SENATE ENQUIRY

Re: The performance of the Australian Securities and Investments Commission (ASIC)

Supporting Information – Attachment 1.2

1.2 AN OVERVIEW OF ASX TRADING AND ITS REGULATION

<u>DISCLAIMER:</u> All Information presented as shareholder research has been sourced from broker trading records and Cudeco registry records. While the author considers the data to be accurate and the summaries presented as also being an accurate reflection of trading, no guarantees are given as to the reliability of data or any conclusions put forward. Shareholders and investors are encouraged to do their own Due Diligence and to make up their own minds in regard to any trends present in the trading data.

CONTENTS

1.2 BACKGROUND INFORMATION – GENERAL COMMENTS ABOUT TRADING ISSUES AND REGULATION

The questionable trading behaviours concerning CuDeco have emerged from analysis of long term empirical trading and registry data. The only plausible explanations to address anomalous data issues are those that refer to wide scale collusion and share price manipulation issues.

Anomalous data trends mainly relate to the activities of a small group of institutional brokers. The identities of their clients are unclear as they are likely to reside within Nominee Entity accounts sitting within Institutional omnibus accounts that are managed by the large investment banks. The system provides layers of camouflage that enables the activities of sophisticated to be opaque to the market. It makes official claims regarding fair and transparent markets grossly misleading <Refer: For dark pools, just wade into the ASX>

The trading activities by either sophisticated investors (e.g., hedge funds) or fund managers on behalf of accounts held by institutions, have unquestionably led to unfair dominance and control over pricing levels. The practice of institutional brokers being used on a rotating basis to buy and sell for major clients has further camouflaged their dominance over trading. Occasionally the services of other brokers, who have reduced trading profiles for most of the time, are utilized whereby they step in and play a prominent role for the same institutional interests.

Importantly, the activity of institutional brokers appears to represent the same substantial interests, as the register shows institutional holdings being retained at reasonably static levels despite all of the trading churn taking place (i.e., large volumes sold then re-purchased which necessarily requires high levels of co-operation). The combined efforts of brokers, acting for much the same interests, have resulted in a compromised and dysfunctional market regarding CuDeco. Research has also shown that similarities regarding dubious trading patterns are also evident in the trading in other companies across the ASX.

The situation translates to cartel-like activity and is facilitated by the use of insidious algorithms that are integrally connected to high frequency trading. Research has shown that high frequency algorithms have the capacity of being able to choose who they deal with and can therefore connect designated sellers to preferred buyers with transactions designed to achieve particular pricing outcomes. The situation effectively translates to share price manipulation that is given safe passage on the ASX as the systems have regulatory approval.

The complexity of algorithmic design and how they actually deliver a competitive advantage to those that use them is beyond the comprehension of most market participants. Certainly the world's most powerful investment banks have poured enormous resources into recruiting and supporting some of the sharpest mathematical/statistical minds in the world, to develop and fine-tune their proprietary algorithms, Refinement s are continually taking place and new programs are appearing constantly. Crucially, by their very design they represent a manipulative influence in the market that advantages one group of investors (sophisticated investors) over another (retail investors) and enables companies to be unfairly targeted resulting in severe undervaluations. The manipulation that occurs with algorithms is referred to in the internet article High-Frequency Trading: A Market Destroying Scam.

There is no doubt that large volumes of high frequency algorithmic transactions have been instrumental in setting and maintaining artificial prices not only in relation to CuDeco, but in all stocks where they are utilized. A common practice borne out by CuDeco research, is for large volumes of small parcels of shares to be sold in a manner that deliberately forces lower prices (i.e., Downticks in price) but where the majority of the transactions are picked up by ‘affiliated’ brokers running algorithms that are tuned to seek out and accept the trades. Such trades generally involve no change to beneficial ownership of shares, as the selling and buying algorithms of brokers are acting in tandem for the same interest or interests ‘loosely’ affiliated and sharing trading agendas. Large numbers of small algorithmic crossings, deliberately putting trades through the market at lower prices, provide another mechanism for share prices to be worked lower.

Daily trading in stocks across the entire ASX is saturated with such spurious activity. The same approach can also be used to force upward movements in price and to cap share prices, and it can be used to manufacture volatility with large volumes of stock passing back and forth through the algorithmic interactions of related interests. Again, there is no effective change to beneficial ownership as institutional holdings have remained relatively unchanged from one month to the next.

Algorithms have a propensity to disguise and confuse trading in such a way that it is difficult to monitor what is exactly taking place. Certainly, all such trades viewed on a tick-by-tick basis appear innocuous. But the reality is that all trades are designed to deliver a strategic advantage, even the plethora of small trades for one or more shares that make no sense to retail investors. A major function of trading algorithms appears to be to disguise trading agendas by recycling shares through the market and controlling price movements. Often a large seller or sellers are able to offload large parcels of shares that get recycled through the market by algorithms buying then selling, or selling then buying, over and over, until the shares eventually end up with a major buyer or buyers. Yet at the end of the day often there are only minor changes to beneficial ownership as the large seller(s) and the large buyer(s) are related to the same shareholder group.

