

EFAMA'S REPLY TO CESR'S CALL FOR EVIDENCE ON REGULATION OF SHORT SELLING BY CESR MEMBERS

EFAMA¹ is grateful to CESR for the possibility to submit comments regarding the regulation of short selling, which we hope will be useful to CESR's Task Force in its ongoing work.

Impact of Short Selling and need for regulation

First of all, EFAMA would like to point out that short selling is an established investment technique whose positive effects have been proven by academic research. Short selling increases liquidity, contributes to a more efficient price formation, and results in lower volatility and narrower bid/ask spreads. In fact, evidence as well as academic studies² points to the fact that recent restrictions did not significantly change the behavior of the affected stocks (vis-à-vis their behavior before the restrictions as well as the rest of the market), while spreads increased and liquidity diminished.

Investor protection and market confidence are essential to the correct functioning of financial markets. EFAMA is therefore in favor of a meaningful regulation of short selling activities and opposes all market abuse or manipulation. However, we are of the opinion that market abuse is already appropriately regulated, and that other regulatory aims should be clearly defined, so as to ensure that any measures have the desired effect.

We do not believe that permanent bans on short selling are necessary, and the existing ones should be lifted as soon as regulators are satisfied they are no longer required. Furthermore, we invite CESR and its members to make a thorough assessment of the impact of recent restrictions, in order to make necessary improvements to possible future restrictions and to the measures still in application.

Assessment of measures introduced by CESR members

Recent market conditions have resulted in the publication by CESR members and other regulators worldwide of a wide range of short selling restrictions. EFAMA regrets the lack of coordination among regulators and the lack of harmonization of these measures, which have had three main effects:

- 1) It is extremely costly for investment managers to track and comply with the many different rules in all jurisdictions. The immediate implementation did not allow

¹ EFAMA is the representative association for the European investment management industry. EFAMA represents through its member associations from 24 member associations and 42 corporate members about EUR 13.5 trillion in assets under management of which EUR 7.3 trillion managed by around 51,000 investment funds at end March 2008

² "The impact of short sales restrictions" by Ian W. Marsh and Norman Niemer, 30 November 2008.

- time to develop systems to deal with the various regimes, further raising the cost in human capital necessary for compliance.
- 2) Legal uncertainty significantly increased, due to the lack of harmonization and to the lack of guidance on implementation. This applies in particular to the definition of the scope of the restrictions (i.e. their application to derivatives).
 - 3) Arbitrage possibilities have emerged due to the many differences in the short selling regimes and the cross-border nature of equity markets, sometimes causing distortions that negatively impacted the trading in specific shares or markets.

It is essential that the existing patchwork of regulatory regimes as well as any future measures be coordinated among CESR members. As far as possible, decisions should also be coordinated at worldwide level with the regulators of other main financial markets, and we believe that IOSCO would offer the best platform to achieve such goal.

CESR members should not only enhance coordination in the adoption of measures, but also harmonize definitions, scope and guidance for implementation.

Furthermore, the information provided by CESR members should be enhanced:

- a. It should be provided in a language customary in the sphere of international finance and not only in the national language(s), and
- b. It would be helpful if detailed lists of affected shares were published (when the short selling restrictions do not affect the entire market).

Disclosure

Disclosure is the best tool to prevent the use of short selling for market abuse purposes.

EFAMA supports timely publication of short sales/positions above specific thresholds. However, such public disclosure should be in aggregate form for each share and with a sufficient delay. Information on individual transactions should not be disclosed, as it could be used to copy proprietary trading strategies, to facilitate front-running, and as it would increase downward pressure on share prices. Whenever disclosure of individual transactions to regulators is necessary for regulatory purposes, confidentiality of the information provided should be strictly maintained.

Furthermore, one of our members with experience with US regulation suggests that the possibility to introduce a circuit breaker-type mechanism like the uptick rule should be considered at EU level. They also believe that regulators could play a useful role raising awareness about issues such as collateral management in relation to stock lending.

In conclusion, we strongly encourage CESR to enhance coordination and cooperation among its members with regard to short selling regulation, and believe that proposed changes should be subject to full consultation. We will be happy to support CESR in this process and in meantime remain at your disposal for any questions.

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