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Response

Proposal for a Pan-European Short Selling Disclosure regime (CESR 09/51)

I. Introduction

The Federation of European Securities Exchanges (FESE) represents the Market Operators of 42 securities exchanges active in equities, bonds, and derivatives in the European Union (EU) and Iceland, Norway and Switzerland.

We welcome the work that CESR has carried out since September 2008 with regard to the measures adopted by its Members on short selling practices. Several EU securities regulators have adopted measures introducing stringent disclosure / reporting requirements by firms to supervisory authorities. We understand the rationale behind the measures taken by the authorities as extreme market conditions triggered extreme measures to seek restoring confidence in the markets. However, notwithstanding the laudable intentions, the restrictions imposed by several authorities in the EU have been both **discriminatory** and **ineffective**:

1) The restrictions on short-selling have been discriminatory because of their scope of instruments and venues. Firstly, in some jurisdictions the short-selling restrictions applied to certain cash equities only and did not cover other instruments that fulfil a similar function in the market (e.g. futures and options that allow investors to profit when the stock or the index declines). Secondly, the restrictions applied only to cash equities admitted to trading on a Regulated Market (RM) and not to privately-issued stocks. Thirdly, in some regimes, the restrictions did not cover trading happening outside of RMs - therefore, the banned stocks could be traded on private markets without limitations. The discriminatory nature of these measures was mainly due to the absence of an appropriate legislative framework that covers instruments traded in multiple execution venues under the supervision of different authorities across Europe. As a result, this situation provided unfair advantages to private OTC markets vis-à-vis RMs (and MTFs) whilst shifting the presumed risk to other venues and instruments not caught by the ban.

2) The restrictions on short-selling have not been effective in reducing share price volatility or limiting share price falls, but rather caused a decline in market efficiency for the affected stocks. A study[1] of London's Cass Business School which analysed the effects of the bans imposed in several jurisdictions (among which, in the EU, France, Germany, Italy, Sweden and the United Kingdom) and concluded that there is "*no strong evidence that the restrictions have been effective in reducing share price volatility or limiting share price falls*". Furthermore, the Capital Markets Cooperative Research Centre Limited study conducted in December 2008[2] (based on statistical analysis on the effect of the prohibition on market quality on the London Stock Exchange) found that the increase in spreads in the banned stocks was 150% greater than the increase in spreads in control stocks and that the deterioration in depth in banned stocks was 37% greater than the deterioration in depth in control stocks. In the banned stocks, trades and volume fell and turnover and liquidity also reduced. Evidence from other markets confirms these findings.

[1] "The Impact of Short Sales Restrictions" by Ian W. Marsh and Norman Niemer, 30 November 2008.

[2] "The Effect of Short-selling Restrictions on Liquidity: Evidence from the London Stock Exchange" by Capital Markets Cooperative Research Centre Limited, 19 December 2008.

II. Responses to CESR's Questions

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

The beneficial role of short-selling is widely recognised by authorities and the academic literature; its key benefits are beyond question: short-selling increases market liquidity, provides more efficient price discovery and facilitates hedging (and other risk management activities). Market players look to it as an important tool to keep the markets stable. Recently, several institutions (e.g. the IOSCO Technical Committee[3], the SEC[4] and the ECB[5]) acknowledged the positive role played by short-selling. CESR puts forward two proposals aimed at enhancing transparency. The first involves the flagging of short sales orders and the second a requirement to report individual significant short positions to the regulator and/pr the market.

With regard to the possibility of flagging short positions, we agree with CESR that it appears to be inherent imperfections in the data arising from the mechanics of aggregation. Questions about how much value such information adds to other data should also be carefully pondered. Significantly, flagging of short sales would not provide the Competent Authorities with information about short selling activity in OTC markets. This element would considerably add to the unreliability of the picture, given that, according to our latest figures, equity OTC trading is around 40% of European trading.

Concerning the possibility of requiring the reporting of significant short positions, proportionate measures that address the policy concerns should be well justified and applied in a non-discriminatory way to all venues and instruments concerned. In the EU, to avoid disruptions to the Single Market, the same principles must apply in all jurisdictions and regulators must act in close coordination. Private reporting to the Regulator would also represent a valuable tool to gain information on market tensions and would be useful for market manipulation analysis. However, it involves increased implementation costs. There are also concerns with ensuring the completeness and correctness of the reported information.

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

Yes.

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

Yes (with the preliminary considerations outlined in Q1 in mind).

[3] http://www.fsa.go.jp/inter/ios/20081113/04.pdf

[4] http://www.sec.gov/news/press/2008/2008-235.htm

[5] http://www.ecb.int/pub/pdf/other/ecconsultationhedgefundseurosystemen.pdf

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

We agree with CESR that any pan-European disclosure model should apply to positions held in issuers traded on RMs and MTFs. However, a disclosure regime that does not apply to positions held in issuers traded OTC would be imperfect and misleading.

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)?

We would not oppose proposals to mandate private disclosure to the Regulators as a regulatory measure in general, but we would not support public disclosure. On the one hand, Competent Authorities would benefit from disclosure of short positions above a certain threshold and would then dispose of an additional tool to detect potential disruptions to the market.

On the other hand, we would discourage CESR to propose public disclosure of short positions. Public disclosure of significant short positions would inevitably encourage some market participants to use this information for investment strategy purposes. Many investors will seek to take advantage of this information by then short sell given financial instruments - such behaviour would not support price efficiency. We can imagine that an Issuer would notice price decrease in its stocks as a consequence of public disclosure of large short position in its stocks (position which may for instance derive from normal hedging activity).

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?

As we stated in Q5, FESE would not oppose proposals concerning private disclosure to regulators as a regulatory measure in general, but we would not support public disclosure. The possible threshold for private disclosure should be determined by the given market based on existing liquidity.

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 we mentioned in Q6, in our opinion there shouldn't be uniform pan-European private disclosure thresholds.

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 would not support public disclosure.

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

No comments.

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?

No comments.

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 calculation on short positions should be done on net basis taking into account transactions in all financial instruments (like stock futures or options). However, given the complexity of such calculations and the risk that the system to calculate it may end up being very expensive, a feasibility study would be necessary.

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

Yes. We agree with CESR's proposals re private disclosure to regulators and with the request that all Competent Authorities effectively co-operate to exchange relevant information.

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).

No.

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

We agree that private disclosure of relevant positions could be disclosed to the regulator on a T+1 basis.

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?

As a matter of principle we can understand the argument in favour of a possible exemption for market makers. However, we note that if market maker positions were never reported, anyone could trade any instrument (future, swap, repo, contracts for difference, etc.) against the market maker instead of in the market (thus deteriorating transparency). Moreover, it would create unintended incentives for OTC trading vis-à-vis exchange trading in equities. Therefore, we suggest that market makers are required to report their positions to the regulator; a narrow definition of a market maker (e.g. including only market makers that are contracted by the Regulated Market defined as the main market of the share) would help.

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

No.

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 agree with the proposal that securities regulators should be given explicit powers to require disclosure, and that these powers should stem from European legislation.