A large amount of trading has the hallmarks of manipulation with trading representing a zero-sum game. Some institutional brokers have trades that net out as losses while others have trades that net out as profits but as the trades are essentially for the one group, (i.e. the register remains relatively static), buying and selling tends to average out. The trading doesn’t necessarily generate profits, so that must not be the motivation behind the copious buying and selling, and as such, it must be regarded as non-genuine and servicing manipulative agendas.

While the design elements of algorithms are not properly understood, their impact over trading is readily noticeable through the anomalous data trends that result from their use.

A prime example is the trading associated with CuDeco shareholder, Citicorp Nominees over the 30 month period January 2010 through June 2012. Citicorp’s holding averaged around just 1.4 million shares on a monthly basis, yet movements ON and OFF the register saw around 124 million shares wash back and forth while its broker affiliate Citigroup Global only bought and sold around 30 million shares.

	Movements OFF	Movements ON
CuDeco Shareholder: Citicorp Nominees	124,057,631	123,164,692
	Sales	Purchases
ASX Broker: Citigroup Global (CITI)	29,521,603	29,724,320

The situation is extraordinary by any measure and demonstrates:

- the non-genuine nature of trading (i.e., broker collusion as <u>genuine</u> buyers of Citicorp shares operating in a <u>genuine</u> market would not be expected to make them so freely available for repurchase so that short sales for example could be conveniently retrieved);
- a compromised and somewhat artificial market where the majority of Citicorp buying and selling was dispersed through a range of brokers in addition to any trading through their affiliate Citigroup. The spread of orders means that the algorithms of different brokers could effectively be buying and

selling to other brokers but all representing the Citicorp Nominees holding; (In housing parlance, it is akin to having a property auction containing multiple dummy bidders.)

- a complete lack of transparency where it is not possible to easily reconcile broker trades to registry activity for Citicorp Nominees as a group. More importantly, it is not possible to reconcile the trading by individual entities within Citicorp Nominees;
- further transparency issues regarding large volumes of registry transactions related to off-market activity and not directly attributable to ASX buying and selling, yet the transfers may have great bearing on the integrity of the market;
- the possible over-servicing of accounts under custodial ownership to generate spurious commissions, fees and charges. While not necessarily demonstrating share price manipulation such over-trading does introduce market integrity issues.

The trading by Citicorp Nominees is by no means an isolated case. It is replicated to varying extents in other institutional entities trading in CuDeco securities, and in the institutional accounts of all major companies trading on the ASX.

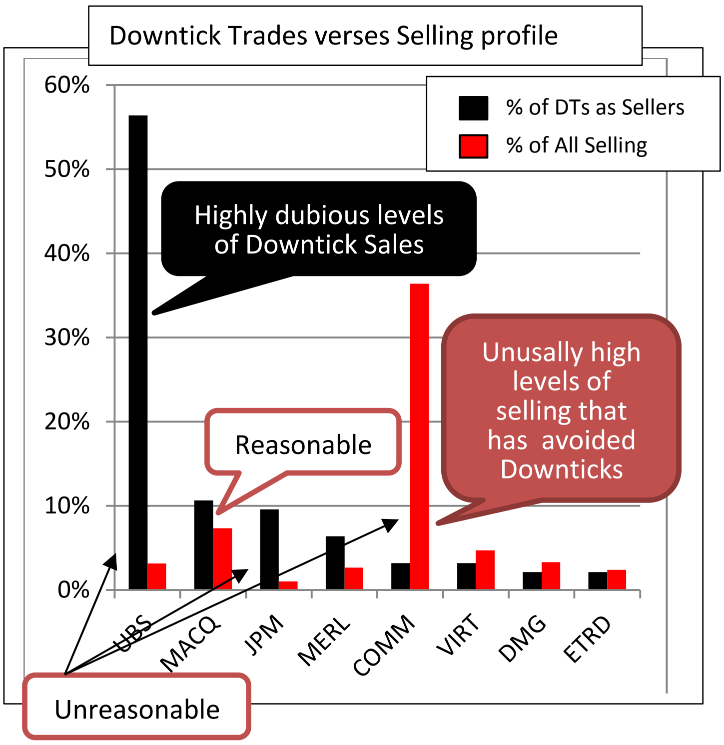
The transparency issue was flagged in an article by Age journalist Adele Ferguson <[Reference Link: A little transparency would go a long way]> although research suggests that problems referred to in the article are far more extensive than suggested. Yet the regulator has largely sat idly by without implementing effective reforms that would address and improve the situation. The trading and transparency issues effectively mean share market investing should be promoted as a 'buyer beware – user onus'' situation, where there is no real transparency and where trading isn't necessarily fair. At least investors would be properly informed.

