



October 1, 2009

Via email

Mr. Kurt Pribil
Chair CESR-Pol
Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris, France

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

Dear Mr. Pribil:

The Managed Funds Association (“MFA”) welcomes the opportunity to provide comments to the Committee of European Securities Regulators (“CESR”) in response to its Consultation Paper, CESR Proposal for a Pan-European Short Selling Disclosure Regime (the “Consultation Paper”).

MFA is the voice of the global alternative investment industry. Its members are professional alternative investment managers, including managers of hedge funds, funds of funds, hybrid funds (such as 130/30 funds) and managed futures funds, as well as industry service providers. Established in 1991, MFA is a key source of information for policy makers and the media about the alternative investment industry and a leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately \$1.5 trillion invested in absolute return strategies. MFA members use a broad variety of different investment strategies and techniques, including short selling. Many MFA members actively trade in European markets and have considerable personnel and resources located in Europe. MFA is headquartered in Washington, D.C., with an office in New York.

EXECUTIVE SUMMARY

MFA and its members share CESR’s concerns about the crisis in the global financial markets and strongly support efforts to prevent, detect and punish manipulative conduct. In the aftermath of this volatile period, it is important that policy makers adopt measured responses that will enhance market confidence and lead to greater market stability. We strongly believe market confidence and stability are best promoted by regulatory measures that are based on rigorous economic analysis that demonstrates the benefits to the markets and fully takes into

account the risk of adverse behavioural changes. Therefore, we strongly urge CESR members to make public their own analyses of the impact of the measures introduced last year requiring public disclosure of short positions in financial stocks.

As described below, while we support the goal of increasing the level of information on short selling available to regulators on a confidential basis, we are concerned that the public disclosure of short positions could increase market volatility, restrict price discovery and preclude investors from performing critical risk management functions. In particular, we consider that a requirement for individual investors to publicly disclose their short positions would have a significant adverse effect. Additionally, the general consensus is that last year's unusual volatility with respect to financial stocks was due primarily to investors with net long positions selling off their long positions to reduce their exposure, out of concern about the increasingly negative financial news regarding the financial services sector.

We suggest modifications to the disclosure proposals that would provide CESR members with more useful short sale information while mitigating undue burdens to individual investors. Specifically, we recommend, among other things:

- Any proposed rules should require that reporting to a CESR member be non-public and fully protect the confidentiality of the information. Public disclosure of information would result in adverse consequences to investors, issuers and other market participants.
- Any proposed rules should be based on a de minimis reporting threshold for private reporting to regulators of at least 0.5%. Short positions below 0.5% are not significant and investors should not have to report that information. Moreover, limiting disclosure to more significant positions permits a regulator to more accurately assess risks rather than being inundated with data.
- If there is evidence available to CESR showing that public disclosure is necessary and beneficial, any proposed rules should only require regulators to make available to the public aggregated anonymised data on short selling using the information privately reported to them. However, if the cost of producing aggregated anonymised data is too high, CESR should consider recommending that regulators publicly disclose anonymised versions of individual private reports of short positions, but at a higher threshold (such as 2%). Such anonymised disclosure would mitigate some of the risks associated with disclosures that identify individual investors, although many of those risks would still remain.
- Any proposed rules should harmonise the timeframe for reporting with reporting timeframes required under the Transparency Directive to reduce reporting costs and

technological burdens imposed on investors and to concentrate reporting to statistically more meaningful data.

- Any proposed rules should require that reporting of short positions in companies undertaking rights issues be consistent with other short position reporting requirements.

INTRODUCTION

The negative impacts of short selling bans on global equity markets has been well documented and supported by a range of parties including market participants and academics. For example, bans on selling short financial stocks in the US and UK last fall had materially negative impacts on liquidity and bid-ask spreads while failing to have meaningfully positive impacts on price declines and volatility.

The available data also indicates that requirements for public disclosure have also had materially negative impacts. For example, in the period after short selling bans the US regulatory regime did not include a provision for public disclosure of short interest in financial stocks while the UK regime did include such a provision. In this same period, the metrics of market efficiency and stability in the US performed significantly better than they did in the UK. Liquidity in affected stocks was better in the US and bid-ask spreads were significantly tighter. While there are other variables that would affect the relative performance of such metrics we believe that the less efficient and stable markets in the UK were to a large part as a result of diminished market participation by short sellers. While increased information flow is important for regulators to be able to ensure market stability any short selling disclosure regime should be designed such that it does not implicitly discourage participation in equity markets.

We attach some information which provides further background on these points.

RESPONSES TO CESR'S QUESTIONS

1. Do you agree that enhanced transparency of short selling should be pursued?
--

We support the goal of increasing the level of information on short selling available to regulators. However, we are concerned that a requirement for individual investors to publicly disclose their short positions could instead increase market volatility and preclude investors, such as MFA members, from performing critical risk management functions.

CESR should require private reporting of short positions to regulators on a confidential basis (we discuss in our response to question 5 below the possibility of regulators using information privately reported to them to provide public disclosure of anonymised data about short selling). Public disclosure of short position information that identifies individual investors and their short positions may be misinterpreted by other market participants,

increase market volatility and harm the trading strategies developed by investment managers and analysts to serve their investors. We encourage CESR to disclose any abusive short selling practices which it has identified that would be effectively addressed by public disclosure.

Public disclosure of short positions likely to be misinterpreted by investors. We believe public disclosure disadvantages those issuers whose stock is shorted and the investors who are long in that stock. Public disclosure of short positions is likely to be misinterpreted, as investors frequently short a stock for portfolio risk management purposes rather than because they have taken a negative view on a particular issuer. For example, an investor that is primarily long in stocks in a particular industry sector may consider that one issuer's stock is likely to outperform another and may express that view by going long the first and short the second stock. Under CESR's proposals, investors engaging in these strategies would not be able to net their long positions in one issuer's stock against their short sales in another stock. Therefore, the investing public could mistakenly interpret disclosure of the information on the short sale as an absolute negative view on that issuer's prospects. Misinterpretation of this information is likely to have a greater impact on those industry sectors which are vulnerable to negative public sentiment, in particular financial institutions.

Public disclosure leads to "herding" and increased volatility. Public disclosure of market participants' short positions may lead to an increase in shorting of stocks as other market participants seek to execute trades which follow firms' publicized short positions. This would increase market volatility. There are examples of situations in recent years where the behaviour of a high profile investor is likely to have influenced the activity of other market participants. This is a particular concern for MFA members, many of whom have well established market reputations.

