

30 September 2009

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Dear Mr Pribil

This letter and appendix provides Chi-X Europe Ltd (Chi-X)'s response to CESR's Consultation Paper on a Proposal for a Pan-European Short Selling Disclosure Regime. Chi-X appreciates the opportunity to comment on the important issue of short selling. Chi-X considers that short selling is an integral part of the proper functioning of markets, contributing to market efficiency through improving price formation and enhancing liquidity. We do not consider, and many studies support, short selling to be a major contributor to market volatility.

If financial regulators would like enhanced disclosure of short selling, Chi-X believes that there are grounds for private disclosure for regulators, but the threshold for disclosure should be set at an appropriate level that does not result in an unreasonable cost to the market. We do not believe that there is a case for a public disclosure regime unless the data is aggregated and anonymous. A cost/benefit analysis should be undertaken to ensure that the benefits of the policy objectives outweigh the cost of implementation and ongoing compliance. In particular, we believe that there is no case for a short sale flagging regime, nor an uptick rule. Any short selling regime should be applied uniformly across the EEA. Our detailed responses to the individual questions within the Consultation Paper are shown in Appendix 1 below.

Yours sincerely

Denzil Jenkins
Director of Regulation

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APPENDIX 1

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

It is unclear what enhanced transparency would achieve. We do not consider that it would constrain market volatility. It is possible that enhanced transparency to regulators would be beneficial to detect and deter market abuse. In addition, aggregated and anonymous public disclosure of net short positions may contribute to overall market understanding and aid price formation. However, it is questionable whether the benefits outweigh the costs. For example, it has not been clearly articulated by regulators how additional private disclosure would add significantly to their ability to detect and investigate market abuse compared to the means already at their disposal.

It is also important to strike a balance between the benefits and the impact of increased transparency. Too granular a requirement may deter legitimate trading and price discovery. In addition, too costly a compliance mechanism will also inhibit legitimate trading; it is imperative that the costs of implementation of such a regime are kept as low as possible, by leveraging off existing mechanisms where possible.

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

Yes. The short sale flag does not provide information about positions. Although regulators may be able to estimate short positions from this information, this solution requires an additional time consuming aggregation and analysis of data which increases the risk of errors. Additionally, there may be significant costs to the industry to implement this solution, and full implementation is likely to take a considerable period of time.

Short position reporting has a lower cost of tracking and a lower risk of computational errors compared to the short sell flag. Additionally the industry may be able to leverage systems implemented to disclose long positions.

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

Yes. See answer to question 2.

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

We agree that any short selling requirements should be applied across all sectors. Applying different requirements across different sectors leads to increased compliance costs for both the industry and the regulators.

The scope should include all equity securities and related instruments traded on a Regulated Market or an MTF within the EEA, irrespective of their location of primary listing. We disagree with the proposal to exclude securities which are traded on exchanges and MTFs inside the EEA, but are listed outside the EEA. An example of these would be global depositary receipts. The current proposal excludes these securities however these securities are subject to the same industry pressures, including the possibility of market abuse, as other stocks. The fact that their primary market of listing is outside the EEA does not change this. Additionally, the fact that these stocks are listed inside the EEA as GDRs indicate that greater liquidity is being sought by their issuers than they can obtain in their home market.

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)?

There needs to be a clearly articulated case for disclosure supported by a compelling cost benefit analysis. If there is to be a disclosure regime, we consider that a two tier disclosure model is only appropriate if public disclosure is restricted to being aggregated and anonymous.

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?

Yes. Pan-European disclosure will mean one standard set of requirements. This will significantly reduce compliance costs for the industry and the regulators.

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

It is important to ensure that compliance costs are not so burdensome that they deter legitimate short selling. We propose a relatively high threshold for private net short disclosure, for example starting at 0.25% and multiples thereof. Ideally disclosure thresholds should be related to the available free-float of every stock; this may in practice be problematic to calculate and implement.

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?

We do not believe that more stringent disclosure for companies engaged in capital raising are necessary. A single disclosure regime across all companies would avoid unnecessary additional costs to the industry.

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

We believe that aggregated net short positions should be disclosed by regulators on the basis of private disclosure information.

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?

We do not consider there to be any such circumstances.

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?

Yes. We agree that positions should be calculated on a net basis, and that derivative positions should be calculated on a Delta-adjusted basis.

In addition, netting at a legal entity level is appropriate. This should be relatively simple to calculate, therefore resulting in a minimum amount of cost and reducing the risk of error.

Although netting across an entire Group of companies gives a more accurate representation of a Group's position than netting at a legal entity level, this may be difficult and expensive for a group to calculate, given that large groups may have positions held across different entities in different time zones, and therefore also prone to error. Firms should, however, have the option to report at group level, should they have the capacity to do so.

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

The "most relevant market in terms of liquidity" may be open to interpretation. We believe that the disclosure should be made to the home state regulator of the regulated firm submitting the report.

As stated in Q2, the industry may be able to leverage existing systems implemented to disclose long positions to their home state regulator.

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).

We agree with the proposals that the disclosure should also make the distinction between the physical elements and any synthetic elements of the position. This would provide transparency to the regulator as to how the short position is reached without significantly increasing the compliance cost for the firm.

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

We agree with CESR's proposal concerning the timeframe for disclosures, and that disclosure of end of day positions on a T+1 basis is appropriate.

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. Market makers should be exempt from disclosure obligations. Care should be taken to ensure that only the market making function is exempt. Other proprietary business conducted by the firm (including within the same Legal entity) should be subject to the standard disclosure requirements.

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

See Q15.

Q17 Should CESR consider any other exemptions?

The definition of liquidity provision provided by CESR is restrictive. We have concern that this definition:

“in a way that ordinarily has the effect of providing liquidity on a regular basis to the market on both bid and offer sides of the market in comparable size.”

significantly narrows the definition of liquidity providers to only those with a contractual obligation to provide liquidity to the trading venue. However many proprietary trading firms provide liquidity to markets on an informal basis. They may commence or terminate liquidity for any stock at will without penalty. Alternatively they may only provide liquidity on one side of the market. We believe that these informal liquidity providers should also be entitled to an exemption with regard to disclosure to both the market and the regulator.

Perhaps a more suitable definition would be:

“in a way that ordinarily has the effect of providing liquidity on a regular basis to the market”

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?

The most important outcome is a uniform regime that can be uniformly applied across all jurisdictions, and is also sufficiently flexible to be amended with respect to ongoing developments. Consideration should be given to make this a simple process. Perhaps the most cost effective and timely way to achieve this would be to make an amendment to the Transparency Directive.