Another example of highly dubious trading behaviours is represented by the following charts of four ASX 200 companies in trading taking place as recently as October 2, 2013. Similar trends are observable on any given day. The charts monitor the proportion of sell trades by brokers that forced a fall in the share price (i.e., a Downtick or DT) and then compare that to their overall selling profile in the market. To clarify, sales can take place at reduced prices (i.e. denoted as a Downtick), or with no change in price, or even at higher prices which is referred to as an Uptick. Upticks and Downticks are key charting indicators so that trading for example that concentrates on creating price falls can then encourage further selling as automated trading programs kick in.

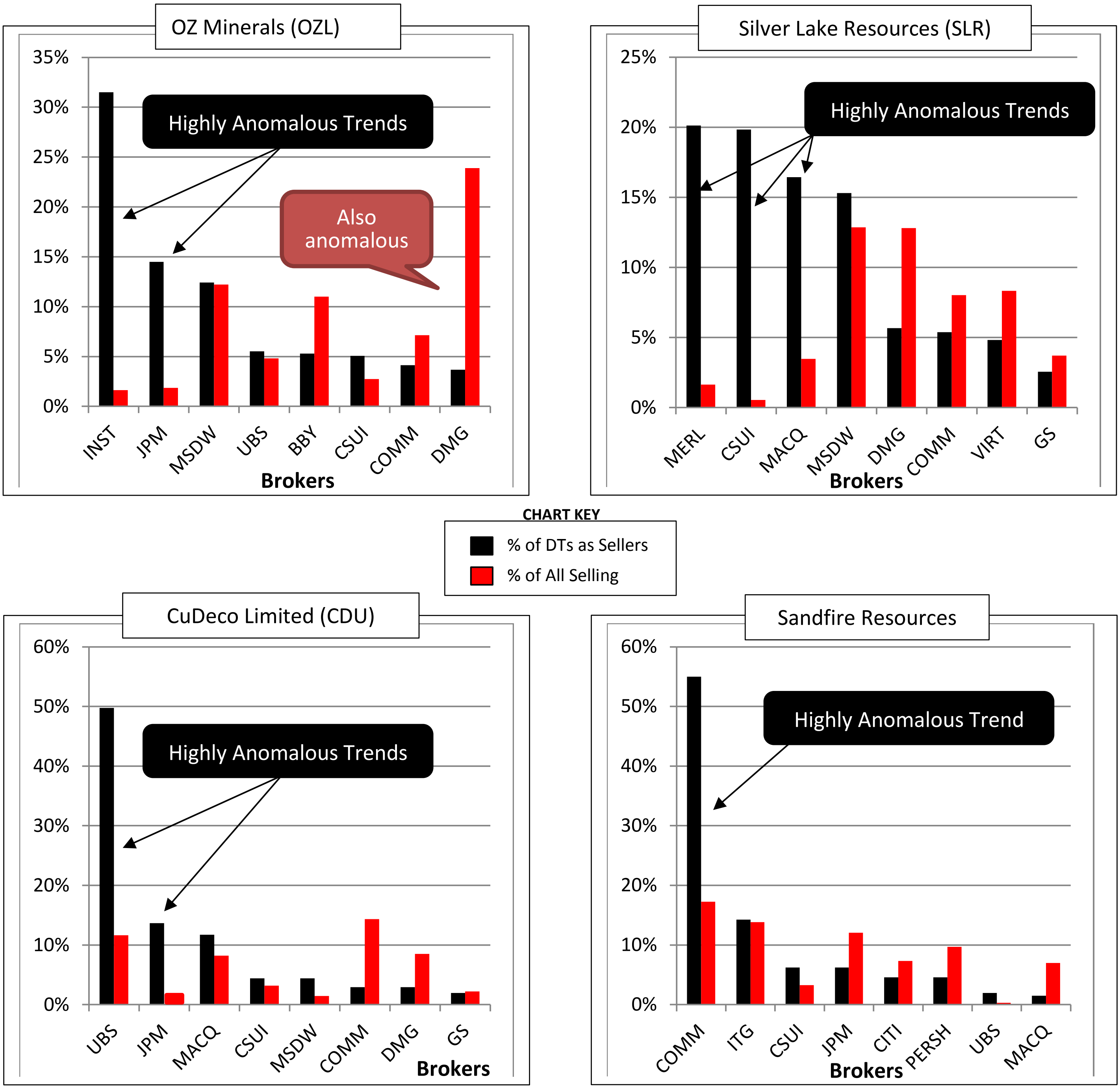
The adjacent chart illustrates trends where share price manipulation becomes an issue on the basis that a broker's level of Downtick sales on any given day ought to be commensurate with their buying profile as a seller.

