

30 September 2009

Mr Kurt Pribil
Short Selling Task Force
CESR-Pol
CESR

Dear Mr Pribil

CESR/09-581: CESR Proposal for a Pan-European Short Selling Disclosure Regime

The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around £3 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies). In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets. The IMA's authoritative Asset Management Survey shows that in 2008 IMA Members managed holdings amounting to 43% of the domestic equity market.

We welcome both the opportunity to comment on the proposals made in the paper, and the work that CESR has done on both co-ordination and convergence of short selling regimes. Please find our detailed comments attached below. I would particularly recommend to CESR's attention the recent position paper on short selling from CONSOB (27 May 2009, DMS ID: 091330256), which sets out very clearly many arguments against bans or price restrictions, and particularly against public disclosure. I would also direct your attention to a [recent study](#) by EDHEC, 'The Undesirable Effects of Banning Short Sales' which thoroughly reviews the recent restrictions put in place on short sales, and their effects on the stocks so restricted, the markets on which they are listed, and also on unrestricted stock on those markets. It highlights the negative impacts of the current restrictions and highlights the lack of clarity by regulators as to why they were imposing the restrictions.

Short selling is a long established investment activity and an integral part of global capital markets. Short selling plays a crucial role in legitimate active investment strategies and risk management activities designed to enhance performance and

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maximise returns to investors. It also contributes to market liquidity, reduces transaction costs and helps to ensure pricing efficiency.

The IMA firmly opposes market manipulation or abuse. Where the specific concern is market manipulation, regulators should have both the information and capability to monitor and investigate thoroughly. We, therefore, support timely disclosure directly to the chief market regulator, or supervisor, of short sale positions above a reasonable threshold. We consider that such regulatory disclosure would be sufficient, and oppose the implementation of bans or price restrictions.

It should be noted that market abuse will occur just as readily, possibly more so, in rising markets, through the use of techniques which make no use of short positions. Short selling, in being the focus of this attention, risks being seen as, in some way, morally wrong. CESR should, in any output, place equal emphasis on the benefits of proper use of short selling and avoid vilifying its use.

We would also support the position taken by your own Markets Participants Consultative Panel at their 24 June 2009 meeting in their opposition to public disclosure.

In your consultation paper CESR identifies three potential problems with short selling, in that it can:

- Be used to commit market abuse;
- Contribute to disorderly markets; and
- Adversely effect market stability.

In our detailed comments (attached below) we argue that public disclosure is not necessary to resolve the potential problems, and could exacerbate some of the problems, when they do arise. Problems of public disclosure of short positions are set out in our answer to Questions 1 and 5.

Disclosure to the regulator should meet all the problems identified by CESR. We agree that regulators should have access to information about those holding significant short positions, given the use that could be made of such to commit market abuse, and the risk that such positions could destabilise the markets, or contribute to disorderly markets. Firms, disclosing such information to their regulators will already regard this as providing sufficient deterrent, or 'grit in the wheels', from taking excessive short positions. Firms are not going to be more concerned about public disclosure than they would be about regulatory disclosure, given the consequences of both: their regulator has the power to fine the firm, or ban it from regulated activities; public disclosure could only lead to publicity, and only then in rare instances. Given the negative possible consequences of public disclosure we do not agree that the benefits could outweigh the supposed benefits.

We are disappointed, given that we are past the crisis period for markets that pertained during the second half of 2008, that regulators are now proposing far wider disclosure of transactions (broadening the range from those firms impacted, primarily financial services firms, to all firms issuing listed equities) and reducing the threshold, from the more general 0.25% to 0.1%. This move seems unjustified, disproportionate and draconian.

We would further argue that disclosure to the regulator should only be necessary during periods of market instability. The blanket imposition of disclosure on short positions in all companies would damage the market, on which the prosperity of Europe relies. However we recognise that permanent regulatory disclosure may be a simpler solution to manage

We would not be opposed to the aggregated, anonymised and suitably delayed reporting of gross short positions, to the market by the regulator (as is done in the USA), should a suitable case for this be made.

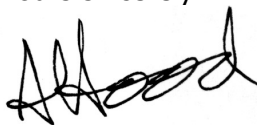
We would also note that in the absence of any enforcing Directive or Regulation we would encourage CESR to encourage as great a degree of consistency among European regulators as possible. We consider that it is important for CESR to continue working to achieve a global solution in terms of harmonised short selling regime.

