



30 September 2009

CESR
11 – 13 Avenue de Friedland
75008 Paris
France

Dear Sirs,

Re: CESR Proposal for a Pan-European Short Selling Disclosure Regime

This is a joint response to CESR/09-581: CESR Proposal for a Pan-European Short Selling Disclosure Regime which is being sent on behalf of the London Investment Banking Association (LIBA), the Securities Industry and Financial Markets Association (SIFMA), the International Swaps and Derivatives Association (ISDA) and the International Securities Lending Association (ISLA). Details of our organisations are attached.

While we do not consider that a strong case has been made to justify the imposition of a permanent disclosure regime for short positions, we welcome the initiative which CESR is taking to harmonise rules in relation to short selling. We also particularly welcome CESR's recognition that short selling plays an important role in financial markets and is not abusive per se. Any regulatory framework should therefore adhere to the principle of proportionality and in this respect we agree with CESR that the objective of the framework must be to retain the benefits of short selling whilst reducing its perceived potential negative effects.

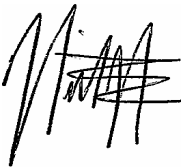
To fully realise the benefits of regulatory convergence, we consider that, if any disclosure regime for short positions is adopted, it should be proportionate and Pan-European, requiring maximum harmonization. In this context we also agree with CESR that flagging short sale transactions would be extremely costly and impractical. We agree that market-makers should be exempted from any disclosure regime; and we would urge that a similar exemption should be established for underwriters and sub-underwriters only to the extent of their bona fide hedging activities (i.e. not beyond their agreed participation in an issue). We also urge that sales by parties who recall their lent shares for settlement purposes should not be considered short sales as is the case in some member states.

We do have serious concerns about the proposals which are included in our attached answers to the specific questions posed in the CP. Our main concerns with the proposals may be summarized as follows:

- Since there is no established case that there is a substantial market failure resulting from the practice of short selling, the proposals constitute a very substantial deviation from the principle of proportionality. This is evident in the expansive scope of the proposed regime from financial shares to all EEA-traded equities and the very low starting disclosure threshold (0.1%). Hence, we do not believe that a strong case has been made in favour of a permanent short selling disclosure regime.
- The proposals would very substantially increase the costs/complexity of short sale disclosure which would entail material systems changes which our members estimate would require up to 24 months to effect, given the overly committed systems budgets of many financial institutions. The cost-benefit analysis should be re-visited.
- The CP suggests that some EU regulators may view aggressive short selling as abusive per se or as otherwise undesirable, even if it is solely based on a bearish view of an issue, its sector, or the market. It has emerged at the CESR public hearing that one reason for the proposed disclosure of short positions by individual investors is to discourage short selling per se i.e. to act as a break on short selling by exposing the investors to public view and its accompanying social and commercial risks. In our view this would be unfair to the investors concerned and harmful to the market. We would respectfully suggest that - if CESR wishes to curtail short selling per se - it must clarify its rationale and in what circumstances short selling causes problems. We note also that a fairer breaking mechanism could be achieved by regulators contacting the disclosing entity directly without the need for public disclosure at investor level.
- If CESR decides to move ahead with a disclosure regime, we strongly urge, given the tenuous case for doing so, that its requirements strike a balance between providing regulators with transparency into material short positions whilst at the same time keeping costs and disruptions to the market as low as possible. Private disclosure thresholds should be set at meaningful (and not de-minimus) levels, the regime should be Pan European and harmonized, there should be no separate public disclosures (which, if pursued, should be aggregated and anonymous), and firms should be given time in which to implement necessary systems changes.

Thank you for your consideration of our joint submission. Please note that we are very willing to engage with CESR on the issues raised by the consultation, if that would be helpful.

Yours faithfully



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Director
LIBA



Christian Krohn
Director – Regulatory
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CESR PROPOSAL FOR A PAN-EUROPEAN SHORT SELLING DISCLOSURE REGIME

Questions and Answers

Q1 Do you agree that enhanced transparency of short selling should be pursued? (Page 6)