Situations where Downticks achieved are far above the levels of selling applied to the market due to large numbers of small DT trades emitted by algorithms, suggests algorithms being tuned to deliberately target lower prices.

Also dubious is where large volumes of selling have somehow avoided Downticks in price. A genuine motivated seller is not likely to be so fortunate.



CHARTS SHOWING DOWNTICK TRADES versus OVERALL SELLING PROFILES of BROKERS
(FEATURING FOUR ASX 200 COMPANIES on OCT 2, 2013)



All charts suggest highly manipulative trading behaviours where large numbers of small trades have caused falls in price over the course of the day, but where the overall selling volumes of the brokers concerned are relatively minor compared to their Downtick profiles. Selling behaviours that target lower prices represents selling that is contrary to a recent decision by the Australian High Court <LINK> where genuine sellers were defined 'as sellers who sought the best returns for their shares'.

It is of immense concern that share price manipulation, as typified above, is becoming the norm in daily trading for many stocks on the ASX. The ASIC Complaints provided as Complaint 2013-1, Complaint 2013-2, Complaint 2013-3 and Complaint 2013-4 extensively feature large volumes of anomalous data that can only be adequately explained in terms of share price manipulation issues.

Research has demonstrated that daily trading is full of anomalies such as those featured for October 2, and the system itself makes attempts to investigate trading irregularities very difficult. Clarity about trading is extremely difficult without the forensic auditing of accounts, which judging by the CuDeco situation, is a task that ASIC goes to great lengths to avoid, irrespective of how over-powering the weight of empirical evidence might be when laid out before them.

The situation regarding anomalous trading in CuDeco, and in the trading taking place in many stocks across the ASX is largely represented by either:

- brokers assisting each other in trading for themselves and major clients (i.e., colluding) with algorithms synchronized to deliver particular pricing agendas. The agendas might include attempts to secure cheap placements or a possible takeover opportunity. Trading isn't necessarily motivated by generating profits, at least over the short term; or,
- entities focussed on achieving strategic agendas by engaging networks of brokers and distributing large volumes of buying and selling across the network for execution via proprietary algorithms.

It is unclear if brokers are responsible for anomalous trading trends in their own right through their own house trading or whether broker clients are responsible. It is why auditing of accounts is required to get to the bottom of spurious trading behaviours.

Multiple brokers running similarly tuned algorithms is actually necessary for algorithms to function effectively in performing the roles required of them. Algorithms need to be able to interact with each other, and if necessary, avoid orders that don't fit particular trading agendas. The end result is to achieve strategic advantages over all other market participants, and the entire process is necessarily manipulative in intent and execution. Why else do institutional brokers require their computers to be installed adjacent to ASX computers where they can interact with orders as they arrive at the exchange, just microseconds before the orders reach the open market? While it is recognized that algorithms have the effect of making retail investors pay more for purchases and to receive less for sales, which is unacceptable in itself, what is not recognized is the role they play in forcing chronic undervaluations in companies across the entire ASX.

Respected financial commentators have penned excellent articles pointing out unfairness issues surrounding privileged arrangements granted to High Frequency Trading (HFT) operators. They include Alan Koehler (High Frequency Trading is Cuckoo) and Robert Gottliebsen (Cut the Pipes on Trading Robots). Even the head of the ASX, Elmer Funke Kupper, has voiced serious concerns about High Frequency Trading and Dark Pool issues and has called for the situation to be rectified despite HFT being a big earner for the ASX.

Regulatory authorities have voiced concerns about some of the issues and announced initiatives to address them although actions have been watered down by the time they have been delivered. Relevant media articles flagging concerns expressed by ASIC and the ASX as well as concerns held by eminent financial sector reporters, all of which have critical importance to our financial markets have included:

- Traders plunder super – Feb 16, 2008, The Australian
- Short sellers ring up $72bn profit over 18 months – Feb 1, 2012, The Australian
- ASIC targets trade manipulation through high-frequency trading - July 14, 2011 The Australian
- Race Against the machines - Nov 2, 2011 The Australian

