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CESR Proposal for a Pan-European Short Selling Disclosure Regime - Responses to Consultation 8 July 2009, Reference number: CESR/09-581
BNP PARIBAS CIB

Please find herein after the answers of the BNP PARIBAS Group. BNP PARIBAS strongly supports the answers provided by the EFSA and the French association AMAFI, and you will find many answers similar to those provided by these 2 associations. You will also find in addition, our own position concerning specific topics.

PRELIMINARY REMARKS

- we are against any form of permanent ban of short selling, and
- we are against any form of public disclosure of short positions and
- even if we have serious doubt about the benefits of a disclosure regime to regulators we would accept such a provision given that :
  - – the regime is fully harmonized within Europe, in particular the definition of "market making",
  - – the reporting should be exclusively addressed to the home regulator,
  - – the threshold should be 1 %,

because of the negative impact of such measures on market efficiency.

It is generally recognized that short selling improves market efficiency and liquidity, reducing trading costs for investors; it plays a pivotal role in the implementation of investment strategies designed to maximize performances; it is an essential component of hedging and arbitraging, so enhancing the liquidity of derivatives markets too.

Historically, restrictive short selling measures have not been of any help in restoring orderly market conditions and certainly their benefits have not outweighed costs. As a matter of fact,

there is no evidence of a relationship between the short selling activity and a high price volatility.
Equally, nobody has demonstrated a connection between short selling and market abuse. On the contrary, the extremely negative trend of several financial shares over the last months has proved the inefficiency of such remedies to prevent slumps.

Against uncertain benefits, any move to ban short selling (either covered or naked) as well as to introduce measures which would negatively impact on the ability of market operator to go short, has serious negative impacts on financial markets efficiency. Besides these effects, further costs have to be considered such as foregone profits deriving from a reduction in the trading activity and in securities lending. Obviously, the negative impact is higher where the restriction is adopted as a permanent regime, applicable regardless of market conditions.

We strongly consider that a ban or a transparency regime could be introduced only as a last resort measure under exceptional and unforeseen market circumstances. Furthermore, it should be targeted at specific sectors and adopted only where benefits can be demonstrated through a cost-benefit analysis.

Anyhow, to the extent that CESR has come to the determination to introduce such a regime, it is understood that disclosure obligations will only be addressed to the final investor, including the financial intermediary itself where it is trading on own account.

With specific regard to the proposal under consultation, we argue that a short position disclosure regime has uncertain benefits while producing negative effects on market efficiency. Indeed, public disclosure of short positions could seriously damage:

- investment managers by exposing their strategies to others;
- other investors, who may attempt to mimic the disclosed investment strategy without bearing costs and understanding the implications;
- the market, i) intensifying prices fall because of the above mentioned “mimic strategies” ii) reducing the efficiency of price discovery iii) increasing volatility and spreads iv) driving the trading activity towards less regulated markets.

As regards the first point, the disclosure regime discourages the assumption of short positions, producing the same effects on market efficiency and liquidity of a short selling ban.

With reference to the second point, it is worth notice that asset managers and institutional investors conduct costly financial analyses to identify overvalued stocks. Public disclosure of short positions would allow other market participants to act unfairly as free riders, so reducing the profits that would otherwise be gained by those that have actually performed the research.

As regards the effects on financial markets, a public disclosure regime could be reason of transferring the short selling activity to markets where the regime is not effective. The result would be opposite to the one pursued by the regulators.

Moreover, public disclosure would expose traders to the opportunistic behavior of other participants that could gain unfair profits squeezing the shorts. A squeeze can result in substantial losses for the holder of a short position while leading to a greater volatility.

Not to mention the fact that traders go short for several reasons, not always due to a negative view of a company's outlook. Operators may trade equity options or futures and then short the individual stock in order to profit from arbitrage opportunities or to hedge their position. In such circumstances, public disclosure of short positions may mislead investors, who may incorrectly assume that the institution has a negative view of the company the stock of which is being shorted.

Furthermore, the communication to the market might determine an unforeseen and unwarranted fall of share prices. Without disclosure, securities prices' adjustments to their fair value would occur in a gradual manner. On the contrary, the communication to the market would act as a catalyst producing the so called "herding effect".