Public disclosure has market effects that result in increased costs for all investors. All equity market participants would realize increased costs associated with trading equities under regulatory regimes that require public disclosure of short positions. Institutional and retail investors alike would also experience increased transaction costs (i.e. wider bid-ask spreads) and longer times to fill orders. Short selling is critical for price discovery, and market participants gain confidence when both positive and negative views are expressed in the market. In addition, short selling can impose a useful discipline on many issuers who do not provide the requisite transparency to investors regarding their financial condition.

Public disclosure may cause issuers to react adversely to short sellers. Public disclosure of short positions would also have harmful consequences to investors. A number of issuers have indicated that if they can identify which firms have been shorting their securities, they will cease or limit communications with analysts of those firms and exclude them from information sessions. Such a result would have a negative impact on capital markets by limiting the free flow of information essential for informed investments and effective price discovery. We are concerned that the public disclosure of detailed short positions would

have long lasting negative effects on European markets by having a chilling effect on the information and disclosure provided by issuers, as well as harming the relationship between investors and issuers. This is a particular concern for MFA members, who believe that it is necessary to have equal access to information from issuers to better serve their own investors by pursuing properly informed investment strategies.

Adverse publicity arising from public disclosure may avert investors from benefiting from alternative investment classes. In addition, a number of pension, endowment and foundation investors in the U.S. have indicated to our members that because of risks of adverse publicity resulting from public misunderstanding of the function of short selling, they would likely withdraw their investments from investment vehicles engaged in short selling if they were required to publicly disclose short positions. European investors with our members are likely to react in a similar manner. In the long-term, such investors would forego diversification and risk management benefits provided by alternative investment vehicles.

Adverse publicity associated with public disclosure may discourage use of hedging strategies. Public disclosure of short position information could have unintended consequences to hedging strategies of investors. Hedging strategies are a critical risk management tool of investors and enable them to make investments on the long side of the market. Short selling is an essential component of a wide range of bona fide hedging strategies by which investors provide liquidity to the financial markets. Because of concerns about adverse publicity, public disclosure of short positions may discourage investors from engaging in short sale transactions for hedging purposes, reducing investors' ability to manage risk, and decreasing market liquidity and capital formation. While these concerns would be reduced if an investor's net short position for a particular security remains below the disclosure threshold, investors, such as MFA members, frequently hedge risk through short sales of different issuers with highly correlated share prices (e.g., companies in the same industry sector).

With the reduced usage of hedging strategies there may also be unanticipated secondary effects. Certain investment strategies use short equity positions to hedge exposures in other products. Convertible arbitrage, for example, relies on short equity positions to hedge exposure in convertible bonds. Were alternative investment managers and other investors to lose the ability to hedge these risks there is a possibility that their appetite for products such as convertible bonds could diminish. As convertible bonds represent a cheaper source of funding than traditional bond issuance short selling disclosure could have real impacts on the financing ability of companies whose equity is subject to regulation. There are many MFA members that pursue these strategies and are significant investors in primary offerings of convertible securities.

Public disclosure exposes investors to risks of short squeezes. In addition, public disclosure of short positions may expose market participants to the risk of a short squeeze¹, which again may deter investors from engaging in short selling. As CESR notes, there has been no study which can confirm that these risks are not significant.

Public disclosure reduces incentives to develop trading strategies that use short selling. Public disclosure of information could permit other market participants to unfairly reverse engineer the trading strategies of an investor. Public disclosure would likely cause harm to the trading strategies of investment managers, and by direct implication the billions of dollars invested in those strategies by investors through vehicles such as pensions, endowments and foundations, as competitors will be able to use the publicly disclosed information not only to profit in the short term from the known positions, but also to reverse engineer the trading strategies themselves.

Policy grounds for public disclosure of long positions are fundamentally different. In addition, requirements for individual investors to publicly disclose their short positions need to be based on fundamentally different policy grounds than requirements on holders of long positions publicly to disclose their individual positions. Public disclosure of long equity positions is justified because investors and other stakeholders have a legitimate interest in knowing who controls the voting rights attached to shares and the size of their stakes. There is no corresponding need for investors or other stakeholders to know the identity of holders of short positions, as holders of short positions do not exercise any voting rights. Secondly, holders of long equity positions have a relatively lower degree of exposure to loss as a result of disclosure of their positions. Holders of short positions are exposed to unlimited loss in the event of stock prices increasing before they can unwind their position and are also exposed to potential squeezes as a result of public disclosure as it is clear that they will be required to unwind their position at some point.

Experience since the crisis provides insufficient evidence to support public disclosure. While CESR acknowledges that public disclosure could have adverse consequences of the kind outlined above, it takes comfort from the experience of CESR members who have operated public short position disclosure rules during the financial crisis, which suggests that those adverse consequences have not materialised in a significant way. However, those rules have only applied to a narrow range of financial stocks, for a relatively short period and in exceptional market conditions. It is difficult to extrapolate from this experience reliably to confirm the absence of likely adverse effects from extending the regime more broadly.

¹ A short squeeze occurs where the price of a security rises as a result of increased demand and limited supply, causing investors to purchase shares to close out their short positions, creating a further increase in demand for securities which are already in limited supply, triggering a further rise in price.

However, as stated above, the US regulatory regime did not provide for public disclosure of short interest in financial stocks, while the UK regime did include such a provision. Liquidity in the affected stocks was better over this period in the US, and bid-ask spreads were significantly tighter. We know that some MFA members have reduced their participation in the markets as a result of the introduction of public disclosure regimes for short selling.

Given the costs to investors and markets generally caused by public disclosure of short position information, we believe that CESR has not clearly demonstrated that public disclosure would provide any benefits to capital markets. It is important that CESR members disclose their market studies of the impact of short selling restrictions and disclosure requirements, in addition to disclosing the extent to which long sales rather than short sales contributed to the volatility in the financial services sector.

In the Consultation Paper, CESR asserts only two benefits from public disclosure: (i) improved pricing efficiency, and (ii) a potential constraint on aggressive large-scale short selling.²

Public disclosure is likely to reduce the efficiency of price discovery. Specifically, CESR explains in the Consultation Paper that public disclosure provides information about the identity of significant short sellers, and, if the information is interpreted correctly by the market, would provide insight into short sellers' price movement expectations and could improve pricing efficiency.³ We strongly believe that public disclosure would, in fact, have the opposite result and reduce pricing efficiency.