Answer: No. We do not consider that the proposed enhanced transparency of short selling is supported by market failure or cost benefit analysis. There has not been a definitive analysis showing that there is a material market failure which requires a permanent and comprehensive disclosure regime for short selling. The temporary restrictions imposed in relation to short selling in a number of CESR Member States were implemented in response to specific and unique circumstances resulting from extreme market conditions. In some jurisdictions the temporary measures were introduced as market abuse identification/prevention measures, and it should be noted that no major incidents of market abuse have been discovered or publicised. Unfortunately, some of the rhetoric around the temporary measures vilified short sellers as a group and tended to generate suspicion that short selling is some form of market abuse or unsavoury predatory practice which should be stamped out. This has been partially alleviated by the positions publicly taken by CESR, IOSCO and certain regulators including the FSA which underscore the positive contribution of short selling to the functioning of a market e.g. efficient price formation and the provision of liquidity. However, there remains in some regulatory quarters a deep suspicion of short selling which is not supported by empirical analysis and which should not be the basis of a permanent and costly disclosure regime for short selling. We therefore urge CESR to articulate more clearly the negative consequences of short selling which it is seeking to mitigate and the basis for its assumptions so that proportionality of the proposed regime can be demonstrated.

In particular, we ask CESR to clarify its assertion that public disclosure would provide “*a measure of deterrence to aggressive short sellers beyond what would be gained from a requirement to disclose to the regulator alone.*” It is unclear to us what is meant by “*aggressive*” short selling. If CESR considers that taking or building a large short position is too aggressive, then it should clearly state its position such that stakeholders can debate the issue. We do not consider that legitimate large short positions should be seen as a precursor to disorderly markets. It is also unclear to us why private disclosure to the regulator is not deemed to be a sufficient measure of deterrence. We are concerned that public disclosure of individual positions is being used as a ‘naming and shaming’ tool given the unjustified perception associated with the practice of short selling.

We would also urge CESR to give sufficient regard in its deliberations to the potential adverse consequences of imposing a permanent disclosure.. The UK FSA has articulated some of these consequences in its Discussion Paper on Short Selling dated February 2009. In particular, we note the following areas of concern:

Liquidity: short selling contributes to and enhances liquidity by increasing the number of sellers in the market. Short sellers do also need to buy back the shares sold at a later point thus also serving as a stimulus for demand. This contributes to a reduction in transaction costs through the narrowing of the bid-offer spreads (thus making trading cheaper) which is of benefit to all market users.

Distortion: public disclosure of short positions, far from deterring market abuse, may actually encourage it by exposing holders of legitimate short positions to the potential for abusive squeezes.

Herding: the risk of herding is more acute in a disclosure regime which identifies the holder of the position. The short position taken by a 'household' investor may well encourage further short-selling and thus lead to a potential over-reaction in the downward price movement.

Price formation: CESR should note that short selling can be good for retail investors in that they may avoid investing at artificially high prices. Short selling is a practice that benefits the markets as a whole and not just those who legitimately engage in its practice.

Q2 Do you agree with CESR's analysis of the pros and cons of flagging short sales versus short position reporting? (Page 6)

Answer: We strongly agree that the "flagging of short sales" would be operationally very difficult and materially expensive for brokers and trading platforms which, if implemented, would raise costs for all investors. It would be a most intrusive form of regulation also, since it would require investors to disclose their trading strategy at the outset of its implementation to third parties and the regulations.

Q3 Do you agree that, on balance, transparency is better achieved through a short position disclosure regime rather than through a 'flagging' requirement? (Page 7)

Answer: We strongly agree that it would be preferable to avoid the costs, complexity, and intrusion of a flagging regime. A short position disclosure regime would be preferable to a flagging regime for these reasons. It is essential to adhere to standards of proportionality in proposing and establishing new regulatory requirements.

Q4 Do you have any comments on CESR's proposals as regards the scope of the disclosure regime? (Page 8)

Answer: Given that there is no definitive analysis showing that short selling requires a permanent disclosure regime (as opposed to a focused temporary regime during extreme market turmoil), we do not believe that the proposed regime should extend to all EEA equities and to those non-EEA equities which are traded primarily on EEA exchanges. Most temporary regimes applied only to shares of financial institutions which - in times of extreme market turmoil - were finding it difficult to raise capital through rights issues or other traditional means. This constituted a systematic risk of financial instability. This

extreme market turmoil posing a compelling systematic risk is not now present. Since to date there has been no showing that market abuse occurred on any scale and there has been no showing that price volatility would be decreased or prices maintained by a disclosure regime, there is an insufficient demonstrable basis to justify a permanent disclosure regime for shares of financial institutions or the extension of such a regime beyond financial institutions.

