Committee of European Securities Regulators

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FEEDBACK STATEMENT

CESR Proposal for a Pan-European Short Selling Disclosure Regime

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Executive summary

This Feedback Statement (FS) summarises the responses to CESR's consultation paper on the proposal for a pan-European short selling disclosure model (Ref. CESR/09-581) that CESR received and sets out CESR's feedback on those responses and any changes to its proposals for a pan-European short selling disclosure regime in the light of them. It should be read in conjunction with CESR's Report, 'Model for a Pan-European Short Selling Disclosure Regime' (Ref. CESR/10- 088).

The first section of the paper sets out the background to this FS, together with high level information on CESR's key modifications and elaborations to the original proposal.

The second section of the paper summarises, on a question by question basis, the responses that CESR received and provides CESR's feedback on those responses.

1. Background

1. In the light of very turbulent market conditions and concerns in the second half of 2008 about the threat to financial stability and the associated risks of disorderly markets and market abuse, a significant number of CESR members took emergency measures to restrict and/or impose conditions on short selling. These measures took various forms: some imposed restrictions on all short selling of specified shares or specified categories of shares (e.g. financial sector), some restricted naked short selling and some also introduced disclosure obligations of different kinds. The majority of these measures still remain in place, having been extended or renewed in modified form.

2. As a result of all the activity on short selling regulation, CESR considered that it was appropriate to launch a review of policy on short selling with a view to formulating some pan-European standards in this area. This initiative also reflected the concerns of market participants who have made clear their views about the burdens of having to comply with a number of different sets of national requirements.

3. CESR therefore launched work to examine what permanent regime would be appropriate for short selling within the EEA. Although market conditions have been more stable than in the period when CESR members first introduced their various short selling measures, CESR still considers that it is important to achieve a harmonised approach to this issue.

4. Following agreement by CESR members that a pan-European regime for enhanced transparency of short selling should be implemented on a permanent and harmonised basis in July 2009, CESR published the consultation paper (CP) 'CESR Proposal for a Pan-European Short Selling Disclosure Regime' (Ref. CESR/09-581). While CESR has focused on the issue of short selling disclosure, it continues to consider whether any further measures are necessary to converge regulation of short selling within the EEA.

5. The CP proposed a two-tier model for disclosure of significant individual net short positions in all shares that were solely or primarily admitted to trading on an EEA regulated market or MTF. At the lower threshold of 0.1%, positions would be disclosed to the regulator of the most relevant market in terms of liquidity (for MiFID purposes). At the higher threshold of 0.5% positions would be disclosed to the market as a whole. All changes of position would be reported at increments of 0.1%, first to the regulator (from 0.2% until 0.4%) and then to the market. In calculating whether a disclosure was required, market participants would need to take account of any position which provided an economic exposure to a particular share. Hence positions in both exchange-traded and OTC derivatives would be covered as well as short positions in the cash markets. Disclosure calculations and reports would be done on a

net basis with any positions involving long economic exposures to a share subtracted from the short positions. Disclosure reports of short positions – whether to the regulator or the market – would be made on the trading day following that on which the relevant trigger threshold had been crossed. There would be exemptions from the disclosure requirements for short positions resulting from market making activities.

Summary of responses

6. CESR received 49 submissions to its CP. The single largest group of respondents was comprised of national trade associations, but pan-European trade associations, individual trading firms and exchanges and MTFs were all well represented as well.

7. Respondents were broadly supportive of CESR's proposals and agreed that, in principle, enhanced transparency is desirable. In addition, other than a small minority, respondents agreed that enhanced transparency is better achieved through a position reporting regime than through a sales flagging regime. Unsurprisingly, there was a degree of divergence of opinion on certain aspects of CESR's proposed position reporting regime. The issue which provoked the most polarised views was whether there should be public individual position disclosure. While many respondents fully supported the proposal, it also attracted a lot of criticism with many respondents arguing that it was not justified and would actually have an adverse impact. Another particular issue of contention was whether there should be two separate thresholds for 'private' and 'public' disclosure. A strong theme emerging from nearly all the respondents was that any pan-European disclosure regime should be as harmonised across Member States as possible. Indeed, several of the respondents urged harmonisation not only at the pan-European but also the global level, perhaps aligning the proposed disclosure requirements with the ones applicable by SEC in the U.S.

8. It is fair to say that many respondents supported enhanced transparency throughout Europe less because they regarded it as a necessary measure to achieve financial stability or prevent disorderly markets or market abuse and more because they felt that this area needs harmonisation. Linked to this was the call from a significant proportion of respondents for harmonisation, based on clearer definitions, of the terminology used in this context. This particular feedback covered concepts such as "abusive short selling", "market maker" and "economic exposure".

9. There were also certain areas where respondents suggested that CESR needed to develop more technical detail as well as more detail on how to implement the proposals in practice. The key areas in this regard were how to calculate net short positions, the level, within an organisational structure, at which netting should take place, how exemptions should be applied and how, in practice, disclosures should be made.

10. Another theme that emerged was respondents' strong belief that short selling should not be perceived as abusive *per se* but should be recognised as a key component of an efficient price discovery process in normal market conditions.