First, as noted above, we believe that in many cases, information on short positions is likely to be misinterpreted if publicly disclosed and may lead to "copycat" investor behaviour which itself exacerbates pricing volatility.

Secondly, as the Consultation Paper acknowledges, public disclosure of short positions will cause potential short sellers to either refrain from engaging in short sales entirely, or to reduce their short sale transactions to avoid triggering the public disclosure requirements. This reduction in short selling activity will adversely affect pricing efficiency. Academic studies on the effects of short selling, most notably those examining the effects of recent short selling prohibitions, strongly support the view that short selling contributes to pricing efficiency.⁴ If a public disclosure requirement causes investors to artificially reduce their

² Pages 6 and 15.

³ We are not aware of any analysis supporting this view. In its Discussion Paper DP09/1, the FSA explains that it did not find any "literature specifically assessing the effects of requirements to disclose individual short positions" on pricing efficiency. FSA Discussion Paper DP09/1, Annex 1.

⁴ See e.g., Boehmer, E., Jones, C. M., Zhang, X., Shackling Short Sellers: The 2008 Shorting Ban, 2008a, preliminary draft, www2.gsb.columbia.edu/faculty/cjones/ShortingBan.pdf; Bris, A., Goetzmann, W. N., Zhu,

level of short selling to remain below the disclosure threshold, as anticipated, the disclosure requirement would lead to diminished pricing efficiency in European markets.

We recommend that CESR and its members conduct and publish the results of research demonstrating that any current public disclosure requirements, such as those adopted in the U.K, have in fact resulted in improvements in pricing efficiency before assuming that such benefits exist.

CESR should identify how public disclosure will address its specific concerns with short selling. In the Consultation Paper, CESR suggests that public disclosure would provide a potential constraint on aggressive large-scale short selling. Given CESR's acknowledgement of the substantial market benefits of short selling, we urge CESR and its members to more explicitly identify their concerns with short selling and the precise manner in which public disclosure could address these concerns.

No evidence that short selling leads to extreme market conditions. CESR's main concern may be that large scale short selling activity may lead to extreme market conditions. For example, during the market turmoil, the price of shares in many financial companies experienced significant declines in a relatively short time period. We are not aware, however, of any evidence of a relationship between short selling and extreme market conditions. Recent academic literature has concluded instead that short sales do not affect the frequency of extreme negative returns. Similarly, studies of the effects of the recent short selling bans confirm that long sales, rather than short sales, were the primary cause of price declines in certain financial stocks.⁵ In researching the effect of short selling on capital markets for its Discussion Paper, the UK Financial Services Authority ("FSA") likewise found no correlation between negative stock returns and increased levels of stock lending in its analysis of the effects of its short selling ban. Accordingly, even if public disclosure were to act as a constraint on short selling, the potential for a recurrence of extreme market conditions would not be reduced.

Enforcement action is more appropriate means to address manipulative conduct. Alternatively, CESR may be concerned that aggressive large-scale short selling may involve manipulative conduct. MFA strongly supports efforts to prevent, detect and punish manipulative conduct. CESR and its members should disclose publicly any potential manipulation of securities prices through spreading of false information, instances of manipulative "naked" short selling or other related market abuses which they have identified.⁶

N., Efficiency and the Bear: Short Sales and Markets Around the World, 2007, Journal of Finance, Vol. 59, No. 4.

⁵ Credit Suisse, Examining the Wake of the Short Selling Restriction, Market Commentary, Oct. 13, 2008.

⁶ MFA submitted a comment letter to a rule proposal by FINRA relating to the spreading of rumors. See letter from Stuart J. Kaswell, Executive Vice President, Managed Funds Association, to Marcia E. Asquith,

If regulators identify such abusive conduct, CESR and its members should consider taking actions more directly applicable to the specific type of manipulation.⁷ Imposing a public disclosure obligation applicable to short sales of all companies is a disproportionately broad response to potential manipulative conduct that has not been sufficiently identified.

Public disclosure will not enhance market stability. As noted above, we remain deeply concerned about the ongoing crisis within global financial markets. A public disclosure requirement, however, would discourage investors from taking short positions exceeding the disclosure threshold during times of market stability. If the disclosure requirement effectively acted as a restraint on short selling, as proposed in the Consultation Paper, it would have pernicious effects for market efficiency, liquidity and price discovery similar to those of a short selling prohibition, and would discourage investors from fully implementing risk management strategies or taking directional short positions based on proprietary research. When investors with capital at risk engage in short selling, markets are more efficient, investors are able to better manage their risk, and securities' prices are more accurate. For these reasons, we believe a public disclosure requirement would provide only limited benefits, if any, and would not enhance market stability.

Private reporting will provide useful information without the harmful effects of public disclosure. As discussed below, private reporting of short selling information to regulators would provide relevant, useful information to CESR members while mitigating the harmful consequences of public disclosure. Private reporting would meet the objectives described in the Consultation Paper for regulators to receive information to allow them to identify significant short positions and to conduct further investigation into whether short selling may lead to disorderly markets. We also discuss in our response to question 5 below the possibility of regulators using information privately reported to them to provide public disclosure of anonymised data about short selling to the market.

2. **Do you agree with CESR's analysis of the pros and cons of flagging short sales versus short positions reporting?**
3. **Do you agree that, on balance, transparency is better achieved through a short position disclosure regime rather than through a 'flagging' requirement?**

FINRA, dated Dec. 18, 2008, ("MFA Letter to FINRA") available at: <http://www.managedfunds.org/downloads/MFA%20Comments%20FINRA%20R.2030.12.18.08.pdf>.

⁷ For example, Rule 105 of U.S. Regulation M is designed to address specifically the concerns of potential manipulation in connection with short sales of a security that is the subject of a public offering

In general, we consider that a flagging regime is a more focused and efficient way of gathering information about short positions. Investment firms executing transactions in equities could be required to mark orders long and / or short and report the data to regulators without incurring disproportionate costs in setting up the required systems, particularly as they already use similar systems in certain markets.

In particular a flagging regime can provide regulators with real time information, as well as aggregate information to the market, covering all short transactions (including those that might otherwise fall below a disclosure threshold). A flagging regime can also require investment firms to provide information to regulators on short over-the-counter transactions, as well as those through an exchange or trading platform. By providing information on physical short sales transactions it provides information that indicates where settlement issues might arise (which is potentially not readily visible where regulators only receive information on larger economic net short positions). If required, regulators can use that information to investigate further and identify holders of large economic net short positions through follow up enquiries through investment firms.

