30th September 2009
Sped n. 73/09

CESR
11-13 avenue de Friedland
75008 – Paris
France

Re: CESR Proposal for a Pan-European Short Selling Disclosure Regime
Responses to Consultation 8 July 2009, Reference number: CESR/09-581

With reference to the Consultation in hand, the Italian, French and Spanish Associations appreciate the opportunity to comment the proposals on short selling because of its relevance for the European financial industry.

We all welcome CESR's consideration of the topic above and we wish to focus attention on the need to weigh the benefits of the short selling practices in the markets.

PRELIMINARY REMARKS

To summarize:

- In the absence of convincing evidence of any market failure, we do not consider the proposed disclosure regime for short positions to be warranted due to its likely negative impact on market efficiency;
- In the event that a disclosure regime is deemed necessary, we believe that the scope of such a regime should be substantially modified, and
- In view of CESR's continuing consideration of other regulatory measures, we reiterate our strong opposition to any permanent short selling ban.

It is generally recognized that short selling improves market efficiency and liquidity, and reduces trading costs for investors; it plays a pivotal role in the implementation of investment strategies designed to maximize performances; it is an essential component of hedging and arbitraging, so enhancing the liquidity of derivatives markets too.

Historically, restrictive short selling measures have not been of any demonstrated help in restoring orderly market conditions, and certainly their benefits have not outweighed costs. As a matter of fact, there is no convincing evidence of a determinative relationship between short selling activity and high price volatility. Equally, it has not

been demonstrated that there is a connection between short selling and market abuse in the absence of other manipulative tactics[1]. On the contrary, the extremely negative trend of several financial shares despite the temporary regulatory measures restricting short selling has shown the inefficiency of such remedies to prevent slumps.

Against uncertain benefits, a move to ban short selling (either covered or naked) or to introduce measures which would negatively impact on the ability of a market operator to go short, would have serious negative effects on financial markets' efficiency. Besides these effects, further costs have to be considered such as foregone profits deriving from a reduction in the trading activity and in securities lending. Obviously, the negative impact is higher where the restriction is adopted as a permanent regime, applicable regardless of market conditions.

We strongly consider that a ban or a transparency regime could be introduced only on a temporary basis as a last resort measure under exceptional and unforeseen market circumstances. Furthermore, it should be targeted at specific sectors and adopted only where benefits can be demonstrated through a cost-benefit analysis. Moreover, should public disclosure be introduced, it should be done on an aggregated basis for all reported short positions in a specific equity; it is of the utmost importance that any obligation to report is fully harmonized throughout the whole EU/EEA area, in particular as regards the definition of "market making".

If CESR decides to recommend such a regime, we trust that the proposed disclosure obligations will lie with the final investor.

With specific regard to the proposal under consultation, we argue that a short position disclosure regime has uncertain benefits while producing negative effects on market efficiency. Indeed, public disclosure of short positions could seriously damage:

- investment managers by exposing their strategies to others;
- other investors, who may attempt to mimic the disclosed investment strategy without bearing costs and understanding the implications;
- the market by i) intensifying prices fall because of the above mentioned "mimic strategies" and ii) reducing the efficiency of price discovery iii) increasing volatility and spreads iv) driving the trading activity towards less regulated markets.

[1] IOSCO, Report on transparency of short selling (June 2003). Salli and Sigurdsson (2008) demonstrated that short selling bans worsen the price discovery process and the market efficiency. Bohmer and Wu (2008) demonstrated that short sellers improve the price discovery process and the market efficiency. Charoenrook and Daouk (2005) demonstrated that bans increase volatility of securities returns.

As regards the first point, the disclosure regime discourages the assumption of short positions, producing the same effects on market efficiency and liquidity as would a short selling ban.

With reference to the second point, it is worth notice that asset managers and institutional investors conduct costly financial analyses to identify overvalued stocks. Public disclosure of short positions would allow other market participants to act unfairly as free riders, so reducing the profits that would otherwise be gained by those that have actually performed the research. As such, public disclosure of short position would as a disincentive to financial research.

As regards the effects on financial markets, a public disclosure regime could result in the transfer of short selling activity to non-EEA markets where the regime is not effective. The result would then be opposite to the one pursued by the regulators.