11. Finally, a number of respondents commented that CESR needed to undertake a more rigorous impact assessment and cost-benefit analysis of its proposals and, absent that, they remained unconvinced of the rationale for operating a permanent short selling disclosure regime. Those who made this comment tended to advocate agreeing a disclosure model in principle, but applying it only as part of a package of emergency measures, when justified by extreme market conditions.

CESR's key modifications and elaborations to the original proposal

12. CESR has considered very carefully the points raised by respondents. Whilst CESR decided not to alter the key elements of the proposed disclosure model in light of the comments

received, there are a number of issues raised by respondents that it does address in this Feedback Statement which have led CESR to modify or elaborate on its proposals.

13. Firstly, in response to the feedback from the consultation and some additional fact-finding by the UK FSA, CESR decided to raise the initial threshold for private disclosure to the regulator to 0.2%, which should significantly reduce the reporting burden but would still facilitate proper market monitoring by competent authorities. All the other thresholds (i.e. incremental thresholds for changes of position and the threshold for public disclosure) remain as originally proposed.

14. Secondly, given that the proposal for a lower threshold for 'private' disclosure to the regulator would provide regulators with scope for monitoring building short positions before they are made public, CESR decided that a separate lower public disclosure threshold for rights issue companies is not necessary, particularly given some of the responses received on that issue.

15. Thirdly, CESR recognises that many respondents were strongly opposed to the proposal for public individual position disclosure (i.e. neither aggregated nor anonymised disclosure) and is mindful of their comments that the case for this has not been fully made out. Whilst CESR remains of the view that this model gives the best outcome from a cost-benefit perspective, it is using this Feedback Statement and the related Final Report (Ref. CESR/10-088) as an opportunity to set out in more detail the objectives and analysis that underpin it.

16. Fourthly, CESR clarified that the short selling disclosure regime will also be applicable to shares admitted to trading on an EEA MTF unless their primary market is located outside the EEA.

17. In addition, CESR recognises the informational benefits of publication of aggregated data and acknowledges that, in addition to the disclosure model as proposed, it is open to members to choose to publish aggregated data that they receive as a result of private disclosures. CESR is prepared to put this forward as an option, rather than a requirement, for members on the basis that it does not undermine the fundamental objective of achieving a regime that describes a harmonised set of disclosure requirements for market participants.

18. Finally, in response to a significant call from respondents, CESR has done considerable work to develop its thinking on a number of detailed technical issues regarding implementation of a disclosure regime. CESR has not yet reached a final view on these issues but anticipates that it is likely to publish its position on these additional issues as and when it is in a position to do so.

2. Summary of responses and CESR's feedback

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

19. Although a few respondents expressed doubt as to whether enhanced transparency of short selling should be pursued, a large majority favoured it. Amongst the justifications cited for greater transparency were that an enhanced regime would bolster market integrity and maintain financial stability, whilst also improving price formation.

20. However a substantial proportion of these respondents considered that individual positions should be disclosed only to the regulator and that only aggregated, anonymised data should be made public. These respondents felt that public disclosure would encourage herding and potentially destabilise the markets. They also questioned whether public disclosure would in fact provide an adequate measure of deterrence to aggressive short sellers. Additionally, it was argued that any public dissemination of data can only be useful if all the data for a specific instrument is available in one place (a single website for example).

21. Some concerns were expressed that any new disclosure requirements would increase costs, which would in turn result in market inefficiencies, inhibit legitimate trading and discourage hedging strategies. Some respondents questioned whether a permanent enhanced transparency regime is necessary and instead favoured different transparency requirements depending on the volatility of the markets.

22. A significant proportion of those few respondents who were opposed to the principle of enhanced transparency did so because they believe that it is more important to concentrate on resolving reckless or negligent settlement failure, either as an alternative or as a complement to enhanced transparency. One comment was that short sellers would simply work around these thresholds and that any new requirement could not constrain volatility.

23. Other issues noted a need for CESR to focus more on the proportionality of a disclosure regime, a need for more evidence collection and a more thorough cost-benefit analysis.

24. One respondent suggested that the information requirements for improved transparency should be aligned to those emanating from the Transparency Directive. Another was concerned that if, as appeared to be the case, these CESR proposals were meant to be minimum harmonisation requirements, there will be a tendency towards gold-plating and, as a result, inconsistency across Member States. One respondent felt that there should be a cap on short selling above a certain percentage of the capital of the issuer and advocated a complete ban on naked short selling.

25. CESR's over-riding objectives in relation to short selling disclosure are to mitigate the risks of market abuse and disorderly markets that the practice can pose and to increase the efficiency of the price formation process through improved information to the market. This will, ultimately, bolster market integrity and help maintain financial stability. Accordingly, CESR continues to hold the view that the benefits of enhanced transparency outweigh the costs and recommends that it should therefore continue to be pursued. That said, CESR notes respondents' observations on various aspects of the disclosure proposals and agrees that the balance between costs and benefits will depend on the precise nature of a disclosure regime. CESR also notes that, although individual CESR members will have the freedom to impose more stringent disclosure requirements in emergency situations, the intention is that the obligations that fall on market participants arising from a pan-European disclosure regime should be harmonised.