Given that CESR is continuing to consider the use of other regulatory solutions (such as bans or price restrictions), which we oppose, then it is important that regulators do not impose any new disclosure requirements before these other areas have been considered in full. It is vital that the short selling requirements are considered in the whole, to get a unified view of how to impose a coherent and workable short selling requirements regime which does not cripple the market it seeks to supervise.

We welcome the work that CESR is pushing forwards on convergence of the regulatory regimes on this topic, but feel that such convergence must be on the right solution if it is to avoid unnecessary economic damage to the European markets and economies.

I look forward to hearing from you if there is any clarification that you would find useful on the points we have raised. We would be happy to meet to discuss the thinking behind the public disclosure requirements.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Adrian Hood', with a stylized, cursive script.

Adrian Hood
Regulatory Adviser

CESR Proposal for a Pan-European Short Selling Disclosure Regime

We provide below answers only to those questions from the consultation that fall within IMA's remit

Chapter 2

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

As the IMA represents buy-side firms who hold approximately 44% of the UK domestic equity market we are naturally keen that the markets remain as free as possible from market abuse, and operate freely and efficiently. Our members are also keen to minimise the number of failed trades, and would seek action against those who deliberately allow trades to fail.

While we recognise the value of regulatory disclosure in allowing national regulators to monitor for market abuse we see no value in the public disclosure of short positions. Public disclosure of short positions could seriously harm: investment managers by exposing their proprietary positions to others; other investors who may attempt to mimic the disclosed investment strategy or use the information for their own benefit, without cost, and without understanding the implications; and the market, by reducing efficient price discovery, increasing volatility and spreads. It should also be recognised that listed firms may seek to retaliate against investment firms that take short positions in their stock.

Disclosure to the regulator should meet the problems identified by CESR, but should (ideally) only be necessary during periods of market instability. The blanket imposition of disclosure on short positions in all EEA issuers would impose considerable cost on the efficient functioning of the market.

None of the studies done to date has identified any benefit to the markets or investors from public disclosure of short positions. As such, and given the inevitable costs and inefficiencies, not to mention the many potential disadvantages, of imposing such disclosure, we would strongly oppose such a move.

We would not be opposed to the aggregated, anonymised and suitably delayed reporting of gross short positions, to the market by the regulator, should a suitable case for this be made.

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

We have nothing to add to CESR's analysis, other than that, as asset managers, our members are not exchange members and therefore, place reliance on their brokers to report trades to markets and to regulators. Unless they manually alert the broker for each short trade, it would not be possible for them to comply. This is not an effective solution. Moreover, in accordance with market practice, as they rely on

their brokers to provide real-time post-trade transparency to the market, they do not have the capability to trade report themselves and the cost of developing such a solution would be significant and unlikely to pass a cost benefit analysis.

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

Yes, and it is consistent with other, existing disclosure regimes.

Chapter 3

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

We agree that the proposals would not be appropriate for non-equity securities, nor should such a regime be extended to the shares of non-EEA issuers with secondary listings on EU regulated markets.

No new obligations should be imposed on the market without full cost-benefit justification, and following a proper Market Failure Analysis.

As we see it, the only time that short sale assisted market abuse would be attempted, and certainly the only time when short selling could contribute to market instability, would be when there are significant falls in the market as a whole, or in a specific sector. As such we consider that disclosure to the regulator should only be necessary during periods of market instability. The blanket imposition of disclosure on short positions in all EEA listed companies would impose considerable costs on, and potentially damage, the market and benefit no-one.

In the absence of conclusive evidence of benefit from the blanket imposition of short position disclosures we do not think that CESR, or national regulators, would be justified in imposing such a regime.

As far as 'economic exposure' to shares admitted to trading goes, we would like to see considerably more detail of what CESR means by this, and how they would expect firms to implement it in practice. We would highlight the difficulties that the FSA faced when it imposed similar (albeit temporary) requirements in the UK in 2008. A large number of FAQs had to be produced soon *after* the new rules were imposed, in order to help firms understand the details of what was required. We would hope that CESR would provide such information *prior* to any new rules being introduced.

Many firms have reported some difficulty in assessing their total economic exposure to certain shares where they are shorting an index of shares. There seems to be no easy way to identify, on a day to day basis, what proportion of the index, and thus of their short position, any individual share comprises. We would appreciate it if CESR

could give this issue some thought, in order to assist firms in their compliance with any final rules.

