

Norwegian Securities Dealers Association Swedish Securities Dealers Association

To the
EUROPEAN COMMISSION

Directorate General Internal Market and Services
FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Securities markets
markt-consultations@ec.europa.eu

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The Norwegian Securities Dealers Association's and Swedish Securities Dealers Association's response to the Commission's public consultation on Short Selling

NSDA and SSDA, the Associations, represent the common interest of banks and investment services firms active on the Norwegian and Swedish securities market.

General Comments

The Associations welcome the opportunity to respond to the Commission's public consultation on Short Selling. By way of introduction, the Associations wish to emphasise that the Association concurs with the European Banking Federation's response to the consultation. In addition, the Associations wish to state the following.

In the opinion of the Associations it is very difficult to answer the parts of this consultation relating to issues other than those connected with short selling and shares. The other parts - transparency regarding financial instruments other than shares and uncovered short selling - lack any factual background information, and there is no analysis of the issues in question, and no impact assessments. These shortcomings mean that the consultation is not in line with the accepted principles for good (and better) regulation. Against that background it is even more surprising that the Commission has allowed such a short consultation period. Such a short period can only be acceptable in case of emergency and if there is enough evidence and analysis backing the proposals.

Regarding the process for this consultation the Associations is of the opinion that the Commission should have started the process by in detail defining the problems that have occurred and then analyzing the reasons for the problems. Without knowing what problems the Commission is aiming to solve, or the targets it is trying to achieve, it is very difficult to comment whether the measures proposed are appropriate, nor in future to follow up on whether those targets have been achieved.

Furthermore, one serious shortcoming of the consultation is the lack of analysis of the possible consequences of the proposed measures. How would liquidity be affected? How much more expensive would it become to borrow money for budget deficits, for companies and households?

To our knowledge there is no evidence that bans on short selling introduced in 2008 in some markets benefited those markets or any of the issuers.

In our opinion short selling instead benefits the markets and adds liquidity. An efficient market demands short selling. Examples where short selling brings efficiency and proper pricing to the market include:

- (1) Short selling assists intermediation between those who think that an equity or bond is too expensive and therefore want to sell, and those who regard the financial instrument as cheap and therefore want to buy.
- (2) With short selling it is possible for the market maker to offer a price whether or not he has the instrument in his portfolio at that moment.
- (3) Short selling also gives the seller a tool to hedge a long position in a similar security.

With an efficient market the allocation of capital works more smoothly, which benefits society and economic growth. Without efficient and practical short selling the market would work less efficiently, and it would become more expensive for companies, countries and individuals to trade.

Whilst the industry is in favour of well functioning efficient short selling facilities without too much burdensome administration, the Associations are well aware of that a well-functioning market needs to have the confidence of the public as well as the authorities. The SSDA is of the opinion that it is necessary to increase the transparency of short selling in equities as it would benefit the confidence. NSDA do not believe in the advantages in reporting shortselling in equities. However it is important that rules for transparency are implemented in an efficient and consistent way throughout Europe. Thus the rules must be fully harmonized in Europe, not giving any space for gold plating nor arbitrage of rules in other countries. With harmonized rules it will also be possible to standardise reporting to the authorities as well as making information public, on an aggregated level, in a cost efficient way throughout Europe.

Regarding the quality of Clearing and Settlement the Associations are positive about measures to increase the quality. A step forward would be for CCPs and CSDs to produce statistics on late deliveries, identifying those Clearing Members who have late deliveries. The necessary measures should be taken care of by the industry itself without legislative intervention.

A. Scope

Q1) Which financial instruments give rise to risks of short selling and what is the evidence of those risks?

The Associations are not aware of any clear evidence that short selling is harmful for the markets. On the contrary short selling benefits efficient markets significantly. Short selling also gives the seller the tool decrease the risk by hedging a long position in a similar security. Investigations done after bans on short selling 2008 on shares have not shown clear evidence that the restrictions had the intended effects.

Q2) What is your preferred option regarding the scope of instruments to which measures should be applied?

There is in the consultation no information about the impacts and effects of the two alternatives. Without such a study with an impact assessment it is not possible to give a fact-based opinion. In our opinion such a study should be made by CESR before any measures are considered regarding other financial instrument then shares. Of the mentioned alternatives the Associations are of the opinion that focus of study and analysis should be on the financial instruments mentioned under option B. However, for the reasons stated above, the Associations are of the opinion that it is not possible to have a clear opinion regarding sovereigns and CDS's without a proper analysis and impact assessment.

Q3) In what circumstances should measures apply to transactions carried on outside the European Union?

The Associations propose that the rules should apply only to EU securities issued inside EU and traded inside as well as outside EU. Regulations that might cut across rules in other jurisdiction are of no benefit, so the rules should not apply to securities issued outside the EU.