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

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

26. Although a very small minority of respondents disagreed with CESR's analysis, the general consensus was fully supportive of CESR's conclusion that short position reporting is preferable to short sale flagging. Nevertheless, there were respondents, even among those who supported position reporting, who questioned whether the respective costs of both options had been assessed fully or accurately, with a number expressing the view that fuller cost-benefit analysis of both systems was needed before any definitive decision could be made.

27. Some of those that agreed with the analysis did so with a degree of caution, expressing concern that the disclosure levels may be made too low and that the calculation of short positions on a net basis could incur many practical difficulties. There was also some doubt as to whether a permanent disclosure regime (as opposed to one that operates in crisis conditions) is actually necessary.

28. The importance of working towards achieving a harmonised system, not necessarily just within Europe but also globally, was noted by more than one respondent. One respondent who opposed position reporting suggested that CESR should proceed instead towards a disclosure regime more similar in style to current requirements in the USA. Additionally, more than one respondent indicated that the reporting obligation should be imposed on the final investor.

29. However, a convincing majority of respondents strongly agreed that a short position disclosure regime would deliver transparency much more effectively than a flagging requirement would. It was considered that a short position disclosure regime would be easier both to implement and subsequently to collect relevant and necessary data.

30. Notwithstanding this preference, one respondent did note that both systems have their benefits noting, in particular, the fact that a flagging regime is the only means of aggregating the total short interest per share.

31. CESR's preference for short position disclosure was supported further by the number of responses that drew attention to the inherent flaws of a potential flagging regime, ranging from it being too costly, to it being complex and intrusive.

32. The view was expressed strongly that the system that is finalised must be harmonised and clear, particularly in terms of the roles and responsibilities of the various market participants for making short selling disclosures, and must impose a proportionate compliance burden.

33. Although a small number of respondents suggested that CESR should undertake a more detailed cost benefit analysis (CBA) of the relative merits of flagging versus position reporting, CESR notes the very strong support amongst respondents for its analysis as it currently stands and does not consider that, in all the circumstances, a more detailed CBA on this issue is required. CESR would note that reporting and flagging both have advantages and disadvantages. Additionally, they are not mutually exclusive and can complement one another. However, there was a strong preference amongst respondents for short *position* reporting rather than a system, based on flagging, for the reporting of short *sales*. Further, a significant number of respondents specifically opposed flagging because of the potential implementation costs involved.

34. In the light of these views and for the reasons set out in the CP, CESR continues to believe that reporting of significant short positions is the more appropriate means for enhancing

transparency of short selling in a pan-European context. Accordingly, whilst CESR recognises that both approaches (flagging and position reporting) have advantages and disadvantages, it has decided, at this time, to proceed on the basis that transparency of short selling should be enhanced on a pan-European basis through the reporting of significant short positions.

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

35. There was widespread support from respondents for the proposal that a disclosure regime should apply to all sectors and not be limited to one sector, although one respondent advocated limiting it to financial sector stocks. There were, however, comments on a number of other issues.

36. The precise territorial scope of the disclosure regime attracted a lot of comments. Most who discussed this issue believed that the scope should be wider than proposed by CESR, suggesting that all equities traded within the EEA should be covered, irrespective of whether the issuer is an EEA issuer or a non-EEA issuer, or whether shares of non-EEA issuers are primarily or solely admitted to trading in the EEA. That said, one or two respondents did think that the regime should be limited to equities admitted to trading on regulated markets (not on MTFs). In addition, a number of respondents, including those who advocated a wide scope, pointed to the difficulties in enforcing a regime outside the EEA.

37. Two respondents suggested that there should be some centralised means of identifying affected stocks, whether through a list on the CESR web-site or through an ISIN system.

38. CESR continues to believe strongly that the risks associated with short selling apply to stocks in all sectors and that, accordingly, enhanced transparency through position reporting should not be limited to any one sector. It is pleased to see the widespread support for this position.

39. The comments from respondents on territorial issues are noted with interest. By way of response, CESR would reiterate that it considers it very important that shares admitted to trading in the EEA (except if their primary market is located outside the EEA) should benefit from the protection of a disclosure regime irrespective of whether the issuer in question is incorporated in the EEA. The location of incorporation of an issuer does not necessarily determine the importance of that issuer in a particular market or the wider impact that disorder in the market in its shares may have.

40. CESR's position that non-EEA shares that only have a secondary listing in the EEA should not be covered is premised on the assumption that, given the international initiatives[1] aimed at achieving international consistency in the regulation of short selling, where possible, there may well be similar transparency requirements in the issuer's 'home' country. Equally, however, if no requirements are in force in the 'home' country, it would seem odd to impose them in markets where the issuer had only a secondary listing.

41. In addition, while CESR acknowledges that there are difficulties in enforcing requirements on investors located outside the EEA, it strongly believes that to exclude such investors would severely undermine any disclosure regime. This issue arises in relation to the enforcement of other EU Directives, such as the Market Abuse Directive (MAD) and the Transparency Directive (TD), where the same approach has been taken. As with these Directives, CESR's view that a short position disclosure regime should be enforceable outside the EEA would rely on effective international co-operation as contemplated in, amongst other things, the 2002 IOSCO Multilateral Memorandum of Understanding.

[1] Most notably, the work undertaken by the International Organisation of Securities Commissions (IOSCO).

