person is not required to file a report if the short position is in an account maintained by a participant.

Participants and access persons must file a short position report with IIROC within two (2) trading days following the date on which the calculation is to be made. IIROC is the sole facility to receive Short Position Reports.

IIROC will then publish a Consolidated Short Position Report (CSPR) on their website as of the 15th day and as of the last day of each calendar month bi-monthly). The CSPR will display:

- aggregate short positions on all listed and quoted securities as of the current reporting date; and
- the net change in short positions from the previous reporting date, on a per security basis.

- v. In Hong Kong, regulation puts the duty to report short positions on both the seller (whether a client or a broker, as a principal) and the broker (as an agent). Therefore, a person who, on the last business day of each week, holds a net short position exceeding a threshold of 0.02% of the "specified shares", or HK\$30 million, is required to report his net short position to the Securities and Futures Commission (SFC)<sup>7</sup> within 2 business days. In certain circumstances, the SFC can order daily reports to be made within 1 business day, where it believes that circumstances exist which "threaten the financial stability of Hong Kong" and that as a result, it believes that it needs to know.

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<sup>5</sup> "Participant" means: a dealer registered in accordance with securities legislation of any jurisdiction and who is a member of an Exchange, a user of a QTRS, or a subscriber of an ATS; or a person who has been granted trading access to a marketplace and who performs the functions of a derivatives market maker.

<sup>6</sup> "Access Person" means a person other than a Participant who is: (a) a subscriber; or (b) a user.

<sup>7</sup> Established in 1989, the Securities and Futures Commission (SFC) is an independent statutory body set up to regulate the securities and futures markets in Hong Kong.



Therefore, the Commission must, after the reporting deadline for a reporting day, publish in the manner that it considers appropriate the particulars of the reportable short positions notified to it in respect of the reporting.

- vi. In Japan, short sellers (investors) are required to submit their outstanding short sale positions for designated securities<sup>8</sup> to the brokers when their short positions exceed 0.2% of the issued shares (ratio of shorted shares to the issued shares). The brokers are required to submit to the approved exchange once the short sales exceed 0.5% of the issued shares. The exchange publicly discloses (at the 0.5% threshold) such information on the exchange's website under the title, "Information on Outstanding Short Selling Positions." The information is consolidated and published as a single Excel file.

As a general rule, the Tokyo Stock Exchange (TSE) will publish information on outstanding short sale positions for designated securities on the day of submission if trading participants submit the information by 4:00 p.m.

- vii. In Singapore, regulations require a person<sup>9</sup> [an entity (broker) or trust] to report its short positions in any specified capital markets products to the Monetary Authority of Singapore (MAS) if the short position is equivalent to or exceeds the short position threshold. The short position threshold is defined to be the lower of:
- 0.2% of the total issued shares in the relevant class of shares or units in the relevant class of units of a business trust or real estate investment trust, or
  - S\$2,000,000 in aggregate value.

Such report should be made to the MAS within two business days after the position day, being the last trading day of each week, by lodging a Short

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<sup>8</sup> Designated Securities means securities issued by an Insured, or by any Affiliated Entity, or by any Fund to which such Insured or any Affiliated Entity provides any services.

<sup>9</sup> MAS clarified in the Guidelines that the statutory duty to report short positions lies with the persons legally responsible for the delivery of specified capital markets products that may result in those short positions. In other words, in the case of a trust or unit trust, the obligation to report short positions lies with the trustee, and not the manager or the unitholders. Similarly, for funds structured as companies, the reporting obligation would fall on the fund.

Position Reporting Form through a new online portal known as the Short Position Reporting System (SPRS).

This means that if the position day is a Friday, the Short Position Reporting Form must be lodged by the following Tuesday (assuming no public holidays in that week). The MAS will therefore publish aggregated short positions of each security on the Wednesday of each week, without disclosing the identities of short sellers.

In all jurisdictions reviewed, reported short positions are subjected to public disclosure, either in individual or aggregated form. In most jurisdictions, the public disclosure of short positions is carried out by regulatory authorities. The reason is that reported short positions are sent to regulatory authorities, except for in Japan, where short position reports are sent to the exchange. As a result, the exchange assumes the responsibility of making public disclosure of short positions reported to them.