- High-frequency trading is cuckoo – Apr 11, 2012 Business Spectator
- Ditch tougher high frequency trading rules: ASX – May 21, 2012, The Business Spectator
- ASIC taskforce to plumb the depths of Dark Pools – Jun1,2012 The Australian
- Rules on the way for those Dark Pools - Jun 2, 2012 The Australian
- ASIC plans to light up dark - Jun 29, 2012 The Australian
- ASIC sets new rules on suspicious trading – Aug 2, 2012 The Australian
- The ASX's attempt to clean up dark pools – Aug 6, 2012, The Business Spectator
- Cut the pipes on trading robots – Aug 28,2012 Business Spectator
- Regulators look to mop up Dark Pools - Sept 12,2012 AFR
- ASIC to delve into secretive trade venues – Sept 12,2012, The Australian
- Super funds call for high frequency trade ban – Sept 17, 2012, The Sydney Morning Herald
- ASX Dark Pool Trades at Record as Bourse Seeks More Rules – Sept 18,2012, Bloomberg
- ASX pushes for dark pools reform – Oct 9, 2012, The Australian (Subscription needed)
- Rise of high speed trading a challenge for ASIC – Oct 11, 2012, The Age
- Funke Kupper chasing shadows in dark pools – Oct 15, 2012, The Age
- ASIC confronts a dark pool abyss – Nov 20, 2012, Business Spectator
- Regulator tightens rules on ultra-fast trades – Nov 22, 2012, The Age
- For dark pools, just wade into the ASX – Nov 24, 2012, The Age
- A little transparency would go a long way- Dec 14, 2012, The Sydney Morning Herald

However, despite extensive media air play that give the impression that the problems are recognized and that something is being done to address the issues affecting our markets, the reality is that very little has been done and the problems are still unfairly impacting our markets on a daily basis (and possibly illegally as well based on the recent High Court decision). To compound the situation further, research has identified several critically important issues that aren't even seeing the light day by either the regulator or financial commentators, who in many ways perform the vital function of 'gatekeepers' of the system.

In terms of trading abuses associated with the use of HFT systems, brokers would know what their trading is attempting to achieve and how algorithmic trading is advantaging their clients by creating artificial markets in many securities. Importantly, there are laws in place to guard against the creation of artificial markets through non-genuine trading activity, yet they are not being enacted because of difficulties in identifying who is responsible and apportioning blame, not to mention an unwillingness to upset the Big End of town. Historically the treatment of white collar crime has been lightly dispensed with, a situation referred to by Federal Court judge Ray Finkelstein QC when he heavily criticised the judiciary for being soft on white-collar crime. <Refer Link>

Finkelstein stated - *lenient sentences for such crimes led the public to conclude there was "one law for the rich and a law for the poor"*.

Generally, penalties handed out from fines and from cases successfully prosecuted by ASIC have involved slap-on-the-wrist penalties not commensurate with the gains obtained from illegal activity, or they have been suspended sentences or just bans from being involved in the financial markets. They reflect a soft approach to regulation which was attempted to be addressed by proposed legislation by the then Labor Government back in January 2010 to increase penalties for market related offences <Refer Link>. Unfortunately the Labor Government appeared to shelve the proposal as reported in February 2010 <Refer Link> coinciding with ASIC was being readied to take over regulatory duties which actually commenced in August 2010. More recently, a High Court Decision <Refer Link> defining share price manipulation in unequivocal terms provided a strong precedent from which to pursue manipulation issues.

Appendix 1 summarizes the results of a number of cases prosecuted by ASIC in regard to market manipulation and other illegal financial activity. Almost always prosecutions have targeted individuals or small firms where it is easier to gather evidence and where defence cases are mounted on limited budgets. Cases concerning institutional share price manipulation rarely feature. Cases that have been prosecuted include charges that have been described with statements such as:

- Share trades that did not involve a change of beneficial ownership of the shares and created a false and misleading appearance of active trading in the shares.
- ASIC was concerned that the transaction did not reflect the genuine forces of supply and demand.
- Trading was likely to create or maintain an artificial price for trading in XYZ shares.
- Trading had created a false or misleading appearance of active trading in XYZ shares.
- Brokers acted in a manner that was likely to create a false or misleading appearance in the market for XYZ. Two of the brokers were used to predominantly place buy orders, whilst one broker was used exclusively to place sell orders.

Many of the successsful litigation cases involve the prosecution of trading behaviours that are identical to what is achieved with brokers using HFT algorithms. The difference is that rather than brokers placing orders through phone contact and being directly accountable, high volumes of trades processing small parcels of shares ad infinitum, are dispensed by automated trading programs. The human element is missing as trades are excuted however brokers still have to fine tune the algorithms so that they can deliver whatever outcomes are required. The culpability for manipulative trading through the use of trading algorithms still exists.

Irrespective of who their clients are, and irrespective of the fact that algorithms are dispensing the trades, brokers are not being made accountable for breaches of trading that conform to behaviours described by law as manipulative and which are reflected by persistently anomalous trading data.