42. One further issue relating to scope has come to CESR's attention. The current CESR proposal, as currently worded would include all shares traded on non-regulated markets. Until now shares admitted to trading on such a market are outside the scope of any other European Directive such as TD or MAD. Hence the issuers on these markets are not obliged to publish any information under these directives.

43. Nevertheless, CESR notes that it has stated in another context2 that it believes that the scope of the MAD should be extended to MTFs. CESR's view is that the issuers whose shares are admitted to trading solely on MTFs are of growing importance to markets in the EEA and that their shares should not be excluded from a short selling disclosure regime. In addition, CESR does not favour giving Member States a discretion to extend the scope of the short selling disclosure regime to shares admitted to trading solely on MTFs as it is a core objective of this proposal to ensure that market participants are subject to the same disclosure obligations regardless of where within the EEA the shares in question are admitted to trading. Accordingly, CESR decided to retain its original proposal regarding the scope of the regime, emphasising however that the regime would not apply to shares admitted to trading on an EEA regulated market and/ or an EEA MTF if their primary market is located outside the EEA.

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)?

44. It is fair to say that only a few respondents agreed with all the elements of CESR's proposal for a two-tier disclosure model. A significant number were opposed to public individual disclosure, either stating that there should only be private disclosure to the regulator or that any public disclosure should be by regulators and should be on an anonymous and/or aggregated basis. A couple of respondents noted that CESR's cost benefit analysis of the two-tier model was not sufficient. The most common reasons for opposing public disclosure of individual positions were the perceived risk of 'herding' behaviour when the identities of big-name short sellers are revealed; concerns about forced disclosure of companies' intellectual property (particularly when the disclosure requirement would come in at a much lower level than that for major long shareholdings disclosures); the risk of short 'squeezes' by competitors; concerns about the impact on the relationship between issuers and short sellers (investors); the perception that public disclosure might be seen as a form of naming and shaming of significant short sellers; and, as a result of all of these factors, that the proposed regime would deter short selling and damage market quality by diminishing the benefits which legitimate short selling can bring. More generally, it was questioned whether there was a material market failure which was required to be remedied by a disclosure regime – in some cases this comment related to the proposal for private disclosure to the regulator as well.

45. That said, there were a significant number of respondents who did explicitly support the notion of public disclosure, seeing it as an essential part of a short selling disclosure regime. Interestingly, four respondents thought there should only be public position disclosure.

46. Strong support for public individual position disclosure tended to come from issuer representatives with financial industry groups having split views. It should be noted that no respondents indicated that they favoured anonymisation and/or aggregation of the private disclosures by regulators *in addition* to a two-fold requirement for private and public disclosure.

[2] See CESR response to the European Commission Call for Evidence on the review of the MAD.

47. CESR recognises that the extent of the compliance burden will depend on the levels at which thresholds are set – the lower the threshold, the greater the number of disclosures and the higher the compliance burden. CESR continues to believe that there are clear benefits to enabling regulators to monitor growing short positions before they are made public. In addition, a two-tier disclosure regime affords a degree of flexibility that enables harmonisation amongst CESR members of the precise disclosure thresholds, an issue that CESR knows is of great importance to respondents.

48. CESR acknowledges that there is significant opposition to the notion of public individual position disclosure and recognises the principal grounds of objection – indeed most were referred to in the CP. However, those CESR members who operate public position disclosure regimes and who have undertaken empirical analysis of the impact of those regimes have not seen these concerns crystallise. Short sellers have continued to show themselves willing to take positions which require public disclosure. So the empirical evidence is that the thresholds do not act as ceilings for short selling, although it is recognised that it is impossible to say what the level of short selling might have been in the absence of the disclosure requirements. Moreover, no clear examples of short squeeses as result of public disclosures of short positions have come to regulators' attention nor have there been any obvious cases of herding behaviour. In CESR's view, a comprehensive short selling regime where disclosures of significant short positions were a routine and regular feature of the market would mitigate rather than intensify any concept of naming and shaming.

49. As it has been stated before, CESR believes that a short selling disclosure regime should aim to achieve a measure of behavioural change and, for that reason, continues to hold the view that public individual position disclosure should be a crucial part of the regime. In addition to the substantial informational benefits it provides to the market, this option will help to constrain particularly aggressive large scale short selling which may involve unacceptable risks of abuse or disorderly markets. CESR considers that when short positions reach certain, relatively high levels, short sellers should be required to decide whether they wish to be identified to the market before they choose to continue with their strategy. Whilst this may have some effect on absolute levels of short selling CESR does not think that, on the basis of the evidence available so far, this will put a halt to short selling or be such as to reduce market quality materially.

50. Because of the monitoring benefits it provides to regulators, CESR continues to regard private disclosure as warranted and valuable. Private disclosures will allow regulators early sight of positions which are building up or which, while not reaching the public disclosure threshold, are still significant – particularly in markets where there are not expected to be many public disclosures.

51. In addition, CESR recognises the potential informational benefits of publishing aggregated data and acknowledges that, in addition to the disclosure model as previously proposed, members may choose to publish aggregated data that they receive as a result of private disclosures. CESR's intention is to put this forward as an optional rather than a mandatory element of the regime for members to implement. CESR believes that this is appropriate because to do so does not affect the nature of the requirements that will fall on market participants and, therefore, the fundamental harmonising objective of the regime is not undermined.