The scope of the rules has a direct impact on the cost to firms. Market participants would have to implement or update their monitoring and compliance systems to reflect the final harmonised regime. We consider that these costs could be significant, particularly as regards monitoring and calculating the economic exposure to short positions contributed by derivatives.

A final point would be to query how this regime would be imposed on investors from outside the EEA who take short positions in listed equities. If they can take short positions with impunity then this could fatally undermine the proposed regime. We consider that it is important for CESR to continue working to achieve a global solution in terms of harmonised short selling regime.

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)?

While, as we have said above, we see the value in regulatory disclosure to mitigate market abuse and instability, we see little or no benefit, and much cost, in requiring public disclosure.

CESR considers that public disclosure of significant short positions would provide the market with valuable information that a share of a particular issuer may be over-valued, allowing it to react rationally and in an orderly fashion. We would disagree with this analysis. Firms short sell stock for many reasons, not only because they consider that the share is over-valued, e.g. to lock in a spread or hedge an investment in convertible bonds. Traders may buy options or futures on stock indices and then short the individual component equities in order to profit from arbitrage opportunities. In these instances, public disclosure of short sale positions may mislead investors, who may incorrectly assume that the institution has a negative view of the company whose stock is being shorted. Public disclosure of short positions could, in fact, seriously harm: investment managers by exposing their proprietary positions to others; other investors who may attempt to mimic the disclosed investment strategy or use the information for their own benefit without cost and without understanding the implications; and the market, by reducing efficient price discovery, increasing volatility and spreads.

We would suggest that the disclosure of short position data to the public would be much more likely to lead to a worsening of the market situation, and disadvantage to investors, than it would to a rational and orderly reaction.

It is also not the uninformed herd movement of the market after such public disclosure that would improve pricing efficiency, indeed such movements will more

likely lead to over-reactions and poorer pricing efficiency. Pricing efficiency is enhanced by the original, informed, short sale, not by others' reaction to it.

CESR's second suggestion, that public disclosure should provide a measure of deterrence to 'aggressive' short sellers beyond what would be gained from a requirement to disclose to the regulator alone, is also one with which we would disagree. Firms looking to commit market abuse would be fully deterred by the initial regulatory disclosure. No firm would be put off taking a larger short position merely because of public disclosure, if they have already had to disclose that position to their regulator. The fact that short sellers have been prepared to take positions which require public disclosure backs this up.

We would also object to the use of the term 'aggressive', which is pejorative. If CESR is seeking to prevent market abuse by such short position takers, then it should refer to deterring market abuse; if it is seeking to ensure market stability then it should state this also. There is no agreement on what is meant by 'aggressive short selling', and as such it is not a useful term.

While we accept that it does not happen often, public disclosure could expose a short position holder to the risk of a short squeeze, whether through deliberate concerted action by other market users, or incidentally following 'herding'. Thus, public disclosure could not only reduce the benefits which short selling provides to the market, but could also open up new opportunities for those wishing to commit market abuse (the squeeze).

The other examples of public disclosure of private information given in the paper can all be distinguished: significant long positions under the Transparency Directive have to be disclosed because the shareholder is a significant owner of the company; managers' transactions in the shares of the company for which they work have to be disclosed because the managers have a fiduciary duty to the company. Neither of these specifics applies to holders of short positions, so the analogies are not relevant. We would also note that in paragraph 38 CESR seems to discount the relevance of these examples.

We consider that the cost of the proposed dual threshold regime with multiple incremental disclosures would be considerable, and should be further assessed by CESR before proceeding. It should be noted that firms would not only have to incur costs on passing a disclosure threshold, but all market participants would have these monitoring and calculation costs imposed on them even should they never pass a threshold, to avoid potentially breaching the regime.

We also have some concern over the possibility of a threshold causing a false market or artificial barrier; the thinking here is that if a regulator views, or treats, short selling above a particular level differently, then that level might be shied away from by the market.

The IMA would not be opposed to the aggregated, anonymised and suitably delayed reporting of gross short positions, to the market by the regulator, should a suitable case for this be made. This would, in principle, be preferable to public disclosure being required from those market participants who take short positions.

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?

We agree that the regulatory disclosure threshold should be uniform across Europe. If there must be public disclosure, then it would be beneficial if the threshold was consistent across Europe.