Of the jurisdictions reviewed, not all of them have thresholds for reporting short positions. For instance, in the US authorised users are required to report short positions to FINRA regardless of the short position size. The same is the case with Canada; authorised users are required to report short positions irrespective of the short position size. The thresholds vary from one jurisdiction to the other.

The platform for disclosing short positions varies among the jurisdictions. Some publish on their websites. Examples in this regard include, among others, the US and Canada. In Hong Kong, the regulatory authority reserves the right to decide the manner of disclosing details of short positions to the public.

**CHAPTER 6: PROPOSED SHORT SALE REPORTING AND DISCLOSURE  
FRAMEWORK IN SOUTH AFRICA**

**6.1 PROPOSED MODELS FOR SHORT SALE REPORTING AND DISCLOSURE**

6.1.1 It should be noted that currently only covered short sales are allowed in South Africa and naked short sales are prohibited.

6.1.2 The FSCA proposes the following models for short sale reporting, namely:

- (a) **Transactional reporting** (flagging of short sale transactions): Covered short sale transactions must be reported to the exchange by the authorised user after the client has disclosed the particulars of their short sale to the authorised user.
- (b) **Positional reporting**: Short positions above an initial threshold must be reported to the FSCA. If the short position reaches a higher threshold which will be determined, the FSCA will disclose the short position on its website to the public.

6.1.3 Mechanics of proposed models

The mechanics of the proposed models are discussed below.

(a) **Transaction reporting and disclosure**

Steps involved in transaction reporting and disclosure are discussed briefly below:

- (i) The client must give details of their short sale to the authorised user on or before entering into an agreement to sell. Some of the details of the short sale required include the name of the issuer of the security, the number of securities that are being shorted, and the description of the shorted securities. The authorised user must not make the short sale on the exchange without first confirming with the client that indeed the sale is a short sale and recording the confirmation from the seller.
- (ii) The authorised user must flag short sale transactions at the point of sale on the exchange's trading system.
- (iii) If the authorised user executes a short sale on its own behalf, the authorised user must also flag its short sales on execution.
- (iv) The exchange must publicly disclose the total number of securities that have been short sold and reported to it on a particular day on its website. The public disclosure must be made on the day the short sales are reported to the exchange (T). As mentioned above, this report should provide an indication of the proportion of trades in a particular security that are sold

short and the overall level of short sales that takes place on the market each day across authorised users.

**b) Position reporting and disclosure**

It is proposed that the two tier framework of reporting and disclosing short positions will form the basis of the mechanics for reporting and disclosing short positions. In terms of the framework, when a short position reaches a certain level, for instance, 0.2% of the issued capital of the security, the authorised user of the client will be expected to report the short sale to the FSCA. If the short position reaches a higher level, for instance 0.5% of the issued capital of the security, the FSCA will disclose the short position on its website to the public.

Steps involved in position reporting and disclosure are discussed below:

- (i) If the short sale is above a threshold (0.2%) of the issued capital of the security, the authorised user must report the short positions to the FSCA on T+3. The FSCA will put in place a reporting platform to allow for authorised users to report their short positions.
- (ii) Short position reports must be received by FSCA before open of business three reporting days after the date of the short position. If the seller continues to have a short position subsequent to the authorised user reporting their short position (exceeding the threshold) to the FSCA, the authorised user must continue to report until the short position is below the threshold.
- (iii) The short position reporting obligation applies to a person irrespective of whether the seller is inside or outside South Africa.
- (iv) In order to report short positions, the client must have a unique identifier. The unique identifier must take the form of a legal entity identifier.
- (v) Provision will be made for clients to appoint submitting agents to act on their behalf. The client may authorise a submitting entity to lodge short position reports on their behalf and respond to any queries related to the submitted reports.
- (vi) The FSCA will publicly disclose on its website the total of short positions that were disclosed to it the previous trading day. That is, total short positions held in a security on day T will be published on T+4. This disclosure will only be applicable to short sales which exceeded a higher threshold of 0.5% of the issued capital of the shorted security.