Moreover, set-up and compliance costs should be taken into account, such as costs for:

- data processing
- communication
- monitoring
- enforcement

Should the disclosure regime be addressed only to the regulator, the above considerations would still be sound. Indeed, if on one hand this regulatory choice permits to avoid opportunistic, mimic behaviours and the "herding effect", on the other hand it acts as a disincentive for short selling activities, so damaging markets efficiency and liquidity. Furthermore, all the above described costs would be equally met.

Without prejudice to the above, we consider that, should CESR reach the conclusion that it would be worth and feasible introducing a transparency regime on short selling, the following issues should be taken into consideration with respect to the specific questions set forth in the consultation.

List of Consultation Questions

Q1 Do you agree that enhanced transparency of short selling should be pursued?

No, but should the regime be introduced, it should be set in accordance with several instructions herebelow stated.

Q2 Do you agree with CESR's analysis of the pros and cons of flagging short sales versus short position reporting?

Yes, we agree with CESR's analysis and we do prefer short position reporting. As we have already declared in the foreword, the reporting obligation has to be addressed to the final investor who might be a natural person, a management company or a financial intermediary which negotiates on its own account.

Q3 Do you agree that, on balance, transparency is better achieved through a short position disclosure regime rather than through a 'flagging' requirement?

Yes, we sustain such analysis.

Q4 Do you have any comments on CESR's proposals as regards the scope of the disclosure regime?

We agree with the scope proposed. Only short positions creating an economic exposure to share should be included and only concerning stocks listed on an EEA market. Regulated markets, MTF and internalisers should be included within the scope and the restrictions must be applicable not only to financial stocks but to all sectors, otherwise the set-up is helpless. Ex: in case of crisis in the real-estate sector tomorrow, the companies in the sector will be obviously impacted Should CESR impose only restrictions on shares of the financial sector, BNP PARIBAS would request CESR to provide investment firms with the list of names of the companies concerned, to facilitated the dissemination of the restrictions and the monitoring..

Q5 Do you agree with the two tier disclosure model CESR is proposing? If you do not support this model, please explain why you do not and what alternative(s) you would suggest. For example, should regulators be required to 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)?

No, we would support a regime which only sets a disclosure obligation to the relevant regulator. Disclosure to the public has several downsides among which:

- the herding effect, due to which normal investors could mimic the strategy of some important and well-know market participant taking unfair advantages of its knowledge;
- short squeeze, namely, once competitors become aware of the short seller activity, they might buy up shares on the exchanges in order to make the financial instrument's price soaring. As a consequence, the short seller shall either repurchase the same lot of securities previously sold short at a substantially higher price or go in fail; and
- analysts and equity researchers will have no more reason to conduct highly expensive researches and studies, and moreover they will not be anymore receivers of funds for such activity. Let's face it: who wish to invest in researches which results must be shared with all direct competitors?

Q6 Do you agree that uniform pan-European disclosure thresholds should be set for both public and private disclosure? If not, what alternatives would you suggest and why?

Accordingly to answer n. 5, we support threshold setting only for private disclosure. Furthermore, following the U.S.A. regulation, the relevant regulator should be given the entitlement to bestow disclosure exemptions (please, see answer to Question n. 18).

Q7 Do you agree with the thresholds for public and private disclosure proposed by CESR? If not, what alternatives would you suggest and why?

No, we believe that thresholds are too low and, should a threshold for public disclosure be introduced, the trigger one, due to the negative effects in the preliminary remarks already stated, should be set at least at a level equal to 1%.

In addition, BNP PARIBAS strongly support the idea that CESR should make available in its website the list of all the public companies listed on all the EEA markets, mentioning **the capital,** in order to have a single data basis available for all the market firms helping them in determining the denominator in the calculation of the net economic exposure in %. This information should be also very helpful for the thresholds imposed by the Transparency Directive. For the time being, investment firms are facing huge difficulties in capturing this information, the websites of the public companies not being updated in many cases. Should CESR decide to adopt a lower threshold for disclosure (0,5 or 0,25%), this issue of the information related to the denominator will become more crucial.

Q8 Do you agree that more stringent public disclosure requirements should be applied in cases where companies are undertaking significant capital raisings through share issues?

