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Schillerstraße 20, D-60313 Frankfurt/Main

Committee of European Securities Regulators
11-13 avenue de Friedland
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France

your reference
CESR/09-581

your message of
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Frankfurt/Main, 30.09.2009

Consultation on CESR's Proposal for a Pan-European Short Selling Disclosure Regime

Dear Sir, dear Madam,

The *Bundesverband der Wertpapierfirmen an den deutschen Börsen e.V. (bwf)*[1] is a trade association representing securities trading firms and brokers at the stock markets throughout Germany. The bwf therefore expressly welcomes the opportunity to participate in the consultation on CESR's proposal for a pan-European short selling disclosure regime, dated 8 July 2009 (Ref.: CESR/09-581).

In order to facilitate an efficient evaluation and further processing, our statement follows the list of consultation questions set out in the annex of the consultative document. However, since we have fundamental reservations against the proposal as such, we consider our comments on Question 1, 15 and 16 to be of particular importance.

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

In the recent past, the discussion about the introduction of new or the enhancement of existing regulatory provisions regarding the market practice of short selling has gained a relatively strong momentum among regulators and policy makers not only on a European but also a global scale.

Against this background the short selling disclosure regime proposed by CESR seems at first glance to be a rather marginal market intervention. However, depending on its effective design with regard to the definition of the reporting thresholds, reporting deadlines and communication channels, the implementation, operation, monitoring and last but not least auditing requirements, the

[1] The Bundesverband der Wertpapierfirmen an den deutschen Börsen e.V. is registered in the list of interest representatives with the European Commission under Registration No. 1880407752-10

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planned disclosure regime would be a complex and costly undertaking while the intended benefits for regulators as well as the market as a whole remain vague.

So far there is simply no contestable scientific evidence, let alone any academic consensus, that the disclosure of short positions – and even more the disclosure of an individual investor's short position – would have any stabilising effect, would increase market efficiency or would be useful to the market in any other meaningful way. Therefore, in our view, the need for such a broad and permanent disclosure regime, covering all listed stocks within the EU, remains highly questionable at the very least.

Furthermore, we are concerned that the requirement to identify and report short positions could create a negative sentiment in the wider public against the well accepted and – in mature and liquid markets – generally agreed beneficial practice of short selling. CESR itself admits that *„short selling plays an important role in financial markets and [...] contributes to efficient price discovery, increases market liquidity, facilitates hedging and other risk management activities and can possibly help mitigate market bubbles."*[2]

When CESR states at the same time that beside this desirable form short selling could be also "*used in an abusive fashion*" by driving down the price of a financial instrument to a "*distorted level*" which *"can contribute to disorderly markets"* and even *"have an adverse impact on financial stability"*, it seems to prove that our concerns about a "stigmatization effect" of the proposed regulation appears real. Even more so since CESR's analysis is missing any definition by which a *"distorting price level"* shall be defined and why it shall make a difference whether it results partly or in full by short selling or other market activities. Thereby CESR creates a misleading, one-sided picture which tends to link short selling to market abuse.[3] We think that being suggestive in such a way – even unintentionally – is wrong and dangerous since it can contribute to a public false impression that short selling is abusive per se.

Not to be mistaken, clearly there is a basis for abusive short selling based on false rumours and such a behavior needs to and shall be prosecuted under the market abuse regime – just like e.g. "pump and dump" cases where "going long" and pushing up prices[4] along with spreading misleading or simply faked overly positive information on the valuation of a financial instrument constitutes abusive behavior as well. Equally true, market operators and regulators need to have predefined and efficient emergency measures in the form of circuit-breakers (e.g. "volatility-interrupts") in place to be able to react to the destabilizing effects of very turbulent self-amplifying market conditions. And of course short selling should be "regulated" by enforcing settlement discipline as the key measure to

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[2] page 5, paragraph 12 of the consultation document

[3] See also the ambiguous differentiation between short selling and market abuse in the first sentence of the consultation document.

[4] After building up an "inventory" beforehand.

prevent short selling from having a disorderly effect on markets. Therefore, instead of disclosures (or even more restrictive measures like temporary or even permanent bans) effective short selling regulation should focus on effective sanctions for failure to deliver on settlement date.[5] Depending on the number of stocks available for lending and with regard to a given settlement cycle, robust settlement procedures also act as a “natural” constraint to overall short selling activity.