B. Transparency

General comment

The Associations are of the opinion that there should not at this point of time be any legal requirements on public disclosure regarding financial instruments other than shares. The effect of such requirements is totally unknown. In the consultation paper the Commission clearly states that the effect of public disclosure on the operation of sovereign bond markets still needs to be assessed. In the opinion of the Associations such requirement should be out of the scope for time being in the absence of factual information of the impacts on such requirements.

Q4) What is your preferred option in relation to the scope of financial instruments to which the transparency requirements should apply?

There is a common interest in short selling of equities. This interest should be met by better transparency according to fully harmonized rules in the European Union for equities.

Regarding transparency in EU sovereign bonds and CDSs related to those instruments, information regarding these instruments would probably have a negative market impact and thus be harmful if made public. If any transparency requirements are to apply the information should be solely for the authorities. However, as stated above, we are not sure what purpose such a reporting requirement would have and thus what the information would be used for by the authorities. Even if analysis showed that publication was necessary, it should at most cover publication of aggregated information.

Q5) Under Option A is it proportionate to apply transparency requirements to all types of instruments that can be subject to short selling?

There has to our knowledge not been any major interest in the market or from the public in transparency of short selling of financial instruments other than equities, sovereigns or CDSs. As the benefit of transparency requirements for other financial instruments than equities is unknown The Associations are of the opinion that further measures regarding transparency requirements should be limited to equities.

Q6) Under Option B do you agree with the proposals for notification to regulators and the markets of significant net short positions in EU shares?

See Q2 and Q5

Q7) In relation to Option B do you agree with the proposals for notification to regulators of net short positions in EU sovereign debt (including through the use of CDS)? In addition to notification to regulators should there be public disclosure of significant short positions?

The Associations are sceptical and it would be useful to get information about the purpose of this notification from the supervisory point of view. As the Associations have stated above information about EU sovereign bonds, CDSs and other derivatives related to those instruments might have severe market impact and thus be harmful if made public. If transparency requirements are to apply, the information should be solely for the authorities.

Q8) Do you agree with the methods of notification and disclosure suggested?

The Associations do not agree that the identity of the person with a negative net position of a specific size should become public. The effect would be the same as prohibiting short selling of a size larger than the threshold for making the information public. The person with such a net position will always be afraid that other market participants will exploit the information putting the person with the negative net position in a disadvantageous situation.

The rules and interfaces for reporting short positions, if reported, should be fully harmonized in the European Union, thus enabling reporting to a competent authority of the holder's choice. The Associations would like to point out that there is already a system for notification of long positions. The system works well and the industry and others that are concerned are used to the interfaces, rules etc. It should not be necessary to have separate infrastructure systems for reporting short positions. By using the present system for reporting long as well as short positions to the authorities would make it possible to introduce the rules in a more cost-efficient way and probably with a higher degree of quality.

Q9) If transparency is required for short positions relating to sovereign bonds, should there be an exemption for primary market activities or market making activities?

Yes, such an exemption would be absolutely necessary if entities are to be prepared to act as market makers in sovereign bonds. It is important to stress that the need for market makers is increasing the

smaller the market is for the specific bond. The need is thus greater in smaller countries than in larger countries.

Q10) What is the likely costs and impact of the different options on the functioning of financial markets?

Short selling, anonymity in positive or negative holdings at least in the short term, and administrative efficiency are important factors for efficient markets with low spreads, low costs for execution, and high liquidity that can absorb high volumes. The proposals all touch on these areas and must therefore be handled with greatest care.

Calculating net positions for equities or bonds are examples of added burdens that would not be free of costs for investors. A requirement to calculate net positions would create an obstacle to investors being active, which is important for well functioning markets. The Associations are of the opinion that retail investors should not be obliged to report negative positions of any size as they will not typically hold large negative positions.

Any type of reporting requirement has to be streamlined with existing reporting requirements in for example MiFID and the Transparency directive. To create new system and new reporting procedure is always a costly procedure for the market and its participants.

C. Uncovered short sales

Q11) What are the risks of uncovered short selling and what is the evidence of those risks?

There is very little information regarding naked short selling and the problems this consultation aims to solve and the impact of the proposals in the consultation. The starting point seems to be recent problems in some markets for sovereign debts. As far as we know there is no empirical evidence that speculation through naked short selling (CDS) has contributed to those problems.

The effects of a ban of naked short selling must be analyzed before any decision is taken. In our opinion such a ban could have grave and negative effects on liquidity, particularly in smaller markets, and would therefore be very expensive for both investors and taxpayers.

Q12) Is there evidence of risks of uncovered short sales for financial instruments other than shares (e.g. bonds or sovereign bonds), which would justify extending the requirements to these instruments?

We do not know of any such evidence.

Q13) Do you agree with the proposed rule setting out conditions for uncovered short selling? Do you consider that more stringent conditions could be put in place? If so please indicate which ones? Do you agree that arrangements other than formal agreements to borrow should be permitted if they ensure the shares are available for borrowing at settlement? If so, why?