In addition, such a regime is likely to be more efficient as it likely to be easier and less costly for investment firms (or exchanges or trading platforms) to build the necessary systems to capture information on short transactions. Imposing a reporting burden on every investor worldwide that has any form of short interest in an EEA stock seems likely to lead to greater overall costs. A flagging regime results in regulators receiving reports from fewer market participants through fewer channels than under CESR's proposals. A flagging system also overcomes some of the enforcement issues that arise with CESR's proposals, which would apply extraterritorially to investors all around the world. In contrast, a flagging regime relies on centralised infrastructure within the EU to handle reporting.

In any event, we consider that CESR has significantly underestimated the costs of implementing its reporting and disclosure system. Many investors will have to build entirely new systems to be able to handle the calculation of net economic short positions in the many thousands of EEA equities in which they might conceivably be short. This is a significantly more demanding task than calculating disclosures in the relatively small number of financial stocks to which the temporary, emergency measures applied, where it was possible to rely on manual processes.

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

We do not agree that there is a case for requiring public disclosure of individual economic net short positions in every EEA equity, as outlined in CESR's proposals. For the reasons outlined above, we consider that this would have adverse effects on investors and market efficiency. Nor would we agree that it is necessary or desirable to require investors to report

to regulators individual economic net short positions in every EEA equity at the low (0.10%) threshold proposed by CESR. We discuss below recommendations for raising the minimum threshold for reporting short positions to regulators (on a confidential basis) with a view to minimising that cost.

5. **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)?**

Only private reporting should be required. For the reasons set out above, we do not agree that the regime should require public disclosure of individual short positions. We consider that the regime should only require investors to report short positions to regulators (on a confidential basis). As the Consultation Paper states, private reporting would “provide regulators with early warning signs of a build up of large short positions” to allow them to identify market abuse, and would help regulators identify whether short selling activity potentially leads to price amplification effects and disorderly markets.⁸ Private reporting would protect investors’ trading and risk management strategies and avoid a chilling effect on the benefits short selling provides to European markets, including enhancing liquidity, increasing market efficiency and facilitating price formation.

Require publication of aggregate anonymised data if supported by evidence. If there is evidence available to CESR showing that public reporting is necessary and beneficial, any proposed rules should only require regulators to make available to the public aggregated anonymised data on short selling using the information privately reported to them. We think that there should be extensive analysis and market testing to determine which aggregate and anonymised data are actually useful to investors, combined with careful analysis with respect to the content and timing of any disclosures to ensure that the data provided is not liable to be misinterpreted and does not itself create the possibility of short squeezes.

If the cost of producing such data is too high, regulators may publicly disclose anonymised data at a higher threshold (such as 2%). If the cost of producing aggregate anonymised data for public disclosure is too high, CESR should consider recommending that regulators publicly disclose anonymised versions of individual private reports of short positions, but at a higher threshold (such as 2%). A system in which regulators make public the information about individual net short positions privately reported to them, after having removed the name of the investor and any other information that would identify the investor, is likely to be

⁸ Page 15.

less costly for regulators to operate and may mitigate some of the risks arising from disclosures that identify individual investors, such as the risk of adverse issuer reaction to a particular investor. However, even such anonymised information is still (even if only disclosed at a higher threshold) likely to be misinterpreted by investors, to cause some market participants to refrain from performing critical risk management functions and to result in increased volatility and the risk of short squeezes.

Privately reported data should be kept confidential. In order to ensure that privately reported information remains non-public, the EU legislation implementing the reporting requirement should ensure that the competent authorities receiving this information will be subject to the duties of professional secrecy and confidentiality set out in article 54 of the Markets in Financial Instruments Directive. The legislation should ensure that the information is not subject to national or EU freedom of information or similar rules.

6. **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 it is desirable to adopt uniform pan-European thresholds for private reporting to the regulator. We believe that it would be beneficial for investors to have a harmonised, pan-European regime for short position reporting.

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

We believe a reporting threshold of 0.10% of the issued capital of a company does not strike an appropriate balance between providing information to regulators that is both comprehensive and relevant.

A threshold of 0.10% will place a disproportionate burden on investors. A reporting threshold of 0.10% would impose material constraints on investors who do not engage in significant short selling activity. If an investor does not have the resources to invest in the necessary systems to identify net economic short positions, then it would have to refrain from any trading activity that might generate even small transitory short positions in relation to European equities that might exceed the 0.10% threshold.

We believe that it is disproportionately burdensome to require all investors to build systems to cope with this extensive and complex reporting requirement for the many thousand EEA stocks within the scope of the proposed regime merely because they might, on an occasional basis, create small transitory short positions. Reporting should only be required where the information is clearly material and relevant. Regulators already have transaction reporting data and other means to help identify abusive behaviours where necessary.

A threshold of 0.5% for private reporting will provide more useful information to regulators. We believe that it would be more efficient and meaningful only to require reporting to regulators where a net short position exceeds 0.5% of an issuer's securities issued and outstanding. Particularly for large issuers, short sales and short positions below this threshold are not significant to the market, and should be considered de minimis. Moreover, limiting reporting to more significant positions permits a regulator to more accurately assess risks rather than being inundated with data.

We do not support public disclosure of individual short positions. As noted above, we do not agree that the regime should require public disclosure of individual short positions. If there is evidence available to CESR showing that public reporting is necessary and beneficial, the rules should only require regulators to make available to the public aggregated anonymised data on short selling using the information privately reported to them. As previously mentioned, if the cost of producing aggregated anonymised data is too high, CESR should consider recommending that regulators publicly disclose anonymised versions of individual private reports of short positions, but at a higher threshold (such as 2%).

8. **Do you agree that more stringent public disclosure requirements should be applied in cases where companies are undertaking significant capital raisings through share issues?**
9. **If so, do you agree that the trigger threshold for public disclosures in such circumstances should be 0.25%?**

As indicated above, we consider that public disclosure of an individual investor's short position in a company, including in a company undergoing a significant capital raising, may increase market volatility, potentially be misinterpreted by investors, and harm the trading strategies of investment managers and their investors.