However, if regulators intend to hold on to the plan of introducing a short selling disclosure regime, its objectives and the means to achieve them should be more precisely defined in the light of a preceding cost benefit analysis. Up to now, as we have learned from the outcomes of the hearing held on 9 September 2009 in Paris, there is not even an adequately precise estimate of how many disclosures would be triggered on which level (private or public) under the proposed regime.

Furthermore, if regulators feel that information on short positions could be useful in order to help them to better control the proper functioning of the market there is still no evidence and therefore justification that the *public* disclosure of an individual investor’s short position to the market would be beneficial under regulatory policy considerations. Moreover, while their disclosures of short positions would expose market participants to increased trading risk, it remains totally unclear which effect such a provision would have in practice. It is in particular questionable whether such a disclosure would limit the (short) selling activities in a particular security. On the contrary: if the fact that an institutional investor with a high reputation and a generally accepted research expertise has built up a significant short position becomes publicly available information, this could easily create or amplify the sentiment that the security in question is overvalued thereby triggering further downward pressure on its price.

We therefore emphatically request CESR not to take forward the current plan of individual public disclosures of short positions.[6] If public disclosure of existing short positions should, despite our concerns mentioned above, be still deemed necessary, we strongly believe that any such disclosure should be done by the regulators and on an aggregate, anonymous basis.[7]

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[5] However such sanctions must remain proportionate and the rules should include valid defense for a seller who provides convincing evidence of timely efforts to settle a transaction in good faith.

[6] Even though the short term experience with disclosure requirements for short positions of stocks in financial institutions which are currently in place in the United Kingdom do not seem to support such concerns, we do not think that this data can be used as a sound basis for a general rule, since the market conditions were exceptional and the sentiment for securities of financial institutions – as a result of the financial crisis – was negative before those rules were introduced.

[7] This would also significantly reduce the complexity of the proposed regime since a duplication of reporting lines and messages could be avoided as only the regulator of the most liquid market - and not the market(operator) – would be the only addressee for the disclosure messages.

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

We agree that a flagging regime of short sale *orders* directed to a regulated market in order to obtain real-time data on short selling interest would be indeed a technically complex, difficult and very expensive exercise which can hardly be justified in the light of cost benefit considerations.

However, the inappropriateness of any "real-time" solution does not make the alternatively proposed "ex post" reporting regime, which shall cover "significant" short *positions* any more convincing. Notwithstanding our general concerns against any public disclosure of individual and identifiable trading positions, we also believe that CESR gravely underestimates the set-up costs and operating expenses of a two tier, multi-channel *ex post* reporting system with its inherent duplication of reporting obligations, which would apply once the intended second trigger threshold for public disclosure had been crossed. Furthermore the consultation document does not shed any light on the question through which channels such information gathered by the most relevant market of a specific security shall be made public, who shall bear the (additional) costs for publication[8] and who shall bear the legal risks arising from any delay in the publication process. Problems which could be avoided if public disclosure, given it is deemed necessary, were to be carried out by the regulator on an aggregated, anonymous basis.

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

Obviously, flagging individual orders or trades[9] would deliver a different data-set than reporting only positions which trigger a predefined threshold. Since the regulatory objectives of the proposal still remain relatively vague, no clear answer can be given to this question at this stage.

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

We agree that if a reporting/disclosure regime should be implemented, it should cover all EEA issuers, resulting in an equal regulation for all sectors. The restriction to EEA issuers on the other hand seems to be coherent since data collected re-

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[8] Under the assumption that the publication should be conducted by the operator of the most liquid market and the costs could be passed on to the "owner" of the short position, this would inherently create a problem of monopolistic pricing which needs to be addressed appropriately. In this context we would like to remind CESR of the practical problems and often unsatisfying results which have arisen in the course of implementing transparency provisions under MiFID with its oversimplified provision that such information should be made public "on a reasonable commercial basis".

[9] Alternatively, in order to minimize costs for implementation and operation, CESR should also examine the option of "flagging" individual trades under the already implemented "ex post" transaction reporting regime.

garding securities from non EEA issuers would be necessarily incomplete and therefore not very meaningful.

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)?

