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The Committee of European Securities Regulators (CESR)

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Luxembourg, 20 January 2009

CESR Call for Evidence on REGULATION OF SHORT SELLING Members

Dear Sir,

Assenagon Asset Management S.A. welcomes the opportunity to comment on CESR´s Call for Evidence on the regulation of short selling by CESR Members. Assenagon Asset Management S.A. takes the view that a Europe wide harmonisation of the current regulation of short selling by CESR Member or a Europe wide abolition of the current regulation of short selling by CESR Members would make markets more efficient and give market participants a clear framework and legal certainty.

1. <u>General Remarks</u>

In general short sales possibilities (physically and net positions) are important features of developed financial markets. Such strategies are needed to provide hedging possibilities even if the hedging entity is not the same as the entity holding the positions, e.g. at parent level of a corporate group or by overlay in an institutional fund separated from the physical positions.

Net short positions should be permitted in order to achieve the best possible market valuation of equity securities. Market participants not holding the respective securities are only in a position to express their view on the market value of the security by creating short positions.

Physical short selling is an important feature for the derivatives market in order to provide liquidity to the derivatives market. In addition physical short selling enables the market participant to act immediately, even if the existing security positions are currently not available for the respective market participant, e.g. in situations where the securities need to be transferred between different settlement systems (EUROCLEAR vs Domestic) involving considerable time delays or in case bad news occur shortly before a shareholders' meetings and the securities are already irrevocably blocked for proxy purposes.

Moreover, according to the Behavioural Finance Theory trends are usually driven by loss position owners. In this scenario it is the short sellers who retroactively support the positive market developments. If short selling would be banned this corrective measure would be lost.

However we have seen undesirable effects caused by short selling recently:

- Market turbulence by panic sales, including short sellers trying to push markets down by artificial sales pressure and its effect on nervous investors. While there might be cases of forbidden but not verifiable market abuse these turbulences seem to be originated not by the short sellers themselves but by uncontrolled risk positions and by a bad communication practise in the financial industry.

- Enormous losses created by exaggerated short positions in single stocks by individuals and or hedge funds. The most spectacular case in Europe was the heavy rise of the Volkswagen stock and its tragic side effects.

- Permanent settlement problems due to short sales not timely delivered, many of them as the countertrades have not been delivered in time, probably worsened by careless settlement procedures as the counterparty has to pay.

While we do not think that the last point creates a major market issue some of the regulations seem to focus on this topic.

We have to admit that due to the exaggerations immediate measures were needed to calm down markets and find a level of fair valuation and we cannot state that in this situation the market had prepared instantaneously profound measures better than those taken.

2. Assessment the impact of the measures that were introduced by CESR Members

The most important impact was a great uncertainty about which is the exact regulation relevant for each single trade as sometimes two, three or even more national regimes have to be considered and each one is different. Some markets, namely trading in financial stocks, are much less efficient as a year ago, while it is not clear, who is to blame for that.

The short selling measures stopped the negative trend as they created artificial immediate demand, but few of the financial stocks recovered substantially and some needed government intervention to avoid total failure. This reaction can either mean that the market did not over-react heavily (the current low market price is justified) or that recovery takes longer without short sellers in the respective markets.

According to new research from Professor Ian Marsh (Cass Business School) on the impact of short selling restrictions there is no strong evidence that restrictions on short selling changed the behaviour of relevant stock markets significantly.

3. Range of policy options for taking a more convergent approach

a. Regardless of more detailed measures we would recommend to extensively harmonise (1) the regulation on definitions such as the terms "short selling", (2) the currently domestic measurement catalogues of CESR members and (3) the time horizon to re-assess the situation.

b. Net short positions might be restricted similar to long positions, i. e. only a certain percentage of the outstanding shares may be short sold by the same group of companies, UCIs managed by the same asset management company, etc.

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If this measure is not taken, at least the information should be disclosed to the public and a buy back in such cases should only be done via a public buy-back order. This would force the short seller to act only on a strongly and fundamentally based analysis before entering in such a position.

c. Exchanges may introduce a short break in trading, if stocks drop or rise by more than a given percentage. The procedure should be the same on either side. Practical experience in the past has shown that the initiative to stop trading for the rest of the day led sometimes to dead markets for several days and prevented the market from finding the right bid-offer equilibrium.

d. No individual natural or legal person should be allowed to enter financial market positions if such person cannot survive expected loss situations regardless whether they are caused by credit finance transactions, derivative transactions or naked short positions. This requirement should not only be imposed on the market participants but also on their financial partners, such as depositary banks and OTC Counterparties.

   In addition to the usual consequences of such misconduct, claims from financial partners such as depository banks or OTC Counterparties which have not used their best efforts to make sure that the trade size was in line with their customers` financial situation, could be declared subordinated claims by the competent supervisory authority.

e. Late delivery of securities in a settlement system could lead to additional fees for the benefit of the regulator. This might be an incentive to borrow stocks in time, even if there is an external reason for not having the stocks in place.

All other measurements we have seen so far seem to be counterproductive and lead to market inefficiency.

4. <u>Enhancement of the coordination and cooperation between CESR Members on the decisions adopted at national level</u>

Assenagon Asset Management S.A. takes the view that a Europe wide harmonisation of the current regulation of short selling by CESR Member or a Europe wide abolition of the current regulation of short selling by CESR Members would make markets more efficient and give market participants a clear framework and legal certainty. In order to achieve this goal close coordination and cooperation between CESR Members is vital. There should be first a common opinion between CESR Members whether a regulation of short selling will make sense in the long run or whether any regulation of short selling should be abolished. If the outcome of this decision finding process will be that the regulation of short selling is desirable then there should be a CESR wide common approach regarding the content of such regulation.

Yours sincerely,

Assenagon Asset Management S.A.

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