



The Committee of European Securities Regulators
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FRANCE

Comments on CESR Proposal for a Pan-European Short Selling Disclosure Regime

The Nordic Securities Association would hereby like to offer our comments on CESR's consultation paper dated 8 July 2009.

General comments to CESR's proposal

It is our opinion, as rightly stated in the CESR consultation paper that short selling has several positive consequences and contributes to a more efficient market. Through short selling market participants can hedge their risks and more easily correct the price of overvalued stocks. This provides added liquidity to the market, which in turn lowers the transaction cost by reducing the bid offer spread.

The association does however acknowledge that short selling also can be used in an abusive manner where it is employed in conjunction with rumors in the market or at a very large scale with the goal of manipulating the price of a stock.

At CESR's open hearing in Paris on 9 October it was mentioned that the purpose of the proposed Pan-European short selling disclosure regime described in a metaphor is to slow down the short selling train, thereby reducing the risk of short selling being used in an abuse manner. The fact that CESR in the consultation paper has chosen to base its proposal on this reasoning is in our view unfortunate, since short selling is not a trade type that the authorities should try to reduce.

Any upcoming regulation on short selling should focus on eliminating potential market abuse. Proposals carrying this objective could naturally have consequences for short selling in general and should then only be proposed and introduced when the benefits towards eliminating market abuse more than offset the negative effects on short selling as a trade type. This approach differs from the one chosen by CESR. In this light, it would have been positive if CESR – based on the premise of eliminating market abuse by short selling instead of trying to reduce the extent of short selling – in this consultation paper had considered and discussed alternatives to a disclosure regime. That being said the Nordic Securities Association do consider enhanced transparency to be one viable method of eliminating the situations where short selling is used in an abusive manner; however there might be better alternatives.

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Finally it is worth noting that a short selling disclosure regime, as proposed by CESR, would entail significant compliance costs for market participants and would de facto increase the costs of securities trading. It is difficult to assess how the costs would be divided between one-off and ongoing costs since market participants might choose different approaches. Nevertheless, it is certain to say that low thresholds and requirements of individual public disclosure will increase compliance costs significantly – especially the ongoing costs. We therefore encourage CESR to undertake a more thorough cost benefit analysis where extra costs and added benefits of each part of the regime are evaluated independently. We firmly believe that such an exercise would show that some of the initiatives proposed by CESR would not be beneficial.

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With this in mind we present our comments to the content of the consultation paper.

Specific comments to CESR's proposal

The Nordic Securities Association does agree that any new short selling regulation to the widest extent possible should be harmonized internationally and in the EEA especially. Furthermore, short selling regulation should apply to all market participants in the same manner, so not to distort the level playing field and provide certain participants with a competitive advantage. To achieve this type of harmonization it is crucial that any obligations imposed will be enforceable in practice on all participants and investors regardless from where they are operating. Before implementing any disclosure regime, CESR should therefore consider how compliance is ensured.

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

As stated above, enhanced transparency can be a viable way to eliminate situations where short selling is used in an abusive manner. There are, however, certain disadvantages to the market participants who either directly or indirectly will have to provide information for this enhanced transparency and this will raise the costs of securities trading.

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

Yes. When looking at how complicated it would be to introduce flagging of short sales and the degree of added transparency this will provide to the market compared to the short position reporting, we believe the latter is the better of the two alternatives proposed by CESR.

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

CESR assumes correctly that a short position disclosure regime will enhance transparency far better than flagging, but thereby not said that in order to prevent abusive short selling transparency is the best solution.

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)?

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We have no reason to question CESR's analysis that regulators would benefit from private disclosure. However, should further disclosure be warranted, we would not support the public disclosure concept such as it is defined in the two tier disclosure model.

The purpose of providing the market with enhanced transparency on short positions must be to eliminate price manipulation through short selling. Enhanced transparency will enable the market to use information about short selling when pricing shares. The market will thereby be able to take into consideration the scale of the short positions and the likelihood that the price will rise when these short positions will be closed out. This will most likely reduce the possibilities of using short selling to drive down the price significantly, since investors and funds will utilize the enhanced transparency when defining their stop loss policies, so as not to sell out of a single stock if within reason the recent price fall can be attributed to an increase in the short positions in that stock. In order to accomplish this, the market only needs to know the aggregate of short positions in the individual stocks. As a result, public disclosure should be limited to publication of the aggregated short positions which the regulators would be able to compile based on the information received from the private disclosures.

Publication of non-anonymous short positions – either in addition to publication of the aggregated short positions or instead of – could have significant harmful effects on short selling and the markets in general without providing any additional upside that could not have been achieved by disclosure of the aggregated short positions. Besides the concerns described by CESR in the consultation paper about the short squeezes and herding behavior, it should also be mentioned that – especially with the low thresholds proposed by CESR – a short position requiring disclosure could be established e.g. as a result of hedging and not an intentional valuation of the share as being overpriced. However, public disclosure would not provide this detailed information to the market but only inform the market that the investor or fund has increased its short position in the share. Public disclosure as proposed by CESR therefore entails a risk of the market reacting on information in a way that increases market volatility.

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?

There might be different sensitiveness regarding disclosure of short selling for different markets. Smaller markets and more illiquid financial instru-

ments (shares) could be more sensitive to disclosures than others as well as smaller companies, companies with smaller turnover and less fragmented ownership of the share capital. We therefore propose that CESR take the initiative and investigate whether there should be different thresholds for different markets, along with differences in size of companies and turnover.

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As part of the study it would be beneficial if CESR examine whether or not the burden of higher costs related to differentiated thresholds to some extent could be mitigated if the higher thresholds were a multiple of a common denominator that coincides with the thresholds applied in the large most liquid European markets, with the largest companies and the highest turnover. This kind of interaction will allow market participants active in different markets provided that the markets participants have the option to disclose at lower thresholds, to set up a system disclosing short positions whenever the common denominator threshold is reached.

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

The disclosure thresholds proposed by CESR is considerably lower than envisioned by the Nordic Securities Association. 0.1% of the share capital in some of the smaller companies e.g. listed on the Nordic markets would very easily be reached and as a result the disclosures could cause in a lot of noise in the market.

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?

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

As pointed out by CESR market making plays an important role through providing liquidity to the market and as such market-making should be exempt from both the private and any public disclosure obligation to ensure that these activities is not unduly restricted.

Should the above comments or specific answers require further elaboration, the association will be at CESR's disposal and you should feel free to contact Mick Thimm Sayed.

Yours sincerely

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