No requirement for a different threshold for reporting short selling during rights issues. However, if CESR intends to proceed with requiring individual public disclosure of economic net short positions, then we consider that there should not be a lower threshold for disclosure during rights issues. Similarly, we do not consider that there should be a different threshold for private reporting to regulators during rights issues.

First, there is no evidence that indicates that short positions reaching the 0.25% threshold are more likely to be problematic during a capital raisings than in other times. In the absence of evidence, there should be a uniform threshold for disclosures/reporting.

Secondly, setting a different threshold in relation to capital raisings requires investors that engage in short selling to create additional systems to identify capital raisings as they are announced for every European listed stock and to determine whether and when they trigger the disclosure/reporting requirement at the lower threshold. Investors may have net short

positions in a range of companies, not because of a particular negative view on those companies, but as a result of a hedging strategy or because of an incidental position arising out of an index or basket trade. There are many thousand relevant European stocks that would need to be monitored. These issuers may raise capital in different ways or announce their intentions to do so in local languages and with varying degrees of firmness of purpose. Few investors would have the resources to keep track of these and make the relevant determinations with the speed that is required for complete compliance. It would also be necessary for CESR to mandate the creation of some centralised service in order to help investors identify relevant issues.

If CESR is to recommend a different disclosure or reporting threshold for short positions in companies undertaking rights issues, it should seek to minimise the burden of that different threshold by only requiring disclosure or reporting (at the lower threshold) of short positions entered into after the date of the announcement of the rights issue and short positions entered into during some short (e.g. 5 trading days) period before the announcement. There is no justification for imposing public disclosure or reporting at a lower threshold on someone who acquired the short position otherwise than during or directly in anticipation of the offering.

10. 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?

In general, we do not consider that there are other circumstances which would merit application of more stringent standards. However, where regulators identify extreme market conditions in relation to particular stocks it may be useful for them to be able to have the power temporarily to reduce the threshold for private reporting to regulators, to enable them to gather more information on short selling activity in that particular stock.

To avoid uncertainty, there should be clearly defined limits on any such power. The change in threshold should be temporary, to allow regulators to gather additional information over a period of particular concern, and regulators should give sufficient notice before any change in threshold comes into force.

Giving regulators this power will enable them to apply the reporting regime to their jurisdiction in a more flexible manner, allowing them to monitor the markets for situations which cause concern and adapt the reporting requirement appropriately, rather than having CESR prescribe the situations in which lower thresholds should apply.

11. Do you have any comments on CESR's proposals concerning how short positions should be calculated? Should CESR consider any alternative method of calculation?

Short positions should be calculated by reference to an investor's net economic short position. We agree that any individual reporting or disclosure on the basis of the investor's net economic short position is likely to be more meaningful to regulators than information on net or gross physical short positions. Information on net economic short positions (rather than net physical short positions) will assist regulators in assessing whether an investor is genuinely short, particularly in markets where a high volume of trading is conducted in instruments such as contracts for differences rather than in physical securities. The information will be more meaningful if the report or disclosure eliminates those cases where there is an offsetting long position of whatever form.

The default position should require reporting at the level of the legal entity or asset management company, but there should be flexibility where this information could be misleading. As regards the level of reporting to the regulator, we agree that the focus should be on where the investment decision is taken and that, therefore, the starting point is that disclosure should be at the level of the decision making entity. This will be the legal entity or, in relation to asset managers, the asset management company (rather than the individual fund).

However, there is a real danger that one size will not fit all, in particular because asset management companies will frequently act for clients representing a wide variety of investment strategies. Reporting net positions across several different strategies could be unhelpful. Therefore there ought to be the flexibility for investors to select larger or smaller reporting units where this would provide more meaningful information. CESR should establish criteria to determine situations where different reporting units may be appropriate (for example, where a unit of an investment manager acts independently of other units, so that aggregating its interests with those of other units would be misleading). We also consider that individual regulators should have some flexibility to allow aggregation or disaggregation on different bases to ensure that data is more meaningful and less costly to prepare.

All relevant issuers should publish information on their issued share capital. It would also be necessary to require issuers not currently subject to the Transparency Directive requirements to publish information on their issued share capital, as the denominator of the calculation. Where a capital raising is announced, investors should be able to include in the calculation of the net short position any economically fungible positions in new shares being issued and to take into account the new shares being issued in the denominator when calculating the size of the position.

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

We agree that reporting to regulators should be to the competent authority of the most relevant market as defined under the Markets in Financial Instruments Directive. If there is to

be public disclosure, the national regulator should then take responsibility for dissemination of any required disclosure to the market.

CESR should consider whether it could provide a centralised facility for receiving reports and distributing them to its members.

If investors are to report individually, we consider that reporting by email to the regulator would only be workable if there is a small number of disclosures, which argues for a higher threshold, such as the 0.5% threshold proposed above.

13. 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).

We agree that the disclosures should be limited to the identity of the reporting party, the issuer, the size of the position and the date on which the relevant position was created or no longer held. Investors should not be required to provide greater breakdowns of positions. Investors should be able to report in English and should not be required to provide reports in local languages, which create particular challenges for international investors, such as MFA members, who are active across all European markets.

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

A longer timeframe for reporting short positions would be more practical. CESR proposes reporting to the regulator (and public disclosure to the market) on the trading day following the day on which the disclosure obligation is triggered (T+1), by reference to end of day data.

CESR suggests that the experience of the temporary disclosure obligations is that systems can cope with calculating (and then disclosing) short positions on this timeframe. However, these temporary disclosure obligations only affected a limited number of financial issuers and investors and other market participants have been able to manage their disclosure obligations by restricting trading in these stocks and using a high degree of manual intervention. The proposed disclosure obligation would cover the entire range of European issuers in a way which is not necessarily aligned with firms' existing risk or other management systems. It would be necessary for firms to develop automated systems but on any basis, given the complexity of the calculation, significant manual intervention is still likely to be necessary.

Therefore, we do not consider that T+1 reporting is practical. If CESR is to require individual reporting (or disclosure) by investors we would recommend a longer timeframe for reporting. These filing requirements are burdensome for individual investors, especially smaller investors with less sophisticated information technology systems. For a firm to establish its

net economic exposure in a company's issued share capital, as required, it must perform complex calculations across all derivative positions in the company on a delta adjusted basis. These calculations can be extremely challenging for firms, and in some instances may pose burdens that cannot be met with existing personnel and resources. Any extension of reporting obligations beyond stocks of financial companies would compound the complexity of determining a firm's net economic exposure, and would significantly increase the burden to comply with the disclosure obligation.