Moreover, public disclosure would expose traders to the opportunistic behavior of other participants that could gain unfair profits by squeezing the shorts. A squeeze can result in substantial losses for the holder of a short position while leading to a greater volatility. It should also be noted that traders go short for several reasons, not always due to a negative view of a company's outlook. Operators may trade equity options or futures and then short the individual stock in order to profit from arbitrage opportunities or to hedge their position. In such circumstances, public disclosure of short positions may mislead investors, who may incorrectly assume that the institution has a negative view of the company whose stock is being shorted.

Furthermore, the communication to the market might result in an unforeseen and unwarranted fall of share prices. Without disclosure, securities prices' adjustments to their fair value would be more likely to occur in a gradual manner. However, the communication to the market could act as a catalyst producing the so called "herding effect".

Moreover, set-up and compliance costs should be taken into account, such as costs for:

- data processing
- communication
- monitoring
- enforcement

Even if the disclosure regime would require disclosure to the regulator alone, the above considerations would still be present. Indeed, if on one the hand this regulatory choice avoids opportunistic, mimic behaviors and the "herding effect", on the other hand it would act as a disincentive for short selling activities, so damaging markets' efficiency and liquidity. Furthermore, all the above described costs would still be incurred.

In view of these substantial costs already incurred, stakeholders would benefit from a public report on the actual benefits derived to date from the temporary short selling measures imposed as a result of the recent crisis. It would be interesting to know if the information obtained from transaction/position reporting has been useful in uncovering actual market abuse.

Without prejudice to the above, we all consider that, should CESR reach the conclusion that it would be worthwhile and feasible to introduce a transparency regime on short selling, the following responses to the questions raised in the consultation are offered for consideration:

List of Consultation Questions

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

No, but should such a regime be introduced, it should be set in accordance with several parameters noted below. In any case, we believe that the relevant national authority should be the addressee of all short selling reporting regarding securities traded both on national regulated markets/MTF and on foreign EEA markets.

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

Yes, we agree with CESR's analysis. We do prefer short position reporting over tagging. As we have already declared in the foreword, the reporting obligation must be on the final investor who might be a natural person, a management company or a financial institution trading on a proprietary basis (not market making). An intermediary will not be in a position to know the net position of the client or customers for which it acts. Neither it should be required to investigate such a position

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

Yes, we agree.

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

We do not agree with the proposed scope which would expand from solely financial firms to all equities traded in the EEA which number in the thousands. We urge that the scope be limited to financial firms for reasons of cost and complexity. We consider that no market failure has occurred to justify an expansion of scope.

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 anonymized 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)?

No, we would support a regime which only sets a private disclosure obligation to the relevant regulator. Disclosure to the public has several downsides among which:

- the herding effect, due to which normal investors could mimic the strategy of some important and well-know market participant without understanding its rationale thereby adding irrationally to downward market pressure;
- short squeeze, namely should competitors become aware of the short seller activity, they might buy up shares on the exchanges in order to make the financial instrument's price soar. As a consequence, the short seller shall be unfairly forced either to repurchase the same lot of securities previously sold short at a substantially higher price for a loss or to post significantly higher collateral with attendant unlimited risks; and
- investors and their analysts and equity researchers will have less incentive to conduct highly expensive research and studies which assist rational price discovery, since they will not be as highly compensated for such activity. Let's face it: who will invest in research which must be shared with all direct competitors?

In our view, if public disclosure is introduced, it should be done at an aggregated level for all reported short selling in a specific equity.

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?

Accordingly to answer no. 5, we do support a pan-European threshold for private disclosure. Furthermore, following the U.S.A. regulation, we propose

that the relevant regulator should be given the power to allow disclosure exemptions (please, see answer to Question no. 18).

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

No, we believe that thresholds are too low. Should a threshold for public disclosure be introduced, the initial threshold should be set not lower than 1%. To mitigate the negative effects noted in our preliminary remarks. In addition, we strongly support the idea that CESR should make available in its website the list of all the public companies listed on all the EEA markets, **including the capital,** in order to have a single data basis available to those request to disclose their short positions and helping them in determining the denominator in the calculation of the net economic exposure in %. This information should be also be made available for the thresholds imposed by the Transparency Directive. At the moment, investment firms are facing huge difficulties in capturing this information, the websites of the public companies not being updated in many cases.

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?

No, we believe it is difficult to manage several thresholds which are unnecessary in normal markets.

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

No, we do not agree (please, see answer to question no. 10).