Regarding CuDeco, algorithmic trading sits at the heart of trading issues such as:

- Severe distortions between ASX buying and selling volumes and the movements of shares on the register following settlements. (Refer Chapter 6 Research). The discrepancies which have been documented on a month-to-month basis are a measure of the enormity of unorthodox trading taking place particularly as buying and selling ought to be a straight forward process with a one to one correspondence.
- Extensive levels of non-genuine trading churn by institutional interests resulting in an artificial market and a detrimental impact on pricing levels. The style of trading undertaken generally represents a zero-sum game with powerful interests overwhelming the market through weight of numbers while achieving their pricing agendas.
- High volumes of non-genuine Wash Trades and non-genuine Dark Trades (Dark Pool trades and other off-market adjustments) which have also had a negative impact on pricing levels. Wash Trade and Dark Trade activity are completely camouflaged from view.
- Control over pricing levels as revealed by extensive anomalies associated with Downtick data.
- Continuous control over opening and closing auctions by the same small group of brokers.
- Control over prices through extensive use of manipulative short selling practices whereby prices are forced lower through selling in the market, and where price discovery is avoided upon covering. Rather than through the re-purchase of shares from the market, large short exposures are generally

reduced via off-market adjustments, which necessarily require high levels of co-operation and/or collusion. These transfers of shares are not transparent to the market.

- Control over market sentiment, which is achieved by ensuring positive announcements have zero or negligible market impact. Strategic selling and buying between brokers colluding with their trading, but with no beneficial change to ownership of shares, is used to accomplish price capping.

The combination of factors, which are repeated in stocks across the ASX, has meant that price discovery, which is one of the primary functions of our market system, is increasingly becoming just a reflection of the trading agendas of powerful financial interests, rather than a fair appraisal of a Company's worth based on fundamentals and market outlook. Markets are identifying more with rigged Casinos, run for the benefit of the powerful elite, rather than fair a medium of exchange for all participants.

Technological innovations and changes to the way the market is allowed to operate, without proper regard for the long term implications associated with change, are seen to have radically altered the market's structure and have prevented it from performing the roles traditionally expected of it. The current situation, when extrapolated across all ASX Companies, means that we no longer have an effective financial system capable of attracting capital and underpinning productive enterprise. The recent departure of LINC Energy from the ASX in seeking to list on the Singaporean Exchange is a case in point. Dubious trading practices that have delivered chronic undervaluations means that the company cannot gain proper recognition in the market which makes accessing capital to develop its projects very difficult.

< Excerpt: Reference Link>

The billionaire LINC Energy boss has found himself increasingly frustrated with Australia's institutional investors, who he believes are undervaluing Linc at a current market cap of $730 million.

Other enterprising Australian companies looking to establish major projects face the same problems. The situation puts in jeopardy the long term financial security of the nation as without confidence in the financial system by all participants, without integrity, without transparency, without fairness and without effective regulation, the ASX may as well close its doors. The Australian financial market is well on the way to being bypassed as a financial hub, both by its own population and by global capital markets. There are of course the exceptions represented by foreign interests looking to acquire cheap Australian assets who are likely to have had a hand in forcing under-valuations in the first place. However, the opportunistic takeover of cheap assets by aggressive multinationals with no allegiance or commitment to Australian national interests is certainly not a positive development for Australia.

The situation desperately requires remediation. With a new government in place, Treasury needs to step in and address the inadequacies associated with ASIC's regulation of the financial markets, and which have been the catalyst for the current Senate enquiry into its operations. What has been allowed to take place with the trading and management of securities, with tacit approval by the regulator, is extremely damaging to the market on so many levels, and by default, extremely damaging to the Australian economy,.

For example:

- Market integrity is an obvious casualty closely followed by a lack of trust and a loss of confidence in the system by many participants impacted by the relentless push for lower prices.
- Low share prices result in many companies being starved of capital with failure and bankruptcy a likely scenario for many juniors and mid-cap companies.