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?

52. There was overwhelming support from respondents for CESR's proposal that there should be pan-European uniformity for disclosure thresholds for both private and public disclosure. A number of respondents continued to indicate that they opposed public individual position disclosure but a number of these stated that, if CESR were to retain public disclosure, there

should be uniform thresholds throughout the EEA. There were also some comments on the precise levels for thresholds. These are addressed in relation to question 7 below.

53. There were a few respondents who advocated differentiated thresholds, based either on existing liquidity or on the turnover of a share.

54. Convergence of standards amongst CESR members and, as a result, lessening the compliance burden of investors operating across borders, was one of the principal motivations for CESR deciding to agree standards in relation to short selling. A key standard for a position disclosure regime as proposed by CESR is the level of disclosure thresholds. The very strong support from respondents for CESR's approach and the complexities of applying differentiated thresholds confirms that this is the right way forward.

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

55. A large majority of respondents thought that both the proposed thresholds (for public and private disclosure) were set too low. A number stated that the lower initial threshold for private disclosure, in particular, would place a disproportionate burden on institutions. In addition, some questioned the informational value and effectiveness of private disclosure with the low thresholds proposed as they considered these reports may actually lead to confusion and regulatory 'noise', decreasing transparency overall. Some referred to the higher thresholds set under extreme market conditions and questioned the rationale for lower permanent thresholds.

56. Most of those who opposed the initial threshold for private disclosure proposed by CESR (0.1%) favoured an alternative initial threshold of 0.25% or even 0.5%. For public disclosure several respondents called for thresholds ranging between 1% and 5%, while others supported the proposed threshold of 0.5 %. However, one respondent preferred a general public disclosure at a 0.1 % threshold.

57. One or two respondents argued for alignment, where possible, of the thresholds and disclosure requirements for short selling with those required under the Transparency Directive.

58. Several respondents made additional comments on the proposed subsequent thresholds triggered by a 0.1% change in the short position with the majority suggesting a higher increment of 0.25 or 0.5%. One respondent actively supported the 0.1% incremental thresholds as proposed by CESR.

59. In general, many respondents felt that more cost-benefit analyses and/or an impact assessment were needed to be able to correctly set the appropriate thresholds. The majority also agreed that the suitability of the thresholds chosen should be reviewed, preferably 12 months after the proposals have been implemented.

60. In view of its continued commitment to a two tier model, CESR considers that the two thresholds should be set at significantly different levels. In the absence of further pan-European short selling measures, the initial 'private threshold' should provide regulators with timely and adequate information on the potential market impact of short positions so as to evaluate the need for supervisory interventions. An initial threshold set too high would not fulfill this requirement. A short position is significant at a lower percentage level in terms of market impact than is a long position in terms of corporate governance impact. Conversely, an initial threshold set too low could generate a great deal of data of little value, creating an unnecessary compliance burden on investors and administrative challenges to regulators but questionable regulatory dividend. CESR notes that it received from

respondents very little empirical evidence[3] that provided insight into the potential numbers of disclosures that might be required by the proposals. This lack of evidence makes the task of giving a reliable estimate of the compliance burden more difficult. However, many respondents indicated that, on the basis of anecdotal evidence, the reporting burden would be likely to become significant at the lower threshold.

61. In response to the feedback from the consultation, CESR decided to raise its proposal for the initial threshold to 0.2%, which should significantly reduce the reporting burden but would still facilitate proper market monitoring by competent authorities. The decision taken by CESR was supported by the results of an informal survey conducted by the UK FSA to assess the impact of the proposed thresholds, particularly the lower threshold for private disclosure, on the daily numbers of disclosures that might be expected. The findings indicate that the FSA would face many hundreds of reports each day with the bulk of the positions never progressing to anywhere close to the 0.5% public disclosure threshold.

62. In addition, for the private and public disclosure regimes steps of 0.1% should be used as incremental threshold bands to trigger further disclosure obligations on change of a short position (either up or down), after the initial disclosure obligation has been incurred. Thus further notifications to the regulator would be required at 0.3% and 0.4%. Further notifications to the market and to the regulator would be required at 0.6%, 0.7% etc. Disclosures would also be required at the point at which the short position fell back below any of the trigger thresholds, including the initial trigger thresholds.

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?

63. The suggestion to increase transparency during significant capital raisings was only supported by a minority of respondents. The majority did not agree with the need to impose stricter public thresholds as they considered that the extent to which the benefits would outweigh the implementation and management costs was not clear. In addition, a number noted that a further disclosure threshold would make the regime more complex and increase compliance costs.

64. The comment was also made that, should different requirements apply during significant capital raisings, it is important that market participants have access to a central database where all EEA issuers undertaking a significant capital raising are listed. Furthermore, a few respondents pointed to the need to clearly define 'significant capital raisings' to prevent confusion.

