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Date 20 January 2009



Investment Management

One Coleman Street
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The Committee of European Securities Regulators
11 – 13 avenue de Friedland
75008 Paris
France

Dear Sir or Madam:

Re: Call for evidence – Regulation of short selling by CESR members (REF: cesr/08-1010)

In response to the call for evidence concerning the regulation of short selling by CESR members please find below our comments. We believe that CESR should consider the following issues in specific – information availability and dissemination, and, protective mechanisms used in falling markets and how short selling fits into a possible solution.

1. Disclosure regimes

As a basis upon which informed investment or regulatory decisions can be made a disclosure regime is essential. The disclosure of short positions must be part of this regime but only reaches its full potential for creating efficiency in the market if done on a common basis by all securities regulators with a common definition for net long and net short positions and common trigger limits for disclosure. Also, although it is accepted that the financial sector has been the target of more short selling than other sectors we have also seen the implication of short selling and the lack of disclosure in the automotive sector and the effects that a lack of disclosure can have across European markets. In order to prevent the short squeeze of securities in other sectors disclosure needs to be considered as universally applied and delivered. However, a disclosure regime that would have the effect of being more onerous and costly to implement and operate at firm level may, in fact, deter the practice of short selling in the market and this could detrimentally effect market efficiency and liquidity.

2. Protective mechanisms in a falling market

Although we understand the necessity for market intervention to prevent further deterioration in the financial markets there has been no research provided to support the success of regulatory bans on the practice of short selling in achieving this. The divergent approaches to the ban by regulators has highlighted the need for further debate on this issue. Instead of instituting regulatory bans on short selling, and only in specific sectors, it is our opinion that

CESR needs to consider more effective mechanisms that can be used to protect against deterioration in a falling market.

The possibility of an “uptick rule” could be considered such as that currently operated in other jurisdictions and previously by the US, or another form of “circuit breaker”. However, consideration should also be given to the possible negative effects of a “circuit breaker” as if instituted may have the effect of encouraging the widespread closing of positions. The use of a “circuit breaker” should only be instituted for a limited period of time such as in times of economic downturn but such limited conditions would have to be clear, uncontroversial and uniform.

An appropriate “circuit breaker” should be considered in conjunction with an appropriate prohibition on naked short selling applied universally across all sectors. Naked short selling should be addressed as to its implication on intra-day short selling and the cost associated with this as opposed to short selling on a longer term basis. Appropriate exemptions for market makers should be considered in order to facilitate the efficient operation of the market. Stock lending rules should also be addressed and a common approach applied in conjunction with rules on naked short selling.

A common approach to prohibiting naked short selling coupled with an appropriate disclosure regime may prevent short squeezes which have the adverse effect of driving prices up. The possibility of operating a form of “uptick rule” or “circuit breaker” may provide a means by which the market is protected against the possibility of short selling turning predatory in a falling market and driving the prices down. Applied together the practice of short selling could be controlled in times of market downturn yet allow its significant benefits to the market to remain. CESR should consider these issues in formulating a long term policy response to the regulation of short selling.

Yours faithfully

Adrian Smart

Compliance Director (LGIM)