## QUESTIONS

3. Do you agree with the proposal that a two-tier system with regards to position reporting be introduced? Please motivate. If you do not support this model, please explain why you do not and what alternative(s) you would suggest.
4. Do you agree that all short sale transactions should be flagged by authorised users and be reported to the exchange concerned within a certain timeline? If not, please motivate.
5. Do you agree that authorised users should report net short positions to the FSCA at certain thresholds and timelines?
6. Do you agree that the FSCA discloses net short positions to the public once a higher threshold has been exceeded and within a certain timeline?
7. If you do not support net short position disclosure to the public by the FSCA, please explain why not and what alternative(s) you would suggest. For example, should the FSCA make some form of anonymised public disclosure based on the information they receive as a result of the first trigger threshold (these disclosures would be in addition to public disclosures of individual short positions at the higher threshold)?
8. Do you agree that thresholds in respect of net short positions should be set for both public disclosure and reporting to the FSCA? If not, what alternatives would you suggest and why?
9. In your opinion what should the initial threshold be for positional reporting to the FSCA? Please motivate.
10. In your opinion what should the higher threshold be for positional disclosure to the public? Please motivate.
11. How can double counting be prevented when reporting short sale transactions?
12. When should the transaction reporting be done to the exchange, and when should position reporting be done to the FSCA?
13. Should third parties be allowed to lodge reports on behalf of short sellers? If so, which reports?
14. When and at what time after T should short sale transaction reports be disclosed to the public by the exchange? Please motivate.
15. When and at what time after T should short position reports be disclosed to the public by FSCA?
16. How frequently should the public release of short position reports be made by the FSCA? Please motivate.
17. Do you agree with the methods of reporting and disclosure suggested?
18. Should the value of the short position be calculated by reference to either:
  - (a) the last sale price of a security for the day; or

- (b) the price determined and published by the exchange after the close of trading that day?
19. What are the likely costs and impact of the different reporting and disclosure frameworks on the functioning of financial markets?

## 6.2 POSSIBLE EXEMPTIONS FROM POSITIONAL AND TRANSACTIONAL SHORT SALE REPORTING

- 6.2.1 Exemptions from reporting will apply to primary dealers and market makers. Market makers and primary dealers will be exempted from both position and transaction reporting. The exemptions will apply only to the transactions carried out in performance of market-making activities or as authorised primary dealers; they do not apply to the entire scope of activities of primary dealers and market makers.
- 6.2.2 Exemptions from reporting apply to on an instrument by instrument basis and should not be considered as a global exemption for market making activities in all securities.
- 6.2.3 The FSCA can prohibit the use of exemption if the FSCA is of the view that the seller who was granted exemption does not satisfy the conditions of the exemption. Notice of the prohibition together with the reasons for the prohibition will be communicated in writing to the seller.
- 6.2.4 A market maker or primary dealer that requires an exemption must lodge an application, as prescribed by the FSCA. The exemption will become effective once the FSCA has granted the exemption.

### QUESTIONS

20. If transparency is required for short sales, should there be an exemption for primary dealers or market making activities from transactional and positional short sale reporting?
21. Should the FSCA consider any other exemptions? Please motivate.
22. What would be the impact on the functioning of the financial markets of applying or not applying the proposed exemptions?
23. Which securities should be exempted from short sale positional and transactional reporting?
24. Please provide any other comments on the proposed framework.

## CHAPTER 7: IMPACT ASSESSMENT

### 7.1 Purpose

- 7.1.1 This Impact Assessment describes the benefits and costs of the proposed short sale reporting and disclosure regime.

### 7.2 Benefits

As discussed in chapter 3 of this paper, the proposed reporting and disclosure regime can help to address potential market abuse and disorderly markets. It can further provide informational benefits to the market by improving transparency of short positions.

