

# POSITION PAPER



## **ESBG response to the public consultation on short selling**

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The European Savings Banks Group (ESBG) appreciates the opportunity to comment on the public consultation on short selling, issued by the European Commission in June 2010.

### **General comments**

ESBG welcomes the acknowledgement by the European Commission of the positive roles of short selling (as presented in the chapter “Introduction”): Short selling in particular contributes to efficient price discovery, increases market liquidity, facilitates hedging and other risk management activities and can possibly help mitigate market bubbles.

ESBG notes that under extreme market conditions, such as those experienced since the second half of 2008, temporary measures have been taken by regulators and coordination efforts have been undertaken by CESR. In this context, the Commission consultation paper stipulates that the concerns related to short selling are its potential use in an abusive fashion as well as the possibility of amplified price falls and of adverse effects on financial stability. As a consequence, the Commission proposes rules to increase the transparency related to short selling, rules to reduce risks relating to uncovered short selling and emergency powers for competent authorities to impose temporary short selling restrictions. ESBG will comment on these proposals below. However, as an overarching remark, ESBG wishes to highlight that in its view the main problem behind short selling are the existing differences between the settlement systems in European financial markets. Also other rules governing short selling (e.g. buy-in procedures and penalties when players get short) differ considerably between Member States. ESBG therefore recommends further harmonisation in these fields and, in particular, harmonisation of settlement cycles. In ESBG’s view these weaknesses in the area of guaranteed settlement should be tackled in parallel to (or quickly after) the work on the measures mentioned above.

### **Specific comments to the questions contained in the consultation paper**

#### **A. Scope of financial instruments covered**

In response to question 2, ESBG is in favor of including in a harmonized manner specific financial instruments which are admitted to trading on a trading venue in the European Union. Looking at option B described in the Commission consultation paper, ESBG agrees including EU shares and derivatives relating to these shares. For sovereign bonds, derivatives relating to those bonds and CDS relating to EU sovereign issuers, the Member States have in principle enough tools to control these instruments (e.g. stop issuing, acquiring repos) and the national supervisors have the necessary tools to know which market participants are short on public bonds. Further assessments should take place and confirm the necessity of an inclusions of such instruments and also take into account the possible detrimental effects on market making activities which in turn can hamper liquidity and even provoke distortion and additional risk premium.

Referring to question 3, ESBG considers that the regime should ideally apply to such European instruments, regardless of where the trade takes place (including outside the EU). In this context, international coordination is of prior importance. Only a global solution will avoid that European markets are disadvantaged and less attractive to market participants (due to an increase in regulatory requirements).

#### **B. Transparency**

As introductory remark, ESBG stresses that enhanced transparency of short selling is beneficial for market transparency in general. Also, it can help deter market abuse and reduce the risks of disorderly markets caused by short selling.

With reference to question 6, ESBG notes that the Commission bases its reflections on the two tier transparency model for EU shares recommended by CESR in its report in March 2010. This model

is already applied on a best effort basis by the CESR members. Technical details have been developed by CESR and published in June 2010; however, additional guidance on how to calculate net short positions, especially for the calculation of deltas, would be helpful. Against this background it should be considered that in illiquid markets as well as with contracts of long duration, volatility is a crucial variable and has a severe impact on the delta to be used for the calculation of the net short position.

Commenting on question 8, ESBG expresses its preference for allowing consolidated reporting of net positions on a group wide basis (in case of different banks belonging to one banking group, including on a cross-border basis). Furthermore ESBG believes that the disclosure of information to be public should take the form of aggregated data.

The impact of public disclosure (being addressed in question 10) may be an increased risk for short sellers due to other participants moving against them, but this could at the same time encourage sounder rationales for short trades. In order to contain costs, ESBG reiterates its request for allowing consolidated reporting of net positions on a group wide basis, including on a cross-border basis.

### **C. Uncovered short sales**

Naked short sales are related to the risk of market manipulation and abuse as well as settlement failures (response to question 11). Commenting on the proposed rules setting out conditions for uncovered short selling (question 13), ESBG agrees to the Commission's proposals. ESBG adds that the monitoring conditions for naked short sales should not reside with the sales force demanding clients to furnish proof of owing the shares before placing a selling order. This would delay and hamper the process of placing orders.

Regarding the question whether a permanent restriction/upfront ban is the right way forward (question 14), ESBG prefers a harmonized choice. Temporary restrictions, especially if on short notice and only in selected geographical markets or market segments, could lead to uncertainty. ESBG supports the idea of setting up harmonized guidelines for buy-in procedures as well as imposing penalty fees for failing parties (question 15). For the time being, the time period needs to stay adapted to specific settlement regimes in the different countries.

### **D. Exemptions**

In general terms a clear, harmonized approach is desirable, while in view of the liquidity provision by market makers, it is worth to reflect on a narrow exemption for market makers (response to question 19). However a situation needs to be avoided where the rules are circumvented by shifts of large short positions to market makers.

Regarding a possible exemption for cases where the principal market for a share is outside the EU (question 20) ESBG expresses its doubts that it will always be clear which market is the principal market and who should decide on this. In order to have legal certainty, ESBG recommends abstaining from the proposed exemption included in question 20.

### **E. Emergency powers of competent authorities**

ESBG considers that the proposals included regarding emergency powers are appropriate (response to question 23) and considers them a good basis for further discussion. ESBG confirms that a coordinating role for ESMA is important in order to avoid non-coordinated action by single Member States.

The conditions for use of emergency powers need to be further defined (response to question 22). Emergency measures should (as suggested in question 24) be restricted to three months (with the possibility to prolong the period once for three months). Finally, ESBG also agrees that competent authorities should 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 (response to question 26).



## **About ESBG (European Savings Banks Group)**

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5967 billion (1 January 2008). It represents the interest of its Members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG Members are typically savings and retail banks or associations thereof. They are often organized in decentralized networks and offer their services throughout their region. ESBG Member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.



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