- The development of important national assets is being jeopardized with the winding back of projects, closures and the mothballing of future projects.
- Control over national assets is being secured by overseas conglomerates through cheap takeovers and through increased ownership over the registers of public companies <Link: Institutional investors strengthen hold on Australian companies>
- Dividend revenues earned from ownership of Australian companies end up offshore and are not necessarily re-circulated back into the Australian economy.
- Any profits taken from the markets by multinationals trading as sophisticated investors represents a loss in tax revenues as they are structured to minimize their taxation obligations.
- Constricted project development is stifling employment growth and reducing state royalty streams.
- Artificially low share prices inevitably lead to reduced productive enterprise, reduced job growth and reduced export revenues because of companies needing to wind back their operations. It also leads to a reduced tax take by the Federal Government.
- There is also a reduction in tax revenues from investors unable to generate profits from their investments because of a severely compromised market.
- Conflicts with compulsory superannuation where substantial amounts of capital belonging to Australian workers is effectively forced into the market. Managed investments are susceptible to being mismanaged through unscrupulous short selling practices and the market abuses associated with high frequency algorithmic trading. Indeed the organization representing superannuation funds has called for a ban on high frequency trading which to date has also been ignored by the regulator. <Refer: Super funds call for high frequency trade ban>. In fact the regulator actually believes that "*public concerns over HFT appear to have been overstated"* <LINK>. ASIC also believes *that "High-frequency trading strategies – like other algorithmic strategies - can create 'noise' in our financial markets through small orders and trades". The r*esearch undertaken suggests that the expression 'noise' should be replaced by 'losses for retail investors' which are likely to be the source of profits reported by HFT firms such as Tibra Trading <Refer: Tibra Trading profits soar>.
- The Labor Government's response to shrinking superannuation returns has been to increase contributions. It would have been more effective to ensure that the ill-gotten gains of investment banks, hedge funds and the like through gross defects in the way the system is allowed to operate are prevented through effective regulation of markets and by putting an end to the various loopholes identified by research. The loopholes concern lamentably ineffective oversight in regard to HFT algorithms, short selling and Dark Trades and a complete lack of transparency associated with the majority of dealings taking place.
- Retirees with reduced income from superannuation because of severely compromised markets are then forced to seek assistance from Government welfare, adding further to budgetary pressures.
- Australia is gaining a reputation of small to mid-tier companies being chronically under-priced resulting in growth companies looking offshore for investment and listings on exchanges other than the ASX. As mentioned, Linc Energy recently aired its frustration with the ASX by its intention to relocate to Singapore. CuDeco has also referred to looking at a Hong Kong listing as means of combatting under-valuation and difficulties accessing the capital markets. Research has demonstrated that to a large extent, the under-pricing is a result of deliberate but questionable trading activity likely to be proven illegal if vigorously investigated and prosecuted.

The issue of unscrupulous short selling activity was flagged by financial journalist Adele Ferguson as far back as February 2008 <Link: Traders plunder super>. The recipients of short selling gains were hedge funds and their gains were at the expense of Australian superannuation holdings. The following excerpts are extremely revealing in regard to the ASX's self-regulation expertise back in 2008.

<Part Extract>

THE Australian Securities Exchange is demanding a review of stock trading rules amid evidence that hedge funds are "borrowing" shares from superannuation funds to force down prices, a practice that is mauling retirement savings. Traders, such as hedge funds that exist to exploit market anomalies and volatility, have been borrowing large parcels of stock, mainly from superannuation funds.

Australia's $1.1 trillion superannuation industry warehouses its shares with "custodian" companies, which often offer a discount for the service if the fund allows the stock to be lent to third parties. Borrowed shares can be used to take long or short positions - betting shares will rise or fall - or to manipulate voting at companies' annual meetings. The transactions are exempt from capital gains tax. Other countries allow stock lending but do not have the same tax exemptions available in Australia. David Bryant, group executive of investments at Australian Unity, which has $6.4 billion in funds under management, likened the practice to leaving a car in a car park, which lends it to local hooligans who return it damaged. The owner is left with the mess.

ASX chief Rob Elstone said yesterday short selling was not the issue, but the related stock lending activity. "It lacks transparency and, depending upon how many links there are in the stock-lending chain, it has the potential to raise systematic risk issues

ASIC took over regulatory duties from ASX in August 2010 but apparently did nothing to address the issues raised by Adele Ferguson back in 2008 and referred to by the ASX itself in its role as self-regulator. In February 2012 it was reported in The Australian newspaper that< Short sellers rang up $72bn profit over 18 months > in respect to the period June 2010 to January 2012, which, with the exception of June and July 2010, coincided with ASIC taking over as regulator. An excerpt from the article follows.

SHORT sellers made a combined $72 billion in profits in the 18 months to last month, as the number of stocks sold short increased. In their second study into the implications of short interest on stocks, Royal Bank of Scotland analysts yesterday confirmed that increased short-selling leads to medium-term underperformance from the stock. The study also shows the massive profits that can be made, or alpha fund managers can generate, by shorting successfully.

The plundering of Australian super funds as per the article has been referred to ASIC by at least one complainant with a response to the effect that they didn't believe the figures were correct. Nothing further was done about it. If anything, the figures probably understated the situation and even if RBS was only half correct, it represents an enormous amount of wealth stripped from the accounts of pension fund holders. Unfortunately the rorts have never been addressed and continue to this day.

Finally, the approach by ASIC is borne out in an article reporting on a presentation by ASIC Chairman Greg Medcraft to a Parliamentary Committee in September 2012. <Reference Link: Could high frequency trading lead to our own 'flash crash'?>.

The then ASIC deputy commissioner, Belinda Gibson, was quoted as suggesting that:

…… algorithmic and high frequency trading is sometimes manipulative or illegal, but it is often simply predatory on other investors.

The comment in conjunction with the regulators response to pressing issues presented to them on several occasions, suggests a recognition and acceptance of illegal activity but without a preparedness to do anything about it. It effectively means that the laws governing our financial markets which are designed to protect the national interest and the rights of Australian citizens, are being ignored.