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

As set out above, we do not agree with the need for public disclosure of short positions, so cannot agree with the proposed 0.5% threshold. We have set out our reasons for this in our cover letter and answers to questions 1, 4 and 5 above. The level chosen for public disclosure seems arbitrary and is not backed up by any substantive research or rationale. The mere fact that the median disclosure to the FSA in September 2008 was about 0.5% does in no way indicate that this is the appropriate threshold for public disclosure. The two figures are not connected: to derive one from the other is a *non sequitur*.

We note that CESR, in paragraph 38, discounts comparisons with the disclosure requirements for long positions, so these cannot provide a guide to reporting thresholds.

If public disclosure is, despite the arguments against it, introduced, then IMA would look for the initial threshold to be set as high as possible, preferably no lower than 1.0% (which is still below the mean UK reported position for September 2008), and possibly even mirroring the levels set out in the Transparency Directive. We would also look for the disclosure requirement to be based on clearly stated, proper economic rationales and evidence.

We consider the proposed threshold for regulatory disclosure to be unnecessarily low. A threshold of 0.1% will result in an overwhelming number of reports, reflecting insignificant short positions of no relevance to either market abuse or market stability issues. We note that most countries in Europe that imposed reporting thresholds recently did so at the 0.25% level. As these were crisis management levels, set to serve during a severe downturn then the thresholds for 'normal' times should be no lower and should, it could be argued, be higher. We note that the FSA proposed a level of 0.5% in their [discussion paper 09/1](#) on this subject. We would recommend that the regulatory threshold should be set at a minimum at 0.25% and ideally at 0.5%.

We understand that CESR set the 0.1% to provide for a 'significant gap' between that level and the higher public disclosure threshold. Should public disclosure, as a result of the consultation, be discarded then the concept of a 'significant gap' becomes moot; and should the public disclosure threshold be introduced, but at a

higher level than proposed, then the regulatory disclosure threshold could be raised, e.g. to 0.25%, while preserving the 'significant gap'.

We note that CESR proposes a 'fine-tuning' review once sufficient experience has been gained. It would be helpful if a timetable for this could be set out by CESR, and we would hope that this would not be more than one year after final proposals are implemented.

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?

While we recognise that share issues can be vulnerable to market abuse, we consider that, as regulators would still be receiving disclosures from those with short positions in the affected companies, we do not see that any extra benefit would be gained from public disclosure in such instances.

Regulators would be receiving information about who is taking short positions in such stock. They also receive details of every transaction undertaken on stocks listed on the markets for which they are responsible. They should have sufficient information to identify any attempts to commit market abuse, or positions which could threaten market stability. It should be up to regulators to take appropriate action to ensure that such positions are not misused. Regulators should be encouraged to make full use of the copious market information with which they are already, at great expense to the market, being provided.

Forcing short sellers to make public disclosures of their positions will not help other market users (other than to reward their prurience), nor have any inhibiting effect on the positions taken, given that the firms will know that their regulator will already be monitoring them.

The only result of advertising the taking of large short positions in a stock during its rights issue period would be to incite others to take similar positions, or liquidate their long position, exacerbating the situation that regulators seek to calm.

We also understand that it can be difficult to identify stocks that are raising capital through share issues. There is no central source for finding the necessary information, rendering it a labour intensive, manual and therefore expensive process. The prospect of having to identify such scattered information from disparate data vendors across Europe is one that daunts even large, well resourced, firms. It is difficult to see how smaller firms could hope to identify the necessary information, and they thus run the risk of inadvertently breaching the rules, if an unexpectedly low threshold applies to certain stocks.

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

N/A

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 are not aware of any. Given the importance of maintaining a harmonised regime across Europe we would consider that such exceptions would be incompatible with this.

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 agree that short positions should be calculated on a net basis.

While we recognise that disclosure of cash equity short positions only would leave numerous loopholes for evading the disclosure regime we consider that any requirements put in place must be practicable and affordable, based on readily available market information.

We are particularly concerned about the ability to identify the 'economically equivalent' position in a share that is taken by a firm with a short position on an index. The information required to identify the equivalent number of shares represented by an index is not available to those taking the position, and will change on a daily basis. Those who do short indices are not taking positions on the stocks within it, but on the market as a whole. CESR should investigate whether, given the non-availability of the necessary information, and the non-relevance of such positions to the aim of the regime, there is scope for excluding (except possibly in exceptional situations) such holdings.