- 7.2.1 **Market abuse** – Private reporting of short positions to the FSCA at a low threshold will provide the FSCA with early warning signs of a build-up of large short positions. This will allow the FSCA to monitor the situation and can alert the FSCA to potentially abusive behavior which will enable the FSCA to take action more effectively. Without a reporting regime, identification of significant short sales would be resource-intensive for the FSCA.
- 7.2.2 The FSCA recognises the limits to these benefits, as short sellers might operate below the disclosure threshold. This issue should be mitigated if a relatively low threshold for private reporting to the Authority is implemented. However, authorised users might also fail to comply with the reporting obligation.
- 7.2.3 **Disorderly markets** – Reporting of short positions to the FSCA at a relatively early stage may help to identify unusual short selling activity. This will assist the FSCA to identify whether short selling activity potentially gives rise to price amplification effects (if markets ‘over-react’ to the negative price signal inherent in short selling) at an early stage and to determine whether intervention is required.
- 7.2.4 **Transparency** – The second element of the reporting and disclosure regime, public disclosure of individual short positions above a second and higher threshold generates information for market participants on the size of significant short positions above this second disclosure threshold. It also provides information about the identity of significant short sellers in the relevant securities. If this information is interpreted correctly by the market, this provides insight into short sellers’ price movement expectations and can improve pricing efficiency.

Providing appropriate information to the market as well as minimising the potential negative side effects of making individual short positions public, depends on the level at which the public disclosure threshold is set. When setting the threshold, a balance needs to be struck between providing too much information which is not meaningful (if the threshold is set too low) and not capturing potentially important information (if the threshold is set too high).

### **7.3 Costs**

7.3.1 Reporting of individual short positions would impose compliance costs on market participants engaging in short selling. These costs are related to monitoring short positions and reporting short sale transactions and positions to the exchange and the FSCA.

7.3.2 It is likely that the major part of these costs is generated by monitoring short positions as authorised users may need to incur once-off costs to adjust their internal systems.

7.3.3 Reporting short sale transactions and positions to the exchange and the FSCA will lead to further ongoing costs. However, it is proposed that reporting to the FSCA can initially be made via email. At this stage, it is more difficult to assess the costs of the disclosures to the market. However, it is anticipated that the costs of making these disclosures will be relatively small.

7.3.4 It is not expected that the levels at which the reporting and disclosure thresholds are set will have a major impact on compliance costs to authorised users. This is for two reasons:

(a) Firstly, these levels are unlikely to have a major impact on once-off costs to update internal systems necessary for complying with the reporting and disclosure obligations.

(b) Secondly, although the levels of the thresholds will affect the number of reporting and disclosures that need to be made, as stated above, it is not anticipated that the costs of reporting and disclosures to the FSCA and to the market will be high.

7.3.5 Public disclosures of short positions might also lead to indirect costs for short sellers. Short sellers might have competitive disadvantages if others follow their short selling strategy. They might also face a short squeeze, i.e. increased costs of closing their short positions if other market participants are alerted to their need to do so.



- 7.3.6 While public disclosure obligations might reduce clients' willingness to hold short positions, the extent to which this might happen is unclear. If this does happen in practice, then it will also reduce liquidity in the market with its associated indirect costs.
- 7.3.7 Another indirect cost of public disclosure of short positions concerns potential over-reactions to the information disclosed by market participants. This risk is likely to be higher in times of severe market turbulence. This may lead to an increase of short selling resulting in excessive sales of securities and price declines following disclosures of short positions to the market.
- 7.3.8 The FSCA would also incur costs as compliance with the private reporting and public disclosure requirements needs to be monitored.

**QUESTION**

- 25. In your view, what would be the impact of the proposed short sale reporting and disclosure framework? Please elaborate.**

## **CHAPTER 8: CONCLUSION**

- 8.1 It is deemed necessary that a short sale reporting and disclosure regime be adopted as per international regulatory best practice and in line with the FSAP recommendation to enhance transparency within the South African financial markets.
- 8.2 The purpose of developing this regime is to reduce and/or mitigate the negative consequences and risks which short sales may introduce to the market without having an undue adverse impact on the benefits which may result from this practice.
- 8.3 Together with enhancements of transparency and monitoring, it is expected that these proposed reforms will contribute to fair and efficient securities regulation that supports both investor protection and competitive financial markets.