The timeframe should be harmonised with other reporting timeframes to reduce the burden on investors. Investors already are subject to a substantial number of reporting requirements for long positions throughout many European jurisdictions. Additional daily short selling reporting requirements would add to the already significant cumulative compliance costs faced by investors that participate in the global capital markets.

We suggest that the timeframe for reporting short positions be aligned with the timeframe set out in Article 12 of the Transparency Directive for disclosure of long positions, and Member States should be required to implement this requirement consistently with their implementation of Article 12 of the Transparency Directive. As investors will use the same data to make their reports under any short selling regime as they do to make their reports under the Transparency Directive, and are likely to make the reports simultaneously, there will be less of an administrative and operational burden on investors if the reporting periods are the same for both reports.

Extended transitional period necessary. Given the degree of investment likely to be required, it will be necessary for there to be an extended transitional period before any new requirement comes into force.

15. **Do you agree, as a matter of principle, that market makers should be exempt from disclosure obligations in respect of their market making activities?**
16. **If so, should they be exempt from disclosure to the regulator?**
17. **Should CESR consider any other exemptions?**

We consider that, if there are to be any exemptions for market making or liquidity providing activity, in framing the scope of the exemptions CESR should take into account the effect of advances in technology and changing market structures which have led to a growing range of types of entity and roles within the market which act to improve liquidity and aid price discovery and the potential competitive advantage given to those who benefit from the exemption over other market participants.

18. **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?

If obligations are to be placed directly on individual investors, there should be a fully harmonised European regime. Divergent national rules would create significant costs for international investors. However, even if the regime is based on a directly effective EU regulation, there would be an important role for CESR in coordinating answers to frequently asked questions by market participants to provide practical guidance and avoid differing national interpretations.

CONCLUSION

Along with policy makers, MFA and its members remain deeply concerned about the ongoing crisis within global financial markets and support timely and targeted initiatives aimed at preventing the crisis from worsening by restoring market integrity and confidence and encouraging investors to return to a more normal market environment. A primary cause of this crisis has been the inadequate risk management practices of global financial institutions. Investors, including alternative investment funds, should not be penalised for accurately predicting that the share prices of poorly managed firms were likely to decline and for making investment decisions based on those predictions, including the reduction of long exposure or short selling for hedging purposes. It is widely acknowledged that short selling plays an integral role in the proper functioning of markets, as it contributes to efficient price discovery, increases market liquidity, and promotes capital formation, among other benefits.

MFA welcomes the opportunity to participate in this important debate and looks forward to an ongoing dialogue with CESR and its members. MFA would also be pleased to respond to any additional inquiries as CESR considers the appropriate short selling regime.

If you have any questions or comments on this submission, in the first instance please contact Stuart J. Kaswell, Executive Vice President and General Counsel, at +1 (202) 367-1140 (stuart@managedfunds.org).