As already argued in detail in our answers to questions 1 & 2, if any public disclosure is deemed necessary, we would be strongly in favour of a publication undertaken by the regulators on an aggregate, anonymous basis. Under the assumption that the information would be made public in aggregate and notwithstanding that the proposed initial threshold of 0,1 % appears too low (please see our answer to question 7), we have no objection to a single threshold. On the contrary this would avoid any possible perception by market participants that short selling activities might have reached a level which is regarded as "critical" from a regulators point of view and *therefore* should be publicly disclosed.

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?

The lessons learned from the hastily introduced, coordinated but not really harmonized "emergency provisions" on short selling from September 2008 clearly indicate that any new regulation in this field should be proportionate and harmonized to the widest extent possible.

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

As we have learned from the public hearing on this issue held on 9 September 2009 in Paris, at this stage there is not even an educated guess on a pan-European basis about the quantity of expected disclosures which would have to be made by market participants as a result of the implementation of the thresholds proposed in the consultative document. Even though we accept the difficulty associated with the necessary evaluation process for a qualified quantitative estimate regarding the number of expected disclosures, this doesn't justify the definition of thresholds on an arbitrary basis.

The only available data to date seems to be the sector specific disclosure regime currently in place in the UK with a threshold of 0.25 %, which is 2.5 times higher than the CESR proposal. In other words, it is hard to understand that a reporting threshold which was defined to satisfy regulatory objectives under extraordinary market conditions, is regarded as "too weak" by CESR for the proposed all sector regime, designed to be permanent.

Furthermore, unnecessary low thresholds would not only pose an unjustified additional cost burden on market participants by inflating disclosure obligations, it would also have an undesired negative effect on the validity of the collected data at the time it is analysed and interpreted by regulators and/or market participants.

As mentioned before, without further analysis it seems to be unfeasible to give reasonable advice as to where a practicable initial (first) threshold should lie. However we do not see any justification to set it below the 0.25 % level currently in place in the UK for stocks of financial institutions which have been under extraordinary pressure before the rule was implemented. In any case, the threshold triggering an initial reporting obligation should be significantly higher than the incremental changes which would release additional follow up disclosures.

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?

Again notwithstanding our general reservation against the proposed regime, any other concept than calculating the short position of an individual investor on a net basis would make the attempt to locate market relevant concentrations of short selling activities completely incomprehensible.

In this context we would like to ask CESR also for a clarification that the underwriting commitments of underwriters/sub-underwriter should be included as long positions in the calculation with the result that bona-fide hedging activities by underwriters and sub-underwriters which mitigate risk and result in lower issuance costs would accordingly would not trigger any disclosure obligation insofar as the sales do not exceed the company's underwriting commitments.

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

Please see our concerns expressed in footnote 7.

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

We strongly agree that real-time disclosure would be neither feasible nor, from a compliance point of view desirable and any disclosure obligation should only arise if the defined threshold is (still) exceeded at the end of the trading day.

We understand that CESR wants private as well as public disclosures to be made at a specific time before the end of the trading day following the day on which the disclosure obligation is triggered. Although this seems to be a pragmatic approach, no reporting deadline should be defined before a sound estimate of the quantity of expected disclosures and the necessary technical efforts resulting hereof are known.

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 strongly agree with the proposed exemption from disclosure obligation for market makers as defined by the consultative document as *"persons providing liquidity to the market in a specified and sustainable way"*. The proposed exemption reflects the general consensus that a liquidity providing function denoted by a firm's availability to enter into transactions with market participants on a continuous basis as part of the price discovery process is beneficial for the overall efficiency of the market and therefore should not be impeded.

However, since market structures differ and "market makers" in the original narrow technical interpretation of the term[10] do not exist in all markets, it should be clarified that it is the liquidity providing function as such which qualifies for exemption. In particular, CESR should give clear advice that the exemption includes also "hybrid systems" whereby the firms responsible for price determination act as a liquidity providers on a continuous basis but only in situations of insufficient market liquidity.

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

We fully agree with CESR's proposal that the exemption for market makers (liquidity providers) should be an absolute one, covering both private and public disclosure. This consideration holds true even more for market makers/market specialists acting on a regulated market under the strict monitoring of the market surveillance office of those markets.

We kindly ask CESR to take these considerations into account in the further discussion and would like to repeat our fundamental scepticism regarding the need for and the expected benefits of the proposed pan-European short selling disclosure regime.

Yours faithfully,

Michael H. Sterzenbach
Secretary General

[10] Defined as a firm which always acts as principal in the course of executing an order.