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ESMA
103 Rue de Grenelle
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London, 13 February 2012

Re: Consultation on draft technical standards on the Regulation on short selling and certain aspects of credit default swaps

Dear Sir, Madam,

Deutsche Bank welcomes the opportunity to respond to the consultation paper on "draft technical standards …on the regulation on short selling and certain aspects of credit default swaps". We fully appreciate the time pressure ESMA is under to provide the European Commission with draft technical standards within the timeframe the Commission has set and generally feel that the proposed technical standards are adequate and reflect market practice. In particular, we support proposals in this paper to harmonise the notification process for short positions.

However, there are several aspects in the paper where more time to reflect and explore regulatory options would be beneficial. This is especially apparent in the aproach ESMA has chosen for 'locate confirmation arrangements'. Defining liquidity is very difficult and must be specific to the purpose of the definition. Using the definition for liquid share of the Markets in Financial Instruments Directive (MiFID) is inappropriate as it is used to determine if a quoting obligation should apply. It does not relate to the availability of shares to put in place a borrowing arrangement. There are better options available to determine whether or not a share is liquid for the purpose of short selling so we strongly urge ESMA and the European Commission to review the definition of liquidity.

We would also add that the proposed requirement to obtain confirmation of the effective allocation of shares by having a third party put on hold illiquid shares, will have a significant market impact. The requirement could lead to a daily practice where a firm must ask a third party for shares to be put on hold *in case* it wants to make a short sale. At the end of the trading day, the firm may not actually have taken the short position. As this would happen on a daily basis some illiquid shares would be put on hold indefinitely, thus effectively taking them out of circulation.

We trust these comments are helpful. We will be happy to provide more information should you so wish.

Yours sincerely,

Andrew Procter
Global head of Government and Regulatory Affairs

Questions

1. **Do you agree with the approach of providing an exhaustive list of types of agreement, arrangement and measure that adequately ensure shares or sovereign debt instruments will be available for settlement and setting out the criteria these should fulfil?**

   Generally, we do not support exhaustive lists in regulation as they do not take into account market developments, special circumstances or differing market practice. We would prefer a non-exhaustive list and believe that the criteria listed in paragraph 12 of the consultation paper provide adequate guidance as to the appropriateness of an arrangement that is not included in the list.

   Should ESMA opt for an exhaustive list in its final technical standards, a process should be put in place to amend the list in a timely manner if emerging market practices and needs so require.

2. **Do you agree with the proposed list of agreements and enforceable claims and the criteria they should meet? Are there any other types of agreement or enforceable claims or criteria which should be added?**

   The proposed list should be expanded to include both prime brokerage and securities lending agreements. They meet the criteria listed in paragraph 12 and are common market practice.

3. **Do you consider that these criteria will entail additional costs as compared to current practices on the market? If so, could you specify the drivers for those additional costs and any indication of their amount?**

   There will be significant costs associated with the proposals as they stand, as they would mean a review of the way in which market participants make borrowing arrangements. Our suggestions under 1 and 2 will help to reduce these costs and ensure a more appropriate approach.

4. **Do you agree with the proposed list of third parties which may be parties to the arrangements or measures and the criteria proposed by ESMA that they should fulfil?**

   We feel that the list provided is sufficient. It is, however, not clear what is meant by “in accordance with EU law” under the last bullet. If it refers to the authorisation regimes in, for example, MiFID or UCITS, this would limit the list of parties too much as it would exclude institutional funds. It is also important that parties from third country jurisdictions with equivalent authorisation regimes are not excluded.

5. **Are there further criteria which should be added?**

   Please see our response to question 4.

6. **Does the fact that a third party should be a distinct legal entity from the entity entering into the short sale entail costs? If so please provide estimates of those costs.**

   It is standard practice for a firm to provide locate arrangements within the firm. From a risk management perspective, this is clearly preferable over having to arrange something with a third party as it prevents counterparty risk. Also, if a firm concludes an arrangement with another firm, it will do so at a fee, which is avoided via an internal arrangement. We do not believe it was the intention of the legislator to rule out intra-firm locate arrangements.

