



CESR Proposal for a pan-European short selling disclosure regime

The ABI's Response to CESR/09-581

Introduction

1. The Association of British Insurers (ABI) is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.
2. The ABI's registration number on the European Commission's Register of Interest Representatives is: **730137075-36**
3. In their capacity as institutional investors ABI members are responsible for the management of funds worth some Euro 1.8 trillion, a substantial proportion of which is invested in European equities. Insurers are responsible for investing a large proportion of the savings of the UK public, including the funds providing their pensions. As a result, ABI members – as both issuers and investors - have a strong interest in the integrity and efficiency of financial markets and in promoting the confidence of the investing public. Matters relating to market efficiency, including short selling, are of fundamental importance to them.

General Comments

4. Our members are largely supportive of CESR's proposals. In particular, we welcome the lead CESR is taking in establishing a pan-European regime: complying with different short selling rules imposed by member states over the last year has been costly for large asset management firms which operate in many different jurisdictions.
5. Our members are also pleased that CESR's focus is firmly on disclosure and transparency rather than on any restrictions of the practice of short selling. We have for some time now been calling for greater transparency of positions of economic interest and we are therefore keen that European competent authorities mandate disclosure of short selling above a certain threshold.
6. Our starting point is that short selling is a legitimate technique which ought to be permitted to continue. Some of the problems associated with it are more perceived than real, and many are not unique to it.

7. We understand CESR is still considering whether any restrictions such as 'tick rules' are desirable but we would urge it give time for the new disclosure regime to work before introducing any further changes.
8. In addition, because any new rules in this area will mark such as departure from the current practice, it will be particularly important to conduct a full and thorough review of how they operate after a period of time – we would suggest one year. CESR should be committed to such a review.

ANNEX

Questions for Consultation

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

We agree that enhanced transparency of positions of economic interest should be pursued, and that the benefits would outweigh the costs.

Our members believe that short selling is a legitimate technique which should be permitted to continue unhindered. However, they have for some time now been calling for additional transparency in this area. This is because the dynamics of capital markets has changed over the last few years – more and more trading is conducted via derivative instruments of some kind, including short sales. Positions of economic interest are therefore increasingly important in understanding the price formation and, on the long side, access to voting rights.

However, we would qualify this by saying that any short selling disclosure regime needs to be very carefully constructed. There is a point at which additional transparency may lead to a decrease in liquidity – and this would be damaging to the market as a whole. There therefore needs to be balance between the two. We believe that the two-tier regime, as being proposed by CESR, addresses this balance adequately.

We would also note that, although disclosure is undoubtedly useful for price formation purposes, there are other buy side concerns in this area that the regulators ought to tackle as a matter of priority. For example, post-MiFID market fragmentation has had a major negative impact on the availability, accuracy and price of trading data. Our members believe that, as a result, there is a serious information asymmetry between the sell side and the buy side. Short selling disclosure is therefore only a part of the solution.

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

We agree. Although the idea of flagging is conceptually appealing, it would be difficult to implement in practice. This is particularly the case for portfolio management firms such as our members: because their trades are generally reported by brokers, each short sale would now have to be flagged as such manually. This leaves too much room for human error and is overly burdensome for both investment managers and brokers.

It would also not 'catch' activity in OTC markets, as CESR acknowledges, and could therefore be circumvented all too easily.

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

A disclosure regime seems a less costly and a more useful way of increasing transparency. Together with disclosure of long positions (hopefully in the long term

of both 'real' and economic), it would help create a comprehensive picture of levels of interest in a particular security.

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

We agree that the regime should apply to all sectors and all securities admitted to trading on EEA regulated markets and MTFs.

However, our members have a strong preference for a more comprehensive regime including shares of all issuers admitted to trading rather than just EEA ones. CESR states that this would not be appropriate but fails to elaborate why this would be the case.

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 suggest. For example, should regulators be required to make some form of anonymised public disclosure based on the information they receive as a result of the first trigger threshold (these disclosures would be in addition to public disclosures of individual short positions at the higher threshold)?

We agree. Two-tier disclosure allows any concerns about market abuse to be addressed by regulators, while permitting much of the legitimate short selling activity to go on anonymously. Only relatively large short positions would have to be declared to the market. This is, in our view, appropriate, and strikes the right balance between transparency and liquidity. However, please see our response to Q7.