If a disclosure regime is nevertheless introduced, we urge CESR to ensure that it is truly pan European (including EEA states) with no variations in disclosure requirements by any Member State. This is not absolutely clear in the CP which indicates that Member States will be free to implement other measures in relation to short selling and that CESR is still considering other measures (undefined). Given the costs and complexity of any permanent disclosure regime, we support maximum harmonisation of any proportionate disclosure 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)? (Page 9)

Answer: No. We do not support the two tier disclosure regime. In our view there is no need for a public disclosure regime for individual investors. Such a regime would put unfair and unnecessary financial risks on short sellers by publicly identifying them. In addition to being an unfair commercial burden on short sellers, it will likely impair a fair market. There is the likelihood that public disclosure of significant short positions would tend to increase volatility on the downside through herding. We urge CESR to seriously consider a public disclosure regime that does not identify the holders of a short position. If a disclosure regime is adopted, we believe the model should be based on private disclosures to the regulator and public disclosure of anonymized data such that individual holders of short positions are not identified. We believe such a model is more proportionate and strikes a better balance, ensuring that information asymmetries are addressed but at the same time protecting liquidity of the market as whole and mitigating the potential consequences of ‘herding’.

As noted in our response to Q.1, the stated intent to use public reporting by individual investors to deter “aggressive short selling” in paragraph 30 requires further explanation. If CESR is taking the view that aggressive short selling is market abuse per se, that would be a very material extension of what has been understood hitherto. Currently, short selling would be considered market abuse only if it were coupled with some sort of false rumour strategy or other manipulative strategy to drive down price in order to allow the position to be covered at a lower price. Hitherto, aggressive short selling which is based on a bearish view of a share would not be considered abusive but would currently be considered legitimate trading which would assist price formation.

Since one stated purpose is to artificially limit market volatility on the downside through public reporting by investors, questions concerning whether that is appropriate in the absence of market abuse arise as does the question whether there should also be checks on aggressive buying. CESR should clarify the basis of considering short selling to be market abuse where it is not coupled with some other manipulative act.

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? (Page 10)

Answer: We agree that any disclosure regime including the applicable threshold(s) should be uniform and applicable in all EEA jurisdictions. Otherwise, the benefits of regulatory convergence and harmonization would be lost and cost factors will be materially enlarged. For the reasons noted in our response to Q.5, we believe that the current proposal for the thresholds is not proportionate.

Q7 Do you agree with the thresholds for public and private disclosure proposed by CESR? If not, what alternatives would you suggest and why? (Page 11)

Answer: We do not agree with the proposed thresholds for private and public disclosures.

Disclosure at the proposed 0.1% level will be disclosure of a de minimus position and is too intrusive. It would be disproportionate. We are concerned that this proposal reflects the more fundamental issue that short selling is viewed with ambivalence and suspicion, such that micro notification is required despite CESR's acknowledgement that short selling has an important role in financial markets. There is no equivalent requirement to disclose similar long positions.

The 0.1% threshold may well result in a flurry of disclosure with limited value for regulators. One firm has estimated that --if disclosure of positions at 0.1% instead of 0.25% had been required under the temporary regime for financial shares—the number of disclosures would have risen by as much as 300%.(i.e.tripled). Most importantly, this threshold will substantially increase the costs and complexity of the regime, since it will apply to a universe of all EEA equities plus others primarily traded in EEA regulated markets and MTFs.

We consider that the discussion of costs in the CP greatly underestimates the real picture. It is true that a harmonised EEA disclosure regime will *ceteris paribus* lead to lower costs than a non-harmonised regime, but CESR should note that the systems and controls in place to monitor compliance with current restrictions (implemented as emergency measures with little or no consultation) include manual adjustments. These restrictions currently only cover a limited number of securities. By increasing the scope to all EEA equities and markets including MTFs and by reducing the threshold to 0.1%, the scale of disclosure has been greatly increased which will require significant systems development

and personnel increases. Thus, the proposal regime is not proportionate especially since no substantial market failure has been demonstrated in the absence of extreme volatility.

If CESR is minded to pursue the proposed model, then a more proportionate threshold for public disclosure would be higher in order to minimize the adverse consequences on the practice of short selling referred to in our response to Q1. We would suggest a threshold of 1%. A more proportionate threshold for private disclosures would be 0.5%.

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? (Page 12)

Answer: We do not believe that public disclosure by individual investors is appropriate generally or in the specific case of rights issues. Also introducing a different set of thresholds for issuers undergoing rights issues would introduce further monitoring complications. Other measures may be taken (e.g. the FSA has reduced the minimum subscription period for rights issues from 21 days to 14 days) to reduce the mandatory time window for rights issues which in normal markets should suffice to reduce market risk for the issuer.