7. **Do you agree with the approach proposed by ESMA on the standard/same day/liquid shares locate confirmation arrangements and measures and the criteria that they must fulfil?**

   See our answer to question 9.

8. **In circumstances other than intraday short selling or short selling on liquid shares, can you suggest any additions to the methods for effective allocation set out in this consultation paper which would provide the necessary comfort that shares can be delivered for settlement in due time?**

   See our answer to question 9.

9. **In relation to the approach suggested for liquid shares, do you consider it appropriate to use the MiFID definition of liquid shares? Do you think ESMA should consider different approaches to determine the reasonable expectation test for liquid and illiquid shares? If not, can you provide indications as to the criteria to consider to define liquid shares or to take into account the liquidity of the shares in these circumstances? Is securities lending activity an additional factor to consider when determining liquidity of a share?**

   The use of the MiFID definition of liquid shares is inappropriate. The MiFID definition is designed to give an indication of the depth of a market, and is used to determine whether the obligation for systemic internalisers to publish firm quotes applies. The definition was not designed to address the ability of a market participant to borrow a share: One person may have access to a “borrow” where another has not. Also, a stock may have a very low turnover, but have plenty of stock available to be borrowed.

   In this context, we would prefer a more bespoke approach to defining liquidity, where it is the responsibility of the third party to decide – on the basis of objective criteria - whether or not a share is sufficiently liquid (for the purposes of this Regulation) to hold a reasonable expectation that a share is available. If the third party does not have such an expectation, it would have to ice the stock.

   A second possibility would be to make a party liable when it fails to settle a short position as a result of not being able to provide a borrow after having confirmed a reasonable expectation. This approach has also been adopted in the US, and has the advantage of preventing a third party claiming to have a reasonable expectation where there is none. In this case the main cost would fall on the person giving false expectations of a borrow.

A final alternative would be to use the 30 day or 90 day average daily traded volume of a stock and compare this data with the number of shares that are available for borrowing. Assuming that short sales are only 50% (this percentage would have to be investigated further) of the daily traded volume, as long as 50% of the average daily volume did not exceed the number of shares available to borrow, a stock could be deemed liquid. If 50% of the daily average did exceed the number of shares available to borrow, the stock could be deemed illiquid, so a third party would have to locate and reserve the shares to provide a reasonable expectation to cover short sales. The data for establishing this principle is generally available from independent data sources and can be calculated at relatively low cost. As such, we feel that this solution should be explored further by ESMA.

10. Do you agree with the approach proposed by ESMA on the location confirmation and reasonable expectation arrangement in relation to sovereign debt and that the reasonable expectation test should only apply in the case of intraday short selling of sovereign debt?

We do not agree with the interpretation that it is the responsibility of a third party to have a reasonable expectation that a share will be available for settlement, rather than that of the person wanting to effect the short sale. We refer to the response to this consultation of AIMA, which includes a legal opinion by law firm Bingham McCutchen setting out that any responsibility should lie with the investor.

11. Do you agree that there should be one standard format for notifying relevant competent authority for each type of instrument?

We agree with this approach and would add that the implementing standards should not allow scope for individual member states to deviate from the standard requirements. For cross border entities, having to make different notifications in various EU member states is unnecessarily onerous.

12. Do you agree that there should be one standard form for public disclosure of information on significant net short position in shares?

See our answer to question 11.

13. Do you agree with the proposed way to identify natural and legal persons, including the contact information details?

We agree.

14. Do you agree with the proposed way to notify and disclose the size of the relevant position?

We agree.

15. Do you have any comments on the proposed way to identify the issuer in relation to which the relevant net short position is held, including how to use the ISIN code in this matter?

We agree.

16. Do you agree with the ISO 8601 2004 standard use to notify and publicly disclose the date on which relevant position was created, changed or ceased to be held?

We agree.

17. Do you agree that the additional information as described above should be provided?

We agree, as long as providing additional information in the suggested comment box is optional.