65. CESR recognises the need for clear definitions and timely public information about issuers undertaking significant capital raisings in order to prevent confusion and avoid high management costs, as well as to enhance a level playing field as much as possible. CESR notes that if a two-tier disclosure regime were implemented, regulators would have access to information about short positions held in rights issues companies from a relatively early stage. If those positions continued to grow and raise regulatory concerns, regulators would, using this information, be in a position to act quickly should they see fit. Accordingly, for these reasons and in light of the responses received, particularly those raising questions about the difficulties of compliance, CESR believes that the additional protection afforded by a separate lower public disclosure threshold for rights issue stocks is not necessary on a permanent basis. However, CESR would note that exceptional circumstances could arise where more stringent standards are required with respect to rights issue stocks.

[3] One respondent ran its systems on a sample of past days trading to provide numbers of disclosures at the two thresholds.

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

66. A minority of the respondents supported the proposed lower threshold for disclosure of short positions held in companies engaged in rights issues. Most opposed it, either reiterating their arguments against public disclosure of individual short positions generally or underlining their preference for consistency in applicable thresholds.

67. As discussed in response to Q8, CESR considers that a lower threshold for public disclosure of short positions held in rights issue shares is not necessary on a permanent basis.

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?

68. The vast majority of the respondents did not believe there were any other circumstances that justify more stringent disclosure standards. A few referred to the need for uniform and consistent standards to underline their preference for equal standards in all circumstances.

69. A number of respondents agreed that there may be exceptional circumstances that justify more stringent standards, namely in case of other circumstances that have an impact on the issuer's Core Tier One Capital Ratio or in case of a takeover. These respondents stated that any emergency measures should always be harmonised across European jurisdictions.

70. One respondent suggested that there may be extraordinary situations that would require a disclosure regime to be extended to include requirements in relation to security lending activity, as lent positions may help to identify shorting by investors.

71. Although CESR has concluded that permanent lower disclosure threshold for rights issue shares is not warranted, it still recognises that right issues by companies in certain circumstances may give rise to a particular vulnerability on the part of the issuer. In those circumstances Member States/competent authorities may wish to consider introducing more stringent disclosure standards than apply generally. It is envisaged that such standards would be likely to be temporary and exceptional. At this stage, CESR does not foresee other specific circumstances that similarly demand a lower public disclosure threshold. However, CESR is aware that further experience may lead to valuable insights in this respect. Review of the thresholds after a regime has been in operation for some time, could include a review of the need for more stringent standards in certain circumstances.

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

72. The majority of respondents supported calculation of short positions on a net basis. However, a number of respondents doubted the extent to which calculations on a net basis would provide the required transparency and feared that it might actually create a risk that transparency obligations could be circumvented.

73. The scope of the proposals, including all financial instruments that create an economic exposure to the relevant share, was supported by most respondents. However, while one respondent expressly stated the view that OTC trading should be included, there were opposing views on whether derivatives trading should be caught. One or two respondents questioned whether short positions created by exposure through positions in indices, baskets or Exchange Traded Funds (ETFs) should be included. Two respondents stated that the calculations should only include short positions in cash markets and should exclude short positions in derivatives contracts.

74. A number of respondents believed that CESR needed to provide greater clarity on the definition of "economic exposure" and on how a "net short position" should be calculated.

75. Respondents' views diverged and questions arose with regard to the level within a group at which (short) positions should be aggregated. Although the calculation of short positions on a legal entity level, as proposed, was supported by a small majority of respondents, a number strongly preferred these calculations to be made at group level. Other respondents asked for further clarification or an analysis to determine the precise level at which the calculation ought to be made given the different levels within one group at which the investment decision can be made. The appropriate aggregation level seemed to be particularly unclear amongst respondents when it came to disclosure requirements for fund managers. In this respect, a few expressed their preference for the disclosure of the aggregated short position to be made at the level of the management company. Three respondents supported the idea that groups should be able to organise their reporting according to their own internal policies. One of the strong themes that emerged from responses to these questions was that CESR needed to provide more technical detail on how positions would be calculated and, within the context of a complex business structure, the level at which positions should be aggregated or netted. CESR acknowledges this call and seeks to provide appropriate additional analysis.

76. As stated in the CP, CESR considers it crucial that short positions are calculated by taking into account trading in all financial instruments, including indexes and derivatives, and that calculations should not be limited to trading in the cash markets. In other words, if the proposed disclosure regime is to be effective and valuable, market participants will need to be aware of their overall position. Without such coverage, it would be easy for investors to circumvent the disclosure requirements. CESR also proposed that short positions should be calculated on a net basis, meaning that long positions could be off-set against short positions in order to determine whether or not an investor was subject to a disclosure obligation. The CP stated that all transactions that create an economic exposure to the issued share capital of the issuer should be taken into account and that "economic exposure" should be calculated taking into account all classes of shares.

77. In the light of responses received, CESR has reached the view that it would be helpful to clarify how these calculations might be undertaken and, where possible, provide more practical detail. CESR has done considerable work to develop its thinking on these issues but has not yet reached a final view on them. CESR anticipates that it is likely to publish its position on these additional issues as and when it is in a position to do so.

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

78. There was strong support for a harmonised method of disclosure across EEA jurisdictions. To further strengthen harmonisation, a few respondents pointed to a role for CESR to lay down clear definitions, standards and harmonised forms and promote consistent implementation of disclosure requirements. Moreover, others expressed their preference for a pan-European database of all disclosed positions and alignment of the mechanics of disclosure with the disclosure requirements set out in other European Directives, e.g. the Transparency Directive.

