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**CESR PROPOSAL FOR A PAN-EUROPEAN SHORT SELLING DISCLOSURE
REGIME: RESPONSE BY THE ASSOCIATION OF PRIVATE CLIENT
INVESTMENT MANAGERS AND STOCKBROKERS (APCIMS)**

Dear Secretary General,

Introduction

The Association of Private Client Investment Managers and Stockbrokers (APCIMS) represents firms acting on behalf of private investors. It has some 180 members of which over 125 are private client investment managers and stockbrokers with the remainder being associate members providing relevant services to them.

APCIMS' member firms deal primarily in stocks and shares but also in other financial instruments for individuals, trusts and charities and offer a range of services from execution only trading (no advice) through advice and non-discretionary business to full discretionary portfolio management.

Our member firms operate on more than 500 sites in the UK, Ireland, Isle of Man and Channel Islands, employing around 25,000 regulated staff and managing some £400 billion of the assets in these jurisdictions. APCIMS aims to ensure that legislative, regulatory, tax and other initiatives for change across the European Union are appropriate and proportionate to the needs of the private investment community.

General

APCIMS welcomes the opportunity to comment on CESR's consultation document with regard to a pan-European short-selling régime, and agrees that there should in general be greater transparency with respect to this practice. However, points of detail should be carefully considered prior to enactment into law and regulation in order to ensure that the sought outcomes are achieved and unintended consequences are avoided. We offer some views below against this background and in the light of our overall support for short selling, briefly elaborated in what follows, as acceptable market behaviour.

APCIMS believes that responsible short selling, or “shorting”, is a fundamentally legitimate investment activity which plays an important role in underpinning efficient markets. Thoughtful and considered shorting for justifiable investment purposes contributes to liquidity and reduces rather than increases volatility. Short sellers may help to stabilise prices in a falling market by covering short sale positions. These may have been opened at the start of a downturn, in which case responsible short selling may help to limit falls and place a floor under a stock price. When deployed as part of an overall hedged trading strategy, for example through use of the traded options market, short selling can help protect retail investors from losses. It may also help to accelerate necessary and indeed inevitable price corrections in over-valued stocks.

However APCIMS also believes that, provided transparency requirements can be justified by cost-benefit analyses and that technical difficulties of collecting and delivering data are not prohibitive, all financial markets should be as transparent as possible without interfering with reasonable liquidity. This not only enables investors to make informed decisions but it also helps to minimise the risk of market abuse, especially of the manipulative kind in which shorting may be used to force down the price of individual stocks to levels which might not otherwise be reached, thus exaggerating share price declines. APCIMS is well aware of the argument that, in extreme cases, manipulative shorting may depress the price of a security so much that it could create problems for the company in question, undermine commercial confidence, and make fundraising more difficult.

APCIMS has in the past stated publicly that we would like to see transparency in respect of short selling (in the UK) strengthened. In particular we have made clear that there should be a requirement for a declaration of interest when going short similar to that applying when going long in order to bring transparency in short selling more into line with other market practice. Going long in 3% or over of the total stock in a company must in the UK be disclosed to the market. A parallel régime should apply when going short. This should make it more difficult to use short selling to manipulate the market and bring benefit to investors and other market users while improving confidence and encouraging trust in the provision of financial services.

The UK Financial Services Authority conducted a review of short selling in 2002/03 and APCIMS responded to the associated consultation. While we noted that the FSA had found “no clear evidence that short selling has played a significant role in recent general market falls” and stated that the FSA should adhere to its existing positions and resist calls for restrictions on short selling in the UK, we also said that more information and better price transparency would benefit users and improve market confidence.

In particular we made the following points which we continue to support and would like to reiterate here:

- A major problem in carrying out an assessment of short selling is the difficulty of obtaining accurate and meaningful data that is not out of date.
- Short selling does not apply only to share purchases; activities in other instruments, such as derivatives and spread betting, should be taken into account when analysing prices and markets.
- Ill-considered regulatory approaches to the issues of data collection and assessment would entail costs in terms of new systems and requirements that would be unjustifiably high and would be passed on to the consumer.
- Care should be taken in respect of approaches to the short selling of equity products that could cause a transfer of short selling to the derivatives market. Any such movement would

obviously depend, at least in part, on whether or not similar disclosure requirements were introduced to the derivatives market as well.

- But it would be extremely difficult and costly to capture information in all derivatives markets, especially the OTC market.
- Market makers have a legitimate claim to confidentiality, a breach of which could damage liquidity in the market. Market makers should have exemption from any disclosure requirements that may be introduced.
- In relation to users of data about short selling, it would be important that where less sophisticated market participants were relying on the advice of an intermediary, the adviser explained the meaning and limitations of such data. If such a participant was not receiving advice, it was important that he understood that he was responsible for making his own assessment of such data.

Detail

Our responses to the individual questions set out in the CESR consultation document are below.

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

Yes; we have set out above the basic consideration which we have in the past stated should apply (3% equity holdings). Currently across the EU there is a patchwork of different requirements and prohibitions with regard to short selling and it will be important to bring consistency to this régime. This will not only help firms trading in different EU markets with greater regulatory certainty but application of the same automated reporting requirements in member states will reduce system development and implementation costs. There may be a difficulty in that the current CESR proposals appear to be minimum requirements and there may as a result be gold plating in at least some jurisdictions. If so this will remove the benefits that EU-wide consistency should be designed to bring.

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

Yes; the issues in each case are in our view correctly described, although see our response to question 3 below.

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

This question is not straightforward for private client investment management firms as there are problems with both approaches.