No, we believe it is difficult to manage several thresholds. In particular, during a capital increase it could be ambiguous to single out the exact date from which the lower percentage (*i.e.* 0.25%) would apply as trigger threshold. As a matter of law, the shareholders' meeting may in-charge the board to carry out such increase up to a given threshold. In such scenario should we considered the date of the shareholders' meeting or the date of the board resolution? In order to throw some light on the issue, in Italy Consob eventually resolved to publish the list of the companies with a capital increase ongoing and set the dates from which the special regime applies (same for Austria).

Q9 If so, do you agree that the trigger threshold for public disclosures in such circumstances should be 0.25%?

No, we do not agree (please, see answer to question n. 10).

Q10 Do you believe that there are other circumstances in which more stringent standards should apply and, if so, what standards and in what other circumstances

No, as far as we are concerned, we do believe that the general discipline should be addressed for every market activity, therefore, it is of the essence that it will be perfectly set and generally applicable. In doing so, certainty will be enhanced as well by removing all doubts regarding which threshold must be met.

Q11 Do you have any comments on CESR's proposals concerning how short positions should be calculated? Should CESR consider any alternative method of calculation?

We strongly support the idea that groups must organize their reporting according to an internal policy. Netting only per legal entities may make no sense in business lines acting globally on the equity markets from different jurisdiction and using different legal entities (broker dealers). At the end of the day, it is the same activity which is concerned and the position has to be calculated globally. On the opposite, it may be meaningless to consolidate in one global position all position for the all group, without taking into account very different activities performed according different strategies in different core businesses protected by the information barriers and Chinese walls. These entities must follow their economic exposure with their own tools and disclose if necessary on their own.

For these reasons, BNP PARIBAS believes that each group should be asked to draft a policy which will define and justify the way positions are calculated and netted. This policy will be available to the regulators on their request.

Furthermore, we agree with CESR's proposal about the method of calculation: the position should be calculated taking into consideration a net basis and regarding derivative and cash positions on a Delta-adjusted basis.

Q12 Do you have any comments on CESR's proposals for the mechanics of the private and public disclosure?

Yes, we agree with the proposal: email is a fast and safe mean.

Q13 Do you consider that the content of the disclosures should include more details? If yes, please indicate what details (e.g. a breakdown between the physical and synthetic elements of a position).

No, it is our belief that the proposed set of information contains enough and all the relevant details.

Q14 Do you have any comments on CESR's proposals concerning the timeframe for disclosures?

No, we believe that t +1 is too short to enable firms to report adequately, in large groups with several trading locations. This timeframe is not realistic and will raise technical difficulties on a regular basis for investment firms.

Q15 Do you agree, as a matter of principle, that market makers should be exempt from disclosure obligations in respect of their market making activities?

Yes, we support their exemption from disclosure obligations but we expect a clear definition of what the market making activity is in this context. The experience of the last quarter of 2008 highlighted the fact that regulators within the EEA did not define market making the same way, and these different definitions created a lot of confusion and uncertainty in the way investment firm could be exempted from restrictions. We suggest that market making in this context should be the activity consisting in “exposing bids and asks on a regular basis and according to an agreement signed with the exchange and/or the issuer” (liquidity provider agreement, market making agreement, “contrats de liquidité” …). There is also a need to define, within the market making activity, how the exemption applies (by portfolio? by desk?)

Without any clear definition, there is a risk that the rules be circumvented by certain market actors.

Q16 If so, should they be exempt from disclosure to the regulator?

Yes, we believe so.

Q17 Should CESR consider any other exemptions?

No, if the market making definition is clear (see Q15)

Q18 Do you agree that EEA securities regulators should be given explicit, stand-alone powers to require disclosure in respect of short selling? If so, do you agree that these powers should stem from European legislation, in the form of a new Directive or Regulation?

Yes, we welcome the proposal and we support that such powers should stem from European legislation in the form of Regulation in order to reach a sufficient harmonization among EU members.
Moreover, the forthcoming legislation should be consistent with the one effective in the USA where the regulator can, on its own discretion, grant disclosure exemptions.

Should you have questions, do not hesitate to contact me.

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