Q9 If so, do you agree that the trigger threshold for public disclosures in such circumstances should be 0.25%? (Page 12)

Answer: We consider that no case has been made to justify a requirement of public disclosure by investors and that such disclosure would be unfair and harmful to markets. For the reasons explained in our responses to Q1, Q5 and Q7, we urge CESR to consider a public disclosure regime that does not identify the holder of the position. : If any public disclosure regime is nevertheless implemented, a single threshold at 1.0% would be more than adequate with incremental disclosure at each change of 0.5% up or down.

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? (Page 12)

Answer: We do not perceive a need for more stringent disclosure standards for short selling in any other context.

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? (Page 12)

Answer: We agree with the CESR proposal that short positions should be disclosed on a net basis. However, we urge for more detailed consultation on the methodology for calculating the net short position and request that such methodology is applied consistently and on a harmonised basis across member states. Consideration should be given to how the calculation methodology interacts with the existing transparency

directive “large holding” disclosure regime. CESR should be mindful that, if public disclosure of short positions are made and the methodology for short and long disclosures differs, firms may end up making conflicting long and short public disclosures in the same securities. This would be confusing to the market and not in the interests of providing enhanced market transparency.

Specific consideration should be given as to how the short disclosure rules would apply to fund management companies and the funds they manage and also to Prime Brokerage arrangements where Prime Brokerage firms hold client assets or take title to client assets under re-hypothecation arrangements in their own names.

In our view it would be advisable for regulators to have the power to agree individual disclosure requirements for companies as is appropriate in the circumstances (e.g. on group level or legal entity level).

Q12 Do you have any comments on CESR’s proposals for the mechanics of the private and public disclosure? (Page 13)

Answer: Given the absence of a substantial market failure outside of extreme crisis periods, we would suggest that private disclosure be required only to the regulator at a 0.5% threshold and at 0.5% increments up and down. For the reasons explained in our responses to Q1 and Q5, there is no reason to require individual short position disclosures to be made publicly because the unintended consequences and costs of such disclosures would not be offset by any tangible advantages and would put an unfair burden on disclosing investors who would be exposed to other market players. A cumulative disclosure of an aggregate market short position by the regulator would be an advantage to the market in a way which would not be achieved by individual disclosures.

It would be necessary to define specifically the term “most relevant market in terms of liquidity”. We propose that regulators on an ongoing basis should agree among themselves which is the most relevant market for each issue which is traded on more than one venue and take steps to make this information readily available for the benefit of market participants. The regulators’ decision could also be published by the trading venue which is agreed to be the most relevant market.

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). (Page 13)

Answer: Our view is that the proposed level of detail of disclosure would be adequate and that more detail would generate unnecessary cost and complexity. We propose that the content and format of required disclosures should be uniform throughout the EEA. It would be counter-productive to set minimum standards for the content of disclosures given the stated goal of establishing a Pan European disclosure regime with maximum harmonisation.

Q14 Do you have any comments on CESR's proposals concerning the timeframe for disclosures? (Page 14)

Answer: We strongly agree with CESR that real-time disclosure is unrealistic and probably impossible. However, we believe that the proposed scope and triggers for disclosure will require a later deadline for reporting, at least until COB on T+ 2. To the extent that the scope and triggers are moderated, it would be realistic to require disclosure by COB on T+1.

Investors have never been given notice of short positions on the proposed timetable, and they will not be significantly disadvantaged by a later disclosure time even if the regulator takes an additional day to aggregate individual disclosures.

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? (Page 14)

Answer: Yes, we strongly agree that market makers should be exempt from the proposed disclosure regime for short sales.

Regulators and commentators have recognized the substantial benefits to the market and to investors which result from market-making activities. Market-makers incur substantial costs and operational and market risks in carrying out these activities, and regulators have understood the need to provide a suitably flexible regulatory framework for these activities.

For example, the SEC has recognized these benefits, and has established exceptions from various short sale regulations for short sales effected by underwriters in connection with offerings. This includes exceptions from 'uptick' rules (both previous and proposed modifications thereto) and an exception for syndicate short positions from the requirement for a person to "borrow or arrange to borrow" prior to effecting short sales, as well as from the "close-out" requirement for fails to deliver occurring in connection with syndicate short positions.

Q16 If so, should they be exempt from disclosure to the regulator? (Page 14)

Answer: Yes, market makers should be exempt. Market makers are subject to supervision by the regulator in any case. The regulator will be able to demand such information as it may deem necessary from a market maker based on its surveillance of the markets or other sources of information. There is no apparent need to create a complex and costly disclosure regime on a permanent basis for market makers or for regulated underwriters and sub-underwriters.