For this purpose it is necessary to define uncovered short selling. The Associations are of the opinion that it does not, for instance, include sellers that have stock lending facilities. It should also not include market making and other activities where a short position in the morning most often is

covered with a buy later on during the day.

Secondly we do not see fact-based arguments for special regulation of naked short selling. When a seller sells a security there is an agreement with the buyer to deliver on the intended and agreed settlement day. That agreement should of course be followed.

Q14) Do you consider that the risks of uncovered short selling are such that they should be subject to an upfront ban/permanent restrictions? If so, why?

No, the Associations do not regard this as a problem but, as set out in our general comments above, we propose a disclosure of statistics of late deliveries. Uncovered short selling is the practice in several markets across Europe. In our view to ban uncovered short selling would put market forces at risk and would harm the markets. It is however important to ensure proper and timely settlement of all transactions, which is in the interests of a well functioning market.

Q15) Do you agree with the proposal requiring buy in procedures for settlement failures due to short sales? If so, what is an appropriate base period that could be specified before buy in procedures are triggered (e.g. T + 4)?

The Associations are of the opinion that rules for buy in should be the same whether it is a short sale or not as the necessity of delivering in time is the same. Regarding the Swedish market our experience is that most of the late trades will be settled within one or two days after the intended settlement day.

Q16) Do you consider that there should be permanent limitations or a ban on entering into naked credit default swaps relating to EU sovereign issuers? If so, please explain why, including if possible any evidence relating to the use of naked CDS.

As stated above the Associations do not consider that it is appropriate to make any judgment before a thorough analysis of the consequences of entering into naked credit default swaps is done. The sometimes heavy movements of prices should be regarded as important signals to politicians and market participants that actions may need to be taken.

Q17) Do you consider that in addition to the measures described above there should be marking of orders for shares that are short sales?

No, the Associations do not see any benefit, but we do see disadvantages. For instance it is not possible to say at time of order if it is a short sale or not. That is it is not possible to clarify the condition.

Q18) What is the likely costs and impact of the different options on the functioning of financial markets?

As stated earlier, it has not been possible to make a realistic fact-based assessment within the very short time allowed to respond to the consultation.

D. Exemptions

Q19) Do you agree with the proposed exemption for market making activities? Which requirements should it apply to?

The Associations agree with the proposal to exempt market making. It is important to stress that market making should have a wide definition. It should for instance not be necessary to have an agreement with the issuer to be a market maker.

Q20) Do we need any exemption where the principal market for a share is outside the European Union? Are any other special rules needed with regard to operators or markets outside the European Union?

The Associations propose that the rules should apply only to EU securities issued inside EU and traded inside as well as outside EU. Regulations that might cut across rules in other jurisdiction are of no benefit, so the rules should not apply to securities issued outside the EU.

Q21) What would be the effects on the functioning of markets of applying or not applying the above exemptions?

Market makers are concerned to ensure that their positions do not become known to anyone outside their part of the trading room, regardless of whether the positions are positive or negative. The market maker will always be concerned that counterparties will use such information in a way that harms the market maker's business. If the risk is too high that market makers' positions will become public, there will be no market making.

Q22) Should the conditions for use of emergency powers be further defined?

Such rules should become applicable only when there is a serious threat to financial stability or to market confidence. The rules must be very clear, precise, detailed and fully harmonized throughout the EU.

Q23) Are the emergency powers given to Competent Authorities and the procedures for their use appropriate?

An important consideration is what would be the rules in a case where an entity already has a short position? How fast would it be required to cover the short position? A short seller that has to cover its short position in a short time is in a very risky situation in a position where all other short sellers also have to cover their positions. The Associations propose that if restrictions are to be introduced they should not be applicable for those entities that already have short positions.

Q24) Should the restrictions be limited in time as suggested above?

Yes

Q25) Are there any further measures that could ensure greater coordination between competent authorities in emergency situations?

Q26) Should competent authorities be given further powers to impose very short term restrictions on short selling of a specific share if there is a significant price fall in that share (e.g. 10%)?

No, we do not think so. These extra rules should not be necessary.

Q27) Should the power to prohibit or impose conditions on short-selling be limited to emergency situations (as set out in the previous section)?

Yes and the rules must be very specific, clear and fully harmonized across the EU.

Q28) Are there any special provisions that are necessary to facilitate enforcement of the future legislation in this area?

Q29) What co-operation powers should be foreseen for ESMA on an ongoing-basis?

Q30) Do the definitions serve their intended purpose?

Kind Regards

Vigg Troedsson

Norwegian Securities Dealers Association
Kongens gate 2
P.O. Box 292 Sentrum, 0103 Oslo
Phone: +47 22 00 74 10
Email: nfmf@nfmf.no

Swedish Securities Dealers Association
Blasieholmsgatan 5, 6tr
Box 1426, 111 84 Stockholm, Sweden
Phone: +46 8 56 26 07 00
e-mail vigg@fondhandlarna.se <http://www.fondhandlarna.se>