

Committee of European Securities Regulators
11-13 avenue de Friedland
75008 PARIS
FRANCE

Subject: Eumedion response to CESR's call for evidence on the regulation of short selling by CESR members
Ref.: 2009.003
Schiphol, 20 January 2009

Dear Sirs, dear Madams,

Eumedion would like to thank CESR for the opportunity to comment on the call for evidence on the regulation of short selling by CESR members.

By way of background, Eumedion is the Dutch corporate governance forum for institutional investors. At present, Eumedion has 65 Dutch and foreign institutional investors as members. Together these members have more than 1 trillion euro of assets under management. They invest for Dutch beneficiaries and in listed companies worldwide.

Comments on the temporary short selling ban

Against the background of the unusual and extraordinary circumstances on the financial markets in the autumn of 2008, Eumedion supported the measures taken by the Governments and financial regulators to calm the financial markets, including temporarily prohibiting any person from effecting a short sale in the publicly traded securities of financial institutions. There was a possibility that many parties simultaneously 'went short' in financial stocks, thereby creating a self-fulfilling prophecy: as a result of the increased supply, the prices will fall automatically.

However, because of the differences between the regulations on short selling in the various countries, institutional investors with their highly diversified investment portfolio had to cope with an additional increase in the administrative burden. Although CESR provided accurately overviews of the measures adopted by CESR members, institutional investors had to make costs to monitor the regulatory developments in the various countries and had to adapt their internal compliance systems or had to implement temporary compliance measures involving manual monitoring. A harmonised set of rules, at least in the European Union, would have saved a lot of compliance costs and agitation. Besides this, we would have preferred prior consultation on the proposed rules instead of an overnight adoption of the rules on short selling by the Governments or regulators.

Moreover, some academic studies raise doubt about the effectiveness of the temporary short selling ban.

For example, professor Ian W. Marsh and Norman Niemer of Cass Business School, London, recently published their study "The impact of Short Sales Restrictions"¹. This study, that was commissioned and funded by the International Securities Lending Association, the Alternative Investment Management Association and the London Investment Banking Association, analyses the impact of the recently imposed short selling restrictions on the behaviour of stock returns. The main findings of this study are:

1. The authors did not find strong evidence that the imposition of restrictions on short selling in the UK or elsewhere changed the behaviour of stock returns. Stocks subject to the restrictions behave very similarly both to how they behaved before the imposition of restrictions and to how stocks not subject to the restrictions behave.
2. Further, comparing behaviour across countries where the nature of the restrictions differs, the authors did not find systematic patterns consistent with the expected effect of the new regulations (i.e. no evidence of a reduced probability of large price falls).
3. The authors also did not find a sign of the expected detrimental impact of constraints (in terms of reduced efficiency of pricing). Autocorrelation coefficients and goodness of fit statistics are if anything slightly lower in the post-restrictions period.
4. Regression analysis of the authors suggests that any change in the key statistics is mainly driven by sector-wide influences than the restrictions on short-selling. That is, some systematic changes in the behaviour of financial sector stocks could be discerned

¹ The research is available at the website of the Cass Business School (www.cass.city.ac.uk).

but no strong evidence of a systematic impact of the restrictions could be identified by the authors.

The study refers to one caveat which relates to the shortness of the post-restrictions period in most countries, which does not appear to the authors to change the robustness of their findings. Therefore, there is no strong case for continued bans on short selling as there is no strong evidence these have been effective in reducing share price volatility and/or limiting share price falls.

These conclusions are more or less confirmed by another recently published study on the September 2008 SEC emergency order that temporarily banned most short sales in nearly 1,000 financial stocks². According to the authors, stocks subject to the US ban suffered a severe degradation in market quality, as measured by spreads, price impacts, and intraday volatility. The authors found that prior to the ban, the average bid-ask spread of 1,066 control group stocks traded on the New York Stock Exchange was 25 basis points. During the ban period, the spread for the control group swelled to 45 basis points, but the spread of the financial sector stocks subject to the short-selling ban swelled to 92 basis points.

The UK Financial Services Authority (FSA) also admitted that the ban may have had some (negative) impact in terms of liquidity and widening the bid/offer spreads in the stocks³. However, according to the FSA, there has not been a significantly deleterious effect on market quality. Eumedion members share these conclusions.

Way Forward

In the recent months, market conditions have become less extreme. The UK Financial Services Authority has already decided not to renew the ban on short selling of specific financial stocks. Against this background and the limited effectiveness of the short selling ban in general (see above), we would recommend all Governments and regulators to lift the remaining short selling bans. Eumedion would welcome a common approach worldwide, maybe to begin in the European Union. CESR could play a coordinating role to reach consensus on this.

Furthermore, we would favour disclosure of substantial short positions, since 'hidden' short positions can lead to distorted price signals: if an investor that has substantial voting rights (f.e. above the first legal threshold to notify a substantial share interest) but a negative net economic position, is trying to block a legal merger or takeover that would be in the interest of the company and its shareholders in the long term. In this case, the incentives of the 'empty voter' are not

² E. Boehmer, C.M. Jones and X. Zhang, "Shackling Short Sellers: The 2008 Shorting Ban", Working Paper, November 18, 2008, available at: <http://www2.gsb.columbia.edu/faculty/cjones/ShortingBan.pdf>.

³ Financial Services Authority, "Temporary short selling measures", Consultation Paper 09/01, January 2009.

aligned with the incentives of other shareholders and will send out distorted price signals. This situation of 'potential empty voting' should, however, be addressed by more disclosure (making short positions public) and not by banning short-selling. Moreover disclosure will help continue to minimise the potential for market abuse and disorderly markets. It will throw light on the individual funds/participants driving the trading. Disclosure of short positions should be enforced by the Transparency Directive. Eumedion would welcome a common approach on this issue in the European Union. CESR could play a coordinating role to reach consensus on this.

If you would like to discuss our views in further detail, please do not hesitate to contact us.

Yours sincerely,



Rients Abma

Executive director