Q17 Should CESR consider any other exemptions? (Page 14)

Answer: Yes – for bona fide hedging by underwriters /sub underwriters.

We note that one of the four principles discussed in the IOSCO Report is that short selling regulation should allow appropriate exceptions for certain types of transactions to ensure “efficient market functioning and development”. It suggests that hedging as well as market making and arbitraging are activities which should be exempted from regulations. Thus, hedging activities of underwriters and sub-underwriters should be exempted to ensure efficient capital raising through the issuance of securities. Requiring public disclosure of hedging activities by underwriters/sub-underwriters will unnecessarily constrain the availability of capital for this purpose by making it riskier for the underwriters and sub-underwriters.

Our view is that the underwriting process must be flexible enough to permit issuers and their advisors to shape an offering in the way most likely to attract strong underwriting support which may be difficult in some liquidity/credit environments such as the current environment. Any measures which may be perceived as increasing risk for underwriters or sub-underwriters could affect the viability of the capital raising process. At this time especially, issuers must be in a position to assess the best way forward with their advisors, taking into account their duties to shareholders.

Moreover, in terms of economic interests, an underwriter should be considered as “flat” with no long or short exposure when hedged. A sale of shares to hedge an underwriters/sub-underwriters’ commitment is not a “short” sale because it is offset by the underwriter’s/sub-underwriter’s long exposure. On this basis our members’ view is that underwriters/sub-underwriters should not be required to publicly disclose sales of securities up to a quantity not exceeding their underwriting commitments. Sales in excess of their underwriting commitments would not be in this category.

For similar reason, we consider that sales by parties who recall shares which they have previously lent should not be considered short sales as is currently the case in some Member States. Clearly, such parties are not short in terms of economic interests and the borrowers may be obliged to return the shares in time for settlement. The situation is analogous to an investor who is waiting to receive shares he has purchased yesterday to settle a sale of those shares a few days later.

We also would seek clarification that a recall of loaned shares should not be required prior to executing a sale. Recall within a reasonable time frame to meet settlement obligations would be an appropriate standard.

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? (Page 14)

Answer:

Regulators should have the necessary power to monitor the markets and to take necessary action in times of extreme volatility or other emergent situations to maintain a fair and orderly market. Such power should be exercisable only in times of crisis or emergency,

and there should be objectively stated criteria for use by the regulator in determining when such a situation exists. Such a power would include the authority to impose temporary regulation for any trading activities including short selling during the crisis or emergency.

In our view, a comprehensive EU regulation would best serve to establish a regime with maximum harmonization. The regulation should encompass the entire short selling regime as opposed to a piecemeal approach e.g. a series of legislative changes following any disclosure regime.

As we have already explained, we believe any pan-European disclosure regime should be subject to maximum harmonization such that the market as a whole can benefit from regulatory convergence. An EU regulation would be most appropriate although a properly considered and well drafted maximum harmonization directive should be able meet this objective. The regulation should encompass the entire short selling regime as opposed to a piecemeal approach e.g. a series of legislative changes following any disclosure regime.

We do not believe a pan European disclosure regime should be implemented by amendments to the Transparency Directive or Market Abuse Directive. In particular, we do not believe a short selling disclosure regime should be identified closely with market abuse as has been the practice in some jurisdictions. Whilst we do not object to enforcement sanctions being imposed for failing to disclose a net short position, such failure should not on its own be considered or classified as market abuse

About our associations:

LIBA is the principal trade association in the United Kingdom for firms which are active in the investment banking and securities industry. The Association represents its members on both domestic and international aspects of this business, and promotes their views to the authorities in the United Kingdom, the European Union, and elsewhere. More information LIBA is available at www.liba.org.uk

SIFMA brings together the shared interests of more than 650 securities firms, banks, investors, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in London, New York, Washington DC, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. More information about SIFMA is available at www.sifma.org.

ISDA, which represents participants in the privately negotiated derivatives industry, is among the world's largest global financial trade associations as measured by number of member firms. ISDA was chartered in 1985, and today has over 800 member institutions from 56 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. Information about ISDA and its activities is available on the Association's web site: www.isda.org

ISLA represents the common interests of nearly one hundred borrowers and lenders of securities in Europe, Asia and the Middle East. While based in London, it has members in more than twenty countries. More information is available at www.isla.co.uk.