Yours truly,

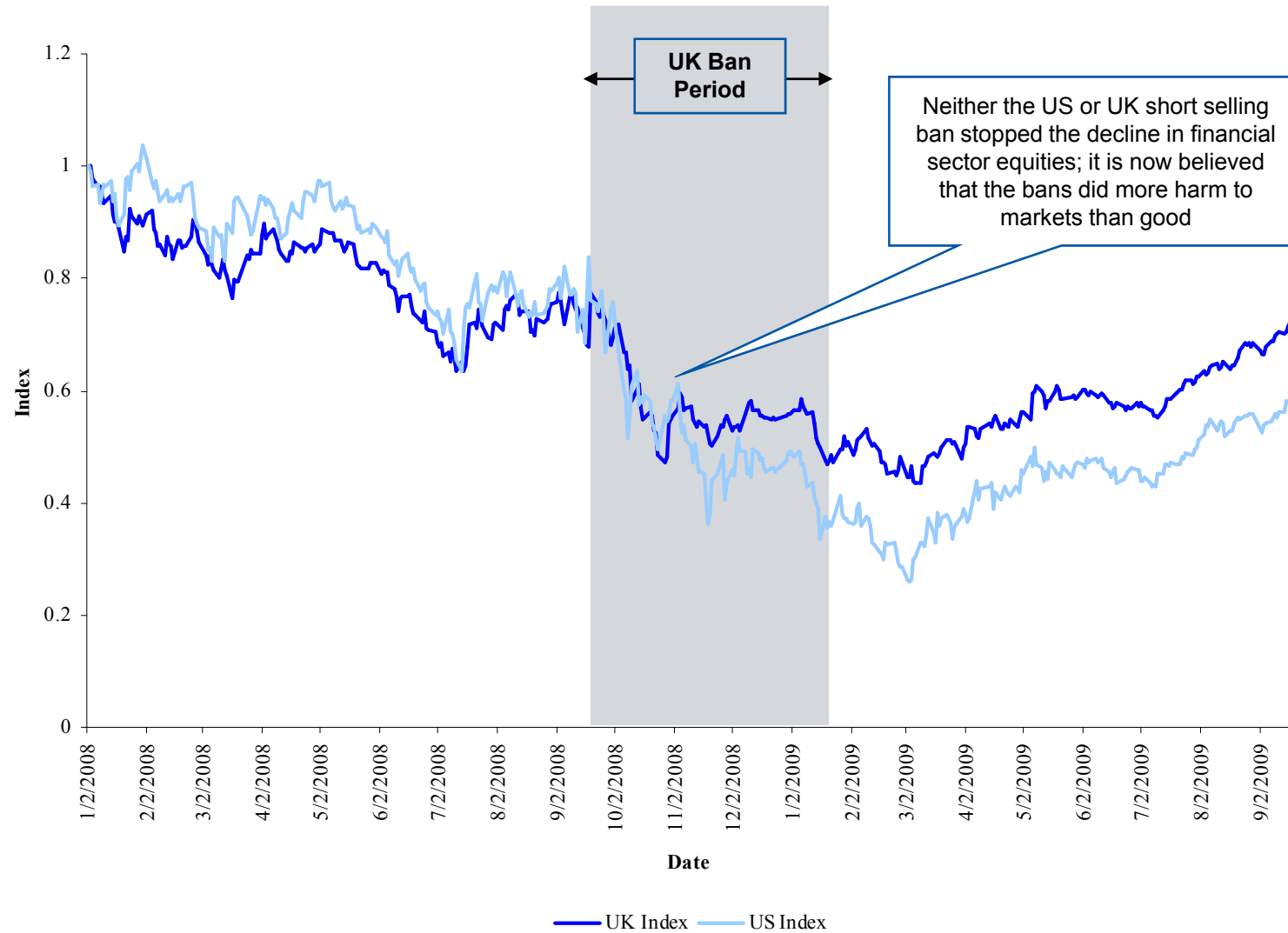
/s/ Richard H. Baker

Richard H. Baker
President and Chief Executive Officer

/s/ John G. Gaine

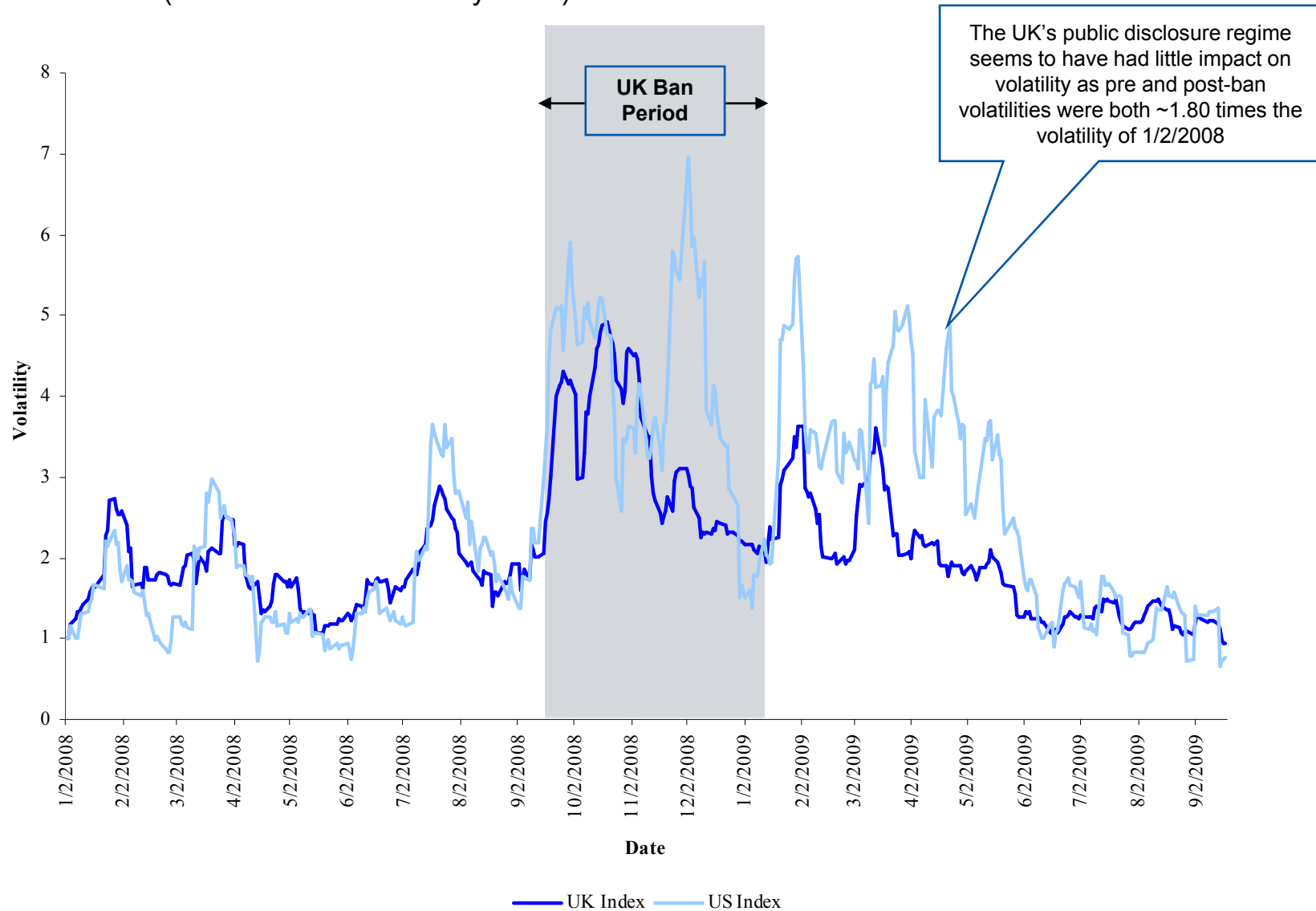
John G. Gaine
President Emeritus and Special Counsel, International Affairs

US Financials Index vs. UK Financials Index 2008-Present (Base 1.0 set to January 2008)