- i. The CESR paper is correct in saying that flagging requires systems changes within firms which could be expensive to implement. APCIMS' firms' retail investors have to conduct short sales through a short sale account and there would need to be an automated internal logic that would recognise when a sale is an opening sale and thus a short sale, as opposed to a closing sale of a previously held long position. Expensive systems development would be required to ensure such trades were flagged correctly. In contrast, for institutional clients the firms would not have custody and would not know a trade was a short sale unless the client told the firm, yet the firm would be

responsible for ensuring they were correctly flagged as short sales. This would obviously be risky and difficult to achieve at all times.

- ii. Similar issues arise with the reporting of net short positions. APCIMS' firms do not necessarily know the totality of any specific retail client's position as the client could have relevant holdings with other firms or even keep records of asset ownership, such as share certificates, at home and beyond the reach of any intermediary. So a firm would not know with confidence a retail client's total net exposure to a stock without first checking with the client. As an example, a daily IT report may suggest that Mr Smith is short 0.5% of a stock, but the firm would still have to call him to check that he was not long with another firm. If a retail investor had three short positions with three different broking firms it would be quite possible that none of them would individually realise that he had breached a particular threshold, and in all likelihood neither would the client. Whilst regulated institutional clients can be expected to get all this right and make any necessary private or public disclosures themselves, a retail investor could well not do so.
- iii. Neither of the above scenarios is likely to present a problem in the case of discretionary clients for whom the firm runs the portfolio and may never go net short anyway. The firm in these instances would automatically aggregate positions as part of meeting other reporting and transparency requirements, such as those of the Transparency Directive. But discretionary clients are only a proportion of the total client base of APCIMS' member firms.
- iv. The argument may be made that retail investors will not often have a 0.1% (private) or 0.5% (public) net short position in a listed issuer. We think that this misses the point. First, a retail investor may have such a position and even if it is less frequent for him/her to hold it this does not mean that his/her situation as described above can be ignored. Second, the lack of frequency may be true of straight equity holdings, but the definition of short extends to derivatives (eg CFDs, traded options, spreadbets) where it is easy for a small investor to gear up a position. Indeed in a small cap stock it is entirely possible and not necessarily infrequent for a retail investor to breach these thresholds.

4. Do you have any comments on CESR's proposals as regards the scope of the disclosure régime?

No; however, our concerns about gold-plating by individual member states (question 1 above) apply also to the likely extension of the scope to markets and exchanges beyond those discussed in the CESR document.

5. 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)?

While APCIMS have no problems with private disclosure, which clients can make themselves, it is not clear what mechanism will be put in place for retail investors to report publicly to the market. We are concerned that if broking firms will be required to handle and transmit the disclosures to the market there will be a substantial cost. For example, in takeover and merger situations in the UK where public reports to the market are made by

the private client brokers on behalf of their retail clients it takes considerable time for such reports to be made and can cost around £45 each time. These costs are passed on to the client.

- 6. 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?**

Yes; we think this is sensible.

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

As recorded above, APCIMS has in the past advocated initial disclosure of short holdings at 3% of equity in a stock to match long reporting requirements. However, this was for the UK only and we recognise that, given the wide disparities of views and practices across the EU market as a whole, this figure is probably not sustainable beyond the UK. We have no views on alternative thresholds, although we are of course aware that at the height of the financial crisis the emergency measures taken by various regulators, including the FSA, in respect of short position disclosures were much nearer to the figures exemplified in the CESR paper than our own.

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

We are concerned that doing this will cause great confusion amongst retail investors especially where they use execution only services or directly trade online. They may not readily appreciate the differences between this situation and information given on short positions in ordinary secondary trading, which may reduce the level of protection offered to such investors by the disclosure régime. Since retail investors may participate in large numbers in some share issues it will be important for regulators to address this issue with great care.

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

As implied above, we have no views on this question.

- 10. 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.

- 11. 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 have no comments.

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

We understand the CESR proposal to be that private disclosures should be made via dedicated email addresses to the issuer's home regulatory authority. This will involve a potential for 27 different email addresses to be known and available to each retail investor in the EU (and elsewhere?). In our view this is highly unlikely to work and could be disastrous. We believe it would be far better for firms and investors to report to their own home regulator, whose email address they will be much more certain about, and who can then forward the information to the relevant issuer home regulator. This can easily be set up automatically and should be at little resource cost to regulators. As regards public disclosure, there is no recognition in the CESR document as to how retail investors will be able to report to the relevant market (see our comments on question 5 above).

13. 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).

In our view the content of disclosures should be as brief and understandable as possible so that retail investors will be able to grasp their meaning and implications. We think that CESR in considering this issue should take account of the concerns underlying work to simplify documents and make them easily understood and comparable in other financial sectors, such as the Key Investor Information Document in the UCITS context or the proposals for a Summary Prospectus in the proposed amendments to the Prospectus Directive.

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

We agree that although T+1 does not give much time to prepare disclosures it is probably necessary given the purpose of the reports.

15. 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: see under the 'General' section above the 6th bullet point referring to the market maker exemption that we supported in our submission to the FSA on short selling disclosure in 2003.

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

We were referring to disclosure to the market.

17. Should CESR consider any other exemptions?

We have no comment.

18. 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?

We would prefer to avoid primary legislation in the form of a Directive followed by national implementing legislation on this issue. Such processes are inevitably cumbersome and difficult to control, and can result in unintended consequences. They are also hard to change once everything is in place. In our view CESR needs to consider in particular how the proposed régime will be made binding on private individuals (ie retail investors) who are part of the unregulated community, as well as how the mechanisms will work in practice for them.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Barrass', with a large, stylized initial 'J' and a checkmark-like flourish at the end.

John Barrass
Deputy Chief Executive
APCIMS

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