European Securities and Markets Authority

CALL FOR EVIDENCE ON THE EVALUATION OF THE REGULATION ON SHORT SELLING AND CERTAIN ASPECTS OF CREDIT DEFAULT SWAPS

The Federation of Finnish Financial Services welcomes the opportunity to response to the call of evidence on the evaluation of the regulation on short selling and certain aspects of credit default swaps (the Regulation).

The Federation of Finnish Financial Services represents banks, insurers, finance houses, securities dealers and financial employers operating in Finland. Its members also include employee pension, motor liability and workers compensation insurers, all three providers of statutory insurance lines that account for much of Finnish social security.

The Federation's membership comprises of 433 financial companies, who employ a total of 42.000 people.

Q7 Do you have any other comments on the reporting and transparency requirements or on their operation since 1 November 2012?

The Regulation has been in force less than six months. In order to adapt the operations to the requirements of the Regulation, our member banks and investment firms have done a lot of hard work on client agreements, client information, short selling operations changes as well as on collecting and handling the position information. Our members have made the interpretations on calculation of short positions and position surveillance along with other short selling provisions are complied with in practice. Thus we are of the opinion that the substance of the regulation should not be amended in haste, but the development in this field should rather be followed as such. Every amendment to the provisions causes a great deal of planning, preparing and system integration. Extra administrative burden should not be laid upon the industry without cogent reason.

Q9 Have you noticed any impact on the cost or availability of securities lending since the Regulation has applied? Please specify any effect you have seen.

Securities lending has become more burdensome, and the reported availability of securities has been reduced, specifically within the small-cap securities universe.

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Q10 Have you observed any improvements in reducing the risks of volatility, downward spirals or settlement problems (e.g. inflation of shares) since the Regulation became applicable?

The Regulation has decreased liquidity, which, in times of distress, could lead to increased volatility and cost of doing business in terms of widening spreads.

Q11 Has the locate rule requirement affected the way you conduct short selling?

The rule has increased the administrative burden of securing securities for lending purposes for our members' clients, and our members have also noticed a less activity from their clients, leading to less business for brokers.

Q13 Are there any changes which could be made to the conditions for entering into a short sale which would improve the efficiency of the arrangements without undermining the purpose of the measures? Please explain any changes you would propose.

Allowing intraday short selling in all shares, without the need of securing the securities beforehand, and, allowing all short selling in liquid shares without the need of reserving the shares beforehand.

Q14 Do you have any other comments on the existing restrictions or their operation since 1 November 2012?

In conclusion, short selling restrictions add to the effective cost of share trading, and increase the volatility and spreads in the market, leading to increased costs to the end user while simultaneously adding to the cost base of brokers operating on behalf of customers.

There are also some alleviations that should be considered to be made to the regulation, concerning, for example, sovereign bonds. A delivery of a sovereign bond should be allowed through a lending operation. This should be made possible concerning at least bonds of lesser value. At the moment, the restriction causes a lot of unnecessary transactions.

Q 15 Have you noticed any effect of the prohibition on entering into an uncovered sovereign CDS transaction on the price and on the volatility of the sovereign debt instruments?

This is a difficult question, because there are an array of things affecting the volatility and price of sovereign debt instruments, but on a general level is seems the prohibition might have reduced volatility, one reason for this being that a wide range of market participants have in effect been shut out of the sovereign risk market.

Q 16 Have any elements of the prohibition on entering into an uncovered sovereign CDS transaction had a noticeable effect on your ability to hedge your exposures? If yes, please quantify the impact and explain where the issue arises.

The prohibition has affected our members' ability to hedge our sovereign risks. The Regulation around the issue is still unclear and the details and actual interpretation still too fuzzy to give our members the opportunity to freely use the hedging instruments available in the market. Before these issues are cleared in a satisfactory manner, the usage of sovereign CDS as hedging tool will be minimal. The most bothering aspect is the difficulty in using systematic hedges such as iTraxx Sovereign CDS-basket, which would be optimal hedging tool for removing at least some more systematic sovereign credit risk.

Q 17 Have the restrictions on entering into an uncovered sovereign CDS led you to use any alternative methods for hedging your exposures? If so, please elaborate.

It has increased the usage of Italian and French government bond futures.

Q 18 Do you have any other comments on the requirements concerning uncovered sovereign CDS positions or on how they have operated since 1 November 2012?

There clearly is need for clear-cut examples of actual positions and how these situations and positions are compatible with the new provisions.

Q22 Does the current definition and scope of the exemption for market making activities allow sufficiently for liquidity provision?

The provision of liquidity by a market maker and the related activities are closely connected to the definition of such. We understand that the current definition and scope of the exemption for market making activities is based on two interlinked requirements:

1. Market maker activities (i.e to provide two-way quotes, trade on behalf of customers and hedging one of these) are regulatory validated by the "Instrument-Exchange membership" principle. In other words, the market maker activity is restricted to only be possible when there is an explicit (and notified) link between Instrument-Exchange membership (and the activity).

2. The Instrument-membership principle is documented by providing evidence on the market maker prices, size and presence in each specific instrument on the exchange (i.e. "qualifying criteria").

We see the principle of "Instrument-Exchange Membership" to a large extent covering the normal market making activities, but also that the second requirement on documentation would be very hard to validate and causing liquidity effects.

Specifically our concern is related to the documentation that would be foreseen if market makers were to document size, prices and presence on all instruments and adhering to special qualifying criteria (ad. VII52, pp. 20 in the Final Report). We would argue that the documentation requirement (i.e. be 80 % of time in market in specific instrument) risks harming the liquidity provision itself - especially in small illiquid equities (or even small exchanges) because should our members document presence for a substantial time on prices that are illiquid - the prices and size would risk not being competitive, which could cause market makers to avoid those – especially if market makers on top also risk losing their exemption.

Finally we find it doubtful how documented prices, size and presence could be validated as competitive (*ex post*) – especially considering smaller illiquid shares. The documentation would additionally be depending on which exchange is under consideration. The amount of smaller and illiquid shares could be quite large (for example First North part of NASDAQ OMX). What would be the benchmarks for such and would the authorities provide those?

Q23 Is the process for obtaining the exemption for market making activities appropriate for timely provision of liquidity in all circumstances?

We understand that there is a 30 day provision for new initial public offerings, which allows for adjustment of the Notification, although this also provides an administrative burden for market makers to survey, notify and receive confirmations on the notified lists of exempted instruments.

FEDERATION OF FINNISH FINANCIAL SERVICES

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