Where an economic equivalence of a derivative exposure has to be calculated using the delta of the investment, CESR should recognise that firms should not be held liable for unusual, or sudden, increases in implied volatility, which can cause a spike in the economic exposure. For example, if one buys a deep out of the money call option it might not, on a share equivalent calculation using its delta, trigger a disclosure requirement. But later on, without adding to the position a rally in the underlying shares could change that. Then of course one could see circumstances where the share equivalent "yo-yo'ed" either side of the disclosure level. This would result in regular, repeated and meaningless disclosures. Is this really what CESR intends?

Should a put-option be considered to be a short sale? If so, which of the counterparties would be expected to report it?

If CFDs are reported by the firm that takes them out, and the bank with whom they have the CFD is short the physical stock, then there would be double counting if both sides report it.

We would consider that if an issuer had different classes of shares admitted to trading that the sum of the positions should be assessed, taking into account the total number of shares issued in each class.

As to the identity of the entity responsible for reporting short positions to the regulator, we recognise the rationale behind CESR's intention that reports should be made by the legal entity which makes the decision to take the short position. Applying this to the discretionary asset management industry, we would take this to mean that funds (whether UCITS or not) and their managers (i.e. UCITS Management Company, ACD, AFM or equivalent) delegate the discretion to make that decision to an asset management company. It is the asset management firm that has the discretion to take specific short positions on behalf of their clients. The asset management firm should thus net off any short positions that they have against any long positions held across all of their clients. This would result in the decision maker (the asset management firm) reporting one net (aggregated) position across all their clients.

Where a single group contains two or more discretionary asset management firms, and they make decisions on taking short positions together, then they should net their positions together before determining whether they should make any disclosure. This would be consistent with other disclosure regimes.

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

We are concerned that the submission of regulatory disclosure reports by email would require another system to be developed by every entity operating in any regulated market across Europe. This could be very expensive. Regulators should accept the required information in a variety of ways, which should certainly include via a RIS provider, or equivalent. Any regime that relies on as manual a mechanism as email is going to be prone to human error.

Where the home state regulator of the issuer is not the regulator of the most liquid market, then these regulators should arrange, between themselves, to forward on any reports made in such stock.

We would exhort CESR to impose, as rigorously as possible, standard definitions, forms and implementation of any final regime, to ensure that the benefits of harmonisation are fully achieved by internationally operating firms.

Should CESR impose public disclosure on short sellers then this would result in even greater cost. We note that no mechanism for public disclosure is discussed leaving the proper quantification of the cost impossible.

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).

CESR should ensure that the information required is consistent across the EU, in the interests of harmony, convergence and the minimisation of the, already substantial, otherwise excessive, cost to firms of implementing systems to comply with the proposed regime. Individual countries should not be allowed to capriciously extend the range of required information.

Given our opposition to public disclosure, should CESR decide to progress with anonymised aggregate reporting then these, obviously, should not include the identity of the short position holder.

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

We understand that a timescale of T+1 may not allow sufficient time for firms to gain certainty of trade settlement in certain regimes. This is exacerbated if deals are undertaken on a global basis, or where the necessary calculations involve complex derivative instruments.

The timescale should be extended to T+2, in line with other significant holdings disclosure regimes and in recognition of the fact that an entity might have to make multiple disclosures to multiple authorities on a given day.

We note that significant, intra-day only, short positions in excess of the reporting thresholds will not need to be reported.

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?

Market makers are offered an exemption from regulatory and public disclosure of short positions on the grounds that public disclosure would put them at risk of short squeezes. We see no reason why they should be exempt from regulatory disclosure on this basis.

If market makers can be seen to be put at risk of short squeezes from public disclosure it is disappointing that CESR do not recognise the same risk as applying to other firms taking short positions.

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

No. We are opposed to any public disclosures, whether by market makers or those who use their services, but, for regulators to have appropriate oversight of the short selling activities of market makers, it is important that they have sufficient information.

We see no reason for any exemption for market makers from regulatory disclosure.

Q17: Should CESR consider any other exemptions?

No.

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?

We have no view on the basis needed for these powers, but we would exhort CESR to ensure that it requires regulators to implement consistent regimes, avoiding opt-out.

We would also ask CESR and regulators, to take their proposals forward in such a way as to recognise that non-reporting of significant positions is not, in itself, market abuse, but would only constitute a reporting breach, albeit one which might result in questions being asked by a firm's regulator.