## ANNEXURE A: SUBMISSION TEMPLATE

SUBMISSION - SHORT SALE REPORTING AND DISCLOSURE FRAMEWORK	
DATE	DD/MM/YYYY
NAME OF ORGANISATION	
TYPE OF ORGANISATION	
CONTACT DETAILS	
PART 1: COMMENTS ON THE BENEFITS AND RISKS OF SHORT SALES	
Question	Response
Q1: Do you agree that enhanced transparency of short sales by way of the implementation of a reporting and disclosure regime should be pursued?	
Q2: Do you agree with the analysis of the benefits and risks of short sale transactions?	
PART 2: SHORT SALE REPORTING AND DISCLOSURE	
Q3: Do you agree with the proposal that a two-tier system with regards to position reporting be introduced? Please motivate. If you do not support this model, please explain why you do not and what alternative(s) you would suggest.	

<b>PART 3: PROPOSED SHORT SALE REPORTING AND DISCLOSURE FRAMEWORK IN SOUTH AFRICA</b>	
Q4: Do you agree that all short sale transactions should be flagged by authorised users and be reported to the exchange concerned within a certain timeline? If not, please motivate.	
Q5: Do you agree that authorised users should report net short positions to the FSCA at certain thresholds and timelines?	
Q6: Do you agree that FSCA discloses net short positions to the public once a higher threshold has been exceeded and within a certain timeline?	
Q7: If you do not support net short position disclosure to the public by the FSCA, please explain why you do not and what alternative(s) you would suggest. For example, should FSCA make some form of anonymised public disclosure based on the information they receive as a result of the first trigger threshold (these disclosures would be in addition to public disclosures of individual short positions at the higher threshold)?	
Q8: Do you agree that thresholds in respect of net short positions should be set for both public disclosure and reporting to the FSCA? If not, what alternatives would you suggest and why?	

<p><b>Q9: In your opinion what should the initial threshold be for positional reporting to the FSCA?</b></p>	
<p><b>Q10: In your opinion what should the higher threshold be for positional disclosure to the public? Please motivate.</b></p>	
<p><b>Q11: How can double counting be prevented when reporting short sale transactions?</b></p>	
<p><b>Q12: When should the transaction reporting be done to the exchange and when should position reporting be done to the FSCA?</b></p>	
<p><b>Q13: Should third parties be allowed to lodge reports on behalf of short sellers? If so, which reports?</b></p>	
<p><b>Q14: When and at what time after T should short sale transaction reports be disclosed to the public by the exchange? Please motivate.</b></p>	
<p><b>Q15: When and at what time after T should short position reports be disclosed to the public by FSCA?</b></p>	
<p><b>Q16: How frequently should the public release of short position reports be made by the FSCA? Please motivate.</b></p>	
<p><b>Q17: Do you agree with the methods of reporting and disclosure suggested?</b></p>	
<p><b>Q18: Should the value of the short position be calculated by reference to either:</b> <b>(a) the last sale price of a security for the day; or</b></p>	

(b) the price determined and published by the exchange after the close of trading that day.	
Q19: What are the likely costs and impact of the different reporting frameworks on the functioning of financial markets?	
<b>PART 4: POSSIBLE EXEMPTIONS FROM POSITIONAL AND TRANSACTIONAL SHORT SALE REPORTING</b>	
Q20: If transparency is required for short positions, should there be an exemption for primary dealers or market making activities from transactional and positional short sale reporting?	
Q21: Should the FSCA consider any other exemptions? Please motivate.	
Q22: What would be the impact on the functioning of financial markets of applying or not applying the proposed exemptions?	
Q23: Which securities should be exempted from short sale positional and transactional reporting?	
Q24: Please provide any other comments on the proposed framework?	
<b>PART 5: IMPACT ASSESSMENT</b>	
Q25: In your view, what would be the impact of the proposed short sale reporting and disclosure framework? Please elaborate.	