We do believe it would be useful if regulators were to publish some information along the lines suggested by CESR. Aggregate figures per stock would probably be of most interest to market participants.

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?

We agree. Our members report that the main problem encountered since the introduction of reporting obligations across the EU last year have been the different thresholds for reporting in various EU member states. Because of the differences, and changes made by the competent authorities subsequently, firms have had to pay lawyers to compile up-to-date lists of requirements in each jurisdiction. A harmonised regime is therefore crucial.

In fact, our members strongly believe that there should be an attempt to harmonise reporting regimes globally. It should be possible to align thresholds of at least the major financial markets around the world.

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

Although we recognise the intuitive appeal of the thresholds proposed, we have not seen a great deal of analysis to justify a particular choice of numbers. This makes it

difficult to judge how many short positions would be subject to disclosure and where the right balance may lie between allowing anonymity on the one hand, and increasing transparency on the other.

However, if sufficient data is not available, the choice of thresholds is inevitably going to be somewhat arbitrary.

We strongly agree that, whatever threshold is chosen, there needs to be a review after a limited period – we would suggest one year.

Q8 Do you agree that more stringent public disclosure requirements should be applied in cases where companies are undertaking significant capital raisings through share issues?

We agree. Companies undertaking rights issues are more vulnerable to abusive short selling, as CESR explains in #45, so it makes sense to require a low threshold for disclosure.

We would, however, agree that it is not that the threshold for rights issues has to automatically be lower than that applied normally. It may be the case that the latter is already set low, in which case there may be no need to lower it further for rights issues as it would reveal little additional information. It would be up to CESR to judge how much more a different threshold would reveal, and whether it is worth imposing additional systems and reporting costs this would entail for market participants.

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

We believe it would be easier if the thresholds for rights issues are not different from the rest of the regime. We would therefore propose disclosures at a decimal point, so 0.2 or 0.3 per cent, with subsequent disclosures in 0.1 per cent increments. Disclosures across the regime as a whole would overlap, and we believe this to be easier for both the firms reporting and for users of the information.

Q10 Do you believe that there are other circumstances in which more stringent standards should apply and, if so, what standards and in what circumstances?

No. We do not believe there are other situations which would elicit a more stringent response.

Q11 Do you have any comments on CESR's proposals concerning how short positions should be calculated? Should CESR consider any alternative method of calculation?

We agree with the calculation methods proposed: we support a net basis for calculations done on a legal entity basis.

For asset management firms, this would mean netting off short positions against any long positions held for all clients. Anything else (e.g. disclosure by fund) could be misleading and would not help the price formation.

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

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).

We agree with CESR's proposals and have no further comments or suggestions to make.

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

No, we believe T+1 disclosures are appropriate.

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?

We agree that market makers should be exempt from public disclosure. The provision of liquidity, especially in the current market conditions where it may be constrained, is of crucial importance to the market as a whole.

Our members do, however, have serious concerns in this area. It will be very important to clearly define the activity of market making and demarcate it from proprietary trading – and, most importantly, for the regulators to police how banks operate this distinction in practice.

Our members believe that structural changes in integrated global investment banks may have, over time, eroded the pure agency role of market makers. They now operate alongside, e.g. prop and derivative desks, or internal hedge fund operations. We are not convinced that the conflicts of interest inherent in these arrangements are always adequately addressed. Our members' view is that the position of market makers in regulation more generally, and the information asymmetry between banks and investment managers of which this is a part, needs to be addressed by the regulators.

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

No. We strongly believe that market makers should be obliged to disclose their positions to regulators, same as all other market participants. Indeed, we fail to see the logic of exempting them from private disclosures.

Q17 Should CESR consider any other exemption?

We do not think CESR should consider any other exemptions.

Q18 Do you agree that EEA securities regulators should be given explicit, stand-alone powers to require disclosure in respect of short selling? If so, do you agree that these powers should stem from European legislation, in the form of a new Directive or Regulation?

We agree. We are not sure at this point whether CESR's objectives are best achieved by a directive or by regulation.

We do, however, believe that the Transparency Directive needs to be revised to make long economic interest positions disclosable as is currently the case in the UK. We see short position disclosure as part of the same comprehensive framework. But if the mechanics of short and long disclosure are aligned, then the legislative background is less relevant. The key is to provide a full picture of long and short positions in a stock to the market.

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