79. The vast majority of respondents supported the idea that the responsibility for making the disclosures should lie with the position holder, and recommended that the disclosure form be submitted to the competent authority by email. Several respondents however questioned the proposal that reports should be made to the regulator of the most relevant market in terms of liquidity: some favoured submission of reports to the home regulator of the issuer, while a small number favoured submission to the home regulator of the position holder. The information could then be shared among the relevant regulators. A small number of respondents expressed their preference for one single, pan-European recipient of disclosed information.

80. Another group of respondents drew attention to the likely high number of disclosures due to the low thresholds and questioned whether a manual method would be workable for regulators and position holders alike and suggested that it might be prone to errors and inaccuracies.

81. Given that the market impact of short positions is generally most significant on the most relevant market in terms of liquidity, CESR continues to consider that the regulator of this market should receive timely and adequate information on the short positions held. CESR acknowledges that other regulators also need this information to supervise the good functioning and stability of their home markets. Therefore, CESR stresses once more the importance of effective information sharing and co-operation among the competent authorities of Member States.

82. CESR notes the comments regarding the practical implications of disclosure and has developed its thinking further in response to these comments. In the CP, CESR proposed a simple approach to making private disclosures - the private disclosure should be submitted by e-mail to the regulator of the most relevant market in terms of liquidity (along the lines of Article 25 3) MiFID). For the public disclosure, CESR only made a high level proposal that the public disclosure should be made in a manner that ensures fast access to such information on a non-discriminatory basis.

83. CESR has done further work to develop its thinking on these issues but has not yet reached a final view on them. CESR is likely to publish its position on these additional issues as and when it is in a position to do so.

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).

84. A large majority of respondents considered the content of the disclosures proposed by CESR to be sufficient, their main reasoning being that being required to disclose more detail would generate additional costs and complexity without bringing additional relevant information. There were no specific suggestions for further details in relation to either the content of disclosures or the form in which they should be made. A few of those who opposed public disclosure mentioned that short seller identity was not necessary. One respondent suggested that position holders should be able to report in English to avoid misunderstandings.

85. Many respondents pointed out that the content and the form should be identical or uniform across the EEA, with no room for individual (national) requirements in order to avoid inconsistency.

86. A few respondents supported inclusion of a breakdown between physical and synthetic elements of a position. This was based on the idea that such a breakdown would be helpful in understanding how the position has been built up. However, some respondents opposed such a breakdown on the basis that it might complicate the assessment of the short position with no added value.

87. One respondent recommended that only short positions in shares should be disclosed without taking into account any derivative position.

88. CESR understands the need for a uniform format and content for the disclosure across its members and will seek a maximum harmonisation so that the room for individual (national) additions or amendments is minimised. Although CESR recognises that there may be some potential regulatory value and market information value if disclosures were more detailed in certain respects, it is not inclined, at this stage, to change this aspect of the proposal Howev-

er, CESR notes that this issue may need to be re-visited in order to take into account future policy developments in other, related areas, such as in relation to the Transparency Directive.

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

89. There were mixed views on this issue since a number of respondents stated concern about the tightness of the timeframe given for disclosures. Some recommended T+2 and T+3 and there were also a couple of calls for T+4 in order to assure consistency with the disclosure duties under the Transparency Directive. One respondent mentioned the concept of "as soon as possible" to be used to be consistent with MAD. However, at least half of the respondents agreed with CESR that T+1 reporting seemed realistic and attainable.

90. Many of those who suggested a longer timeframe did so because they thought that group-wide reporting and aggregation could make reporting within T+1 very challenging. These respondents claimed that sometimes time-consuming calculations due to the use of complex derivatives and netting out positions need to be performed. Additionally, the existence of different time zones might delay disclosure. There was also one reference to the fact that enlargement of the scope of the regime might mean that an entity could have to make multiple disclosures to multiple authorities on any given day.

91. A small group of respondents took the opportunity to demand a common and precise definition of T (trading day on which the disclosure obligation is triggered) to ensure the same notion is addressed by all market participants.

92. As noted in the CP, CESR thinks that disclosures of short positions should not be delayed and should be divulged as soon as possible. So far, CESR members with disclosure regimes have not been aware of market participants' systems not being able to cope with calculating and disclosing short positions within a day of the trading taking place. However, it recognises that this model applies to a very wide population of shares and that, in some circumstances, communication and aggregation will be complicated. CESR may review and, if necessary, revise this aspect of the proposal if it forms the view that a T+1 reporting obligation is too onerous and difficult to comply with.

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?

93. About two thirds of the respondents agreed with CESR's position that market makers should be exempt from the public disclosure obligation. They particularly noted that the exemption should only apply when an entity is acting in a client facilitation capacity and/or when it provides liquidity on a regular basis.

94. Those who objected to the exemption did so mainly for two reasons. Firstly, they failed to see the need for such an exemption that would result in some levels of short selling not being reported. Secondly, they noted the potential for abuse by those falsely claiming that they are acting in a market making capacity. Some respondents asked explicitly for a clear differentiation between market making and proprietary trading activities. One respondent stated that this exemption would create incentives to trade OTC rather than on regulated markets and MTFs.