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?

No, we do believe that a general discipline should be established for all market activities. Therefore, it is of the essence that it should be set at a proportionate level and be generally applicable. In doing so, uncertainty will be avoided by removing all doubts regarding which threshold must be met.

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 CESR's proposal method of calculation: the position should be calculated taking into consideration a net basis and, regarding derivative and cash positions, on a Delta adjusted basis.
Moreover, we strongly support the idea that groups can organize their reporting according to an internal policy. Netting only per legal entities may have no sense in business lines acting globally on the equity markets from different jurisdiction, and using different legal entities (broker dealers). At the end of the day, it is the same activity which is concerned and the position has to been calculated globally. On the opposite, it may be meaningless to consolidate in one global position all position for the all group, without taking into account very different activities performed according different strategies. In different core businesses protected by the information barriers. These entities must follow their economic exposure with their tools and disclose if necessary on their own.

For these reasons, we believe that each group should be asked to draft a policy which will define and justify the way positions are calculated and netted. This policy will be available to the regulators on their request.

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

Yes, we agree with the proposal: email is a fast and safe means.

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).

No, it is our view that the proposed set of information is sufficient.

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

Yes, we believe that T+1 is an advisable timeframe but only if the scope of the regime is substantially reduced e.g. financial companies only and only private disclosure (to the regulator) at a 0.5% level. If the scope remains as proposed in the consultation paper, we believe that the timeframe should be T + 2.

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?

Yes, we support their exemption from disclosure obligations but we expect a clear definition of what the market making activity is in this context. The experience of the last quarter of 2008 highlighted the fact that regulators within

the EEA did not define market making the same way, and these different definitions created a lot of confusion and uncertainty. Without any clear definition, there is a risk that the rules could be circumvented by certain market actors.

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

Yes, we consider that they are subject to regulatory supervision at all times and disclosure to the regulator is not necessary.

Q17 Should CESR consider any other exemptions?

Yes, we would propose that specialists as well as underwriters/sub-underwriters (for their hedging activities) should be exempt from disclosure obligations. A specialist is committed to guarantee the liquidity of one or more securities on the market by constantly exposing bid and ask offers and, as such, it should be considered a market maker. Underwriters and sub underwriters are also bringing shares to the market and their *bona fide* hedging by selling shares does not cause them to be short in their economic interest.

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?

Yes, we would welcome a power for European regulators to establish temporary disclosure in respect of short selling in emergency situations such as extreme market turmoil or other crisis. Such powers should stem from European legislation in the form of Regulation in order to reach a sufficient harmonization among EU members.
Moreover, the forthcoming legislation should be similar to the one effective in the USA where the regulator can, on its own discretion, grant disclosure exemptions[2], including the possibility to allow the netting of positions to be carried out at group level.

[2] About such subject it is worth reading Regulation SHO which states in rule 200 "upon written application or upon its own motion, the Commission may grant an exemption from the provisions of this section, either unconditionally or on specified terms and conditions, to any transaction or class of transactions, or to any security or class of securities, or to any person or class of persons.
Furthermore, the Securities Exchange Act under section 28 states that "the Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation issued under this title, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors" and under section 36 that "the Commission shall, by rule or regulation, determine the procedures under which an exemptive order under

AMAFI **ASSOSIM** **AMF**

On behalf of the three signatory Associations

(ASSOSIM)

this section shall be granted and may, in its sole discretion, decline to entertain any application for an order of exemption under this section",

ANNEX

About our associations:

AMAFI, (*Association française des marchés financiers*), has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

ASSOSIM, (*Associazione Italiana Intermediari Mobiliari*), is the Italian Association of Financial Intermediaries, which represents the majority of financial intermediaries acting in the Italian Markets. ASSOSIM has nearly 80 members represented by banks, investment firms, branches of foreign brokerage houses, active in the Investment Services Industry, mostly in primary and secondary markets of equities, bonds and derivatives, for some 82% of the total trading volume.

AMF, (*Asociación de Mercados Financieros*), is a Spanish Institutional Association encompassing some 95 major financial members including private banks, savings banks, stock exchange houses, investment portfolio and investment fund firms, as well as brokers in many of these markets. AMF has been very active in relations and institutional contacts with the European Central Bank, the Bank of Spain, European Commission and CESR as well as the Spanish Stock Exchange Commission.