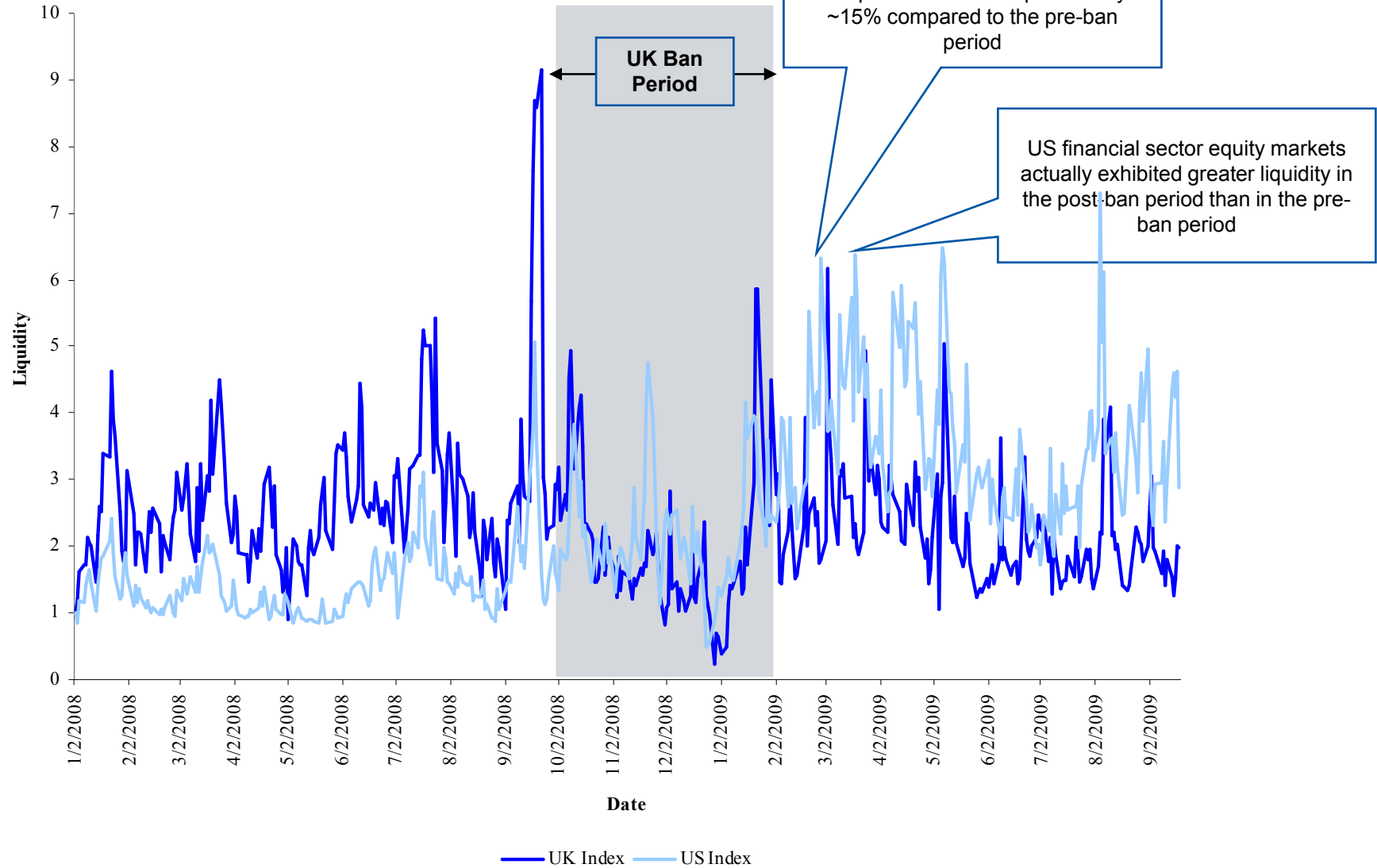
Source: Bloomberg

US Financials Index vs. UK Financials Index 2008-Present (Base 1.0 set to January 2008)



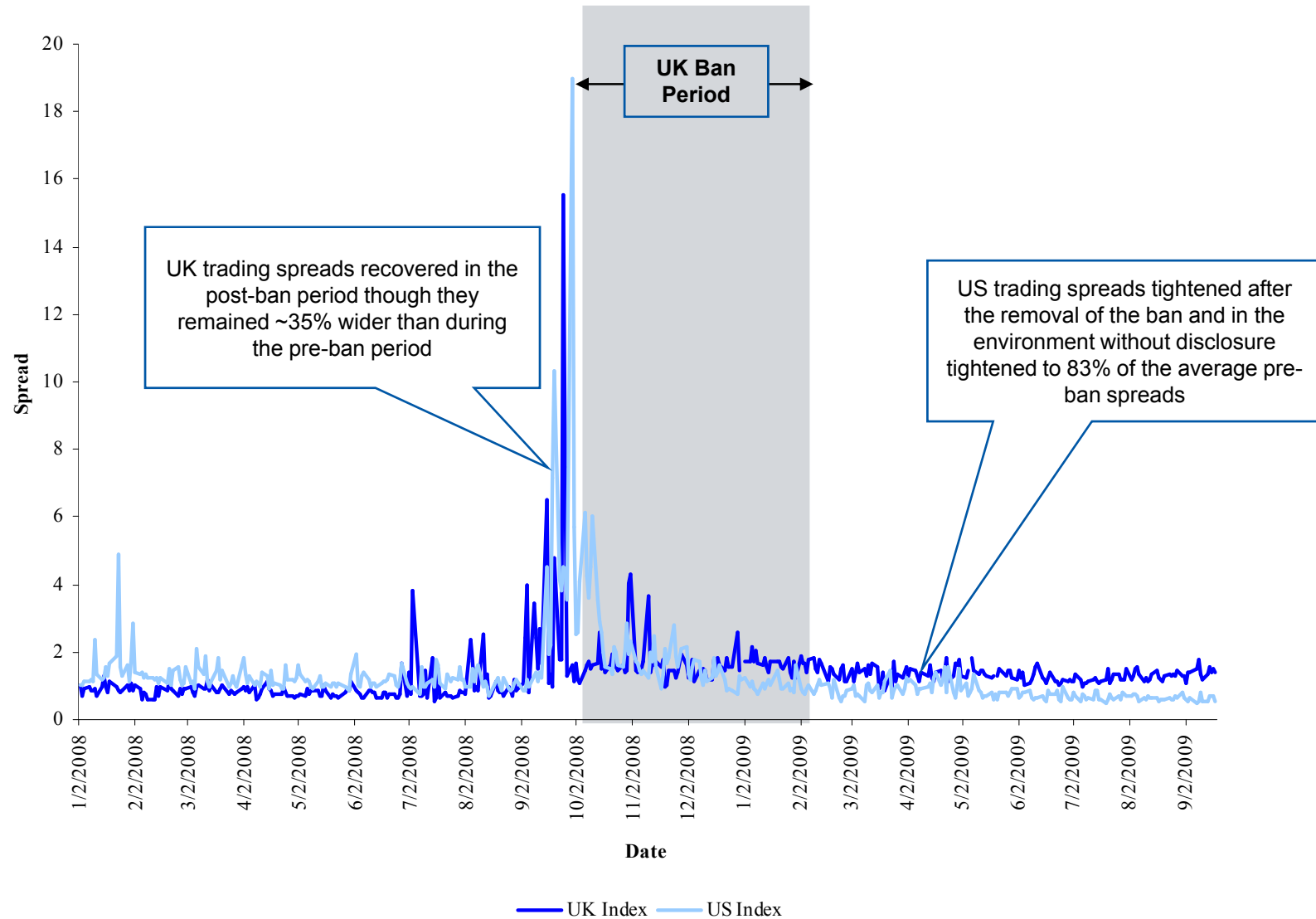
Source: Bloomberg

US Financials Index vs. UK Financials Index 2008-Present (Base 1.0 set to January 2008)



Source: Bloomberg

US Financials Index vs. UK Financials Index 2008-Present (Base 1.0 set to January 2008)



Source: Bloomberg