95. There was a request, most notably from those who shared CESR`s view to exempt market makers from disclosure obligations, that CESR provide a unified and generally accepted definition of "market maker". A number of respondents provided comments on how market makers should be defined for these purposes. Only two explicitly included client facilitation

in the definition, while others, by contrast, focused on the provision of liquidity to the market on a regular basis on both bid and offer sides in comparable size. One respondent specifically said that the definition in MiFID (Art 4.1.8.) was too wide for these purposes while another recommended that the definition should include market makers that are non-MiFID firms. Additionally, there was one view that suggested extending the exemption to market makers that are not registered within a regulated market or MTF. There was one answer encouraging CESR not to give any greater definition of market making as it may cause more difficulties than it solves.

96. CESR continues to consider that market makers should be exempted from public disclosure requirements. It is generally recognised that, because of their central role in the market, such entities may require special regimes to be applied to them. As regards short selling, their function can require them to take short positions on a regular basis. However, in doing so they are acting to fulfill market demand rather than taking a directional stance on the shares and look to hold positions for only a very limited duration. As such they are in a different category to other short sellers and an exemption is warranted. As far as definitional issues are concerned, CESR's current view is that the exemption should refer to market makers and not to liquidity providers more generally. CESR also holds the view that proprietary trading does not fall within the scope of market-making and therefore should not be exempt.

97. CESR continues to develop its thinking on the definition of market maker that it believes should apply for these purposes and is likely to publish its position on this as and when it is in a position to do so.

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

98. Views were very evenly balanced on this point. Those who agreed with CESR did so mainly on the grounds that limited, temporary short selling activity as a result of market making would not be the kind of practice that regulators wanted to oversee. In most cases no additional remarks were given. Respondents who disagreed with CESR based their opinion on the fact that regulators should not be deprived of this useful information.

99. CESR would not expect market makers to hold significant short positions other than for short periods of time and therefore maintains its position that the absolute disclosure exemption should apply for them. However, in order to assist competent authorities monitor appropriate reliance on this exemption and prevent abuse of it, it would be open to CESR members to require those financial institutions intending to rely on this exemption to notify the relevant regulator of this intention before making use of the exemption.

Q17 Should CESR consider any other exemptions?

100. Almost half the respondents replied that CESR should not consider other exemptions and nearly a quarter did not answer this question.

101. Among other possible candidates for exemption suggested by respondents were underwriters/sub-underwriters in their hedging activities and specialists or liquidity providers (some of the descriptions provided would fall into the market-making activity). One respondent raised concerns about CESR`s narrow view of liquidity provision because only liquidity providers with contractual obligations to the trading venue would be eligible for exemption.

102. The main reason that some respondents wanted to exempt underwriters/sub-underwriters was the fact that they are subject to hold long positions or long economic exposure or interests. On this basis it was felt that they should not be required to disclose "bona fide" sales of

shares to hedge such a position up to a quantity not exceeding their underwriting commitments.

103. There was one suggestion that stock lending recalls should be discharged from the disclosure obligation. Recall of loaned shares should not be disclosed if done prior to executing a sale. Additionally, one respondent suggested that short positions held as a result of short positions in indices, baskets and ETFs should be exempt from disclosure.

104. Some included for consideration broader concepts like "bona fide" hedging and arbitrage activities.

105. CESR recognises that there are arguments for including a wider concept of liquidity provision for exemption but retains concerns that to do so could give rise to abuse by those falsely claiming to be liquidity providers. At this stage CESR is not minded to include any further categories, such as underwriters and sub-writers, for exemption. CESR also considers that exempting positions held as a result of short positions in indices, baskets and ETFs from the disclosure calculations could leave a significant loophole in the disclosure regime and therefore does not plan to exempt them.

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?

106. There was strong support for CESR's proposal that regulators should have explicit powers to require short selling disclosures in stand-alone legislation. It was also mentioned in a number of responses that new legislation should not be associated with or implemented within MAD in order to avoid associating short selling with market abuse.

107. Most agreed that if new legislation were to be introduced it should be done in the form of a European Regulation (rather than a Directive) to ensure as harmonised a European framework as possible (there were also some calls to try to be as consistent as possible with US regulation). Some respondents suggested including these provisions into an amendment of the Transparency Directive to align the mechanics of long and short disclosure, although there were others who explicitly stated the opposite. One respondent suggested including the issue within MiFID.

108. Only a small number of respondents disagreed with CESR that there should be separate legislation. This view tended to be based on the fact that emergency measures had already been implemented in many Member States and that new European legislation, which in their view is often burdensome and lengthy to implement, was not necessary.

109. In light of the strong support for CESR's proposal and for the reasons set out in the CP, CESR recommends proceeding with new European legislation via a discrete Directive or Regulation. It is clear that legislation is required to ensure that there is a harmonised European approach in this area. As regards the legislative vehicle, CESR continues to believe that an amendment to the Transparency Directive is not the right way since short selling legislation pursues different objectives. Additionally, the existence of different thresholds for different purposes within the same Directive might also unnecessarily complicate understanding of the Transparency Directive. Nor is MiFID suitable for a short selling disclosure regime as those who engage in short selling are investors at large not just MiFID regulated entities.