While there can be no doubting that ASIC has the theory correct with statements such as *"Companies should have confidence that share prices reflect their true value, and that they are able to efficiently raise capital. Similarly, investors should have confidence that they will be able to buy and sell shares at a fair and efficient price on an orderly market"* <LINK>, the problem is that they have great difficulty in being able to put theory into practice.

It is precisely why a Senate enquiry is needed to kick-start long overdue reforms to ensure markets conform with what they are claimed to be and what they are expected to be. Anything less is completely unacceptable.

Appendix 1 – Summary of Successful ASIC Prosecutions

The links provided below refer to ASIC court cases that have been successfully prosecuted in its supervisory role over the financial markets. Many of the cases were referred to ASIC by the ASX when it was a self-regulating organization prior to ASIC taking over in August 2010.

The penalites applied by the judiciary are shown in red with concessions granted for admissions of guilt a regular feature of the determinations made.

- Feb 2009 AD09-19 Brokers sentenced over market manipulation - Jail terms suspended
- May 2009 09-82AD Sydney man in court on ASIC market manipulation charges Not proceeded with
- Mar 2005 05-61 Perth man sentenced for market manipulation -$30,000 Fine
- Mar 2010 10-58AD Executive sentenced over market manipulation 22 months jail reduced to 6
- Mar 2010 10-49AD Macquarie broker pleads guilty to market manipulation charges -20 months jail to 4
- Jan 2010 10-09AD Executive pleads guilty to market manipulation - 22 months reduced to 6 months
- Sept 2008 AD08-06 ASIC bans Melbourne financial adviser for market manipulation - Banned for 5 years
- Jun 2001 01/204 Austin and Manasseh sentenced market manipulation case - 3 Year Good behaviour Bond
- Sep 2011 11-192AD Former company director pleads guilty to market manipulation charges – 2 Year Ban
- Feb 201111-30AD Daughter of CEO sentenced for market manipulation - 2 Years Suspended Sentence
- Nov 2010 10-230AD ASIC bans Melbourne client adviser for market manipulation - 5 Year Ban
- Jan 2008 08-02 ASIC bans Wollongong financial adviser for market manipulation - 4 Year Ban
- Feb 2005 05-40 Former Astron company director found guilty of market manipulation - $30,000 Fine
- Aug 2001 01/309 Stockbroker pleads guilty to market manipulation - good behaviour bond
- Feb 2009 AD09-19 Brokers sentenced over market manipulation - Custodial sentences fully suspended
- Dec 2011 11–286MR Former company director convicted of market manipulation - $10,000 Fine
- Nov 2010 10-230AD ASIC bans Melbourne client adviser for market manipulation - 5 Year Ban
- Jan 2008 08-02 ASIC bans Wollongong financial adviser for market manipulation 4 Year Ban
- Dec 201111–286MR Former company director convicted of market manipulation 5 Year Ban
- Jun 2001 01/053 ASIC secures conviction in Diamond Rose market case 3 Year Good Behaviour Bond
- Dec 2010 10-189AD ASIC Sydney stockbroker market manipulation sentence - 3 Year Ban
- Aug 2001 01/309 Stockbroker pleads guilty to market manipulation 3 Year Bond
- Jun 200 00 276 Court Rules on Manipulation Charges - Dismissed
- 00 026.PDF AAT varies banning order against Andrew Donald - 4 years to 2 years
- May 1999 99 137 Empire Directors Banned - 10 Year Ban
- Jun 2007 07-171 Decision in ASIC v Citigroup Citgroup Cleared

OTHER

ASIC: Insider Trading Convictions and Civil Penalties (July 2004 – April 2007)

Bart Doff	Convicted of insider trading in shares in Qantas Airways Limited;	Sentenced to 350 hours community service, a fine of $30,000 and a pecuniary penalty of $37,255.25.
Maxwell John Sweetman	Convicted of insider trading in shares in Harts Australasia Limited;	18 months prison sentence (to be released after serving 3 months).
John Petsas and Marc Miot	Civil penalty orders obtained against Petsas ($75,000) and Miot ($65,000) for insider trading in BRL Hardy Limited;	Compensation order of $128,495.15.
Richard James Frawley	Convicted of insider trading in the shares of JNA Telecommunications Ltd;	Sentenced to 2 ½ years periodic detention.
Stephen William Vizard	Civil penalty proceedings – alleged that Vizard breached his duty as a director of Telstra Corporation Limited (Telstra) by improperly using information given to him as a director of Telstra to gain an advantage for either himself and/or others;	Banned from managing any corporation for 10 years and ordered to pay pecuniary penalties of $390,000.
Ian Robert Hall	Convicted of insider trading in shares in Clifford Corporation Limited;	Sentenced to serve two years one month with a minimum of one year in prison.
Margot Olive MacKay	Convicted of insider trading in shares of Aristocrat Leisure Limited;	Sentenced to 15 months periodic detention.