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CESR Issues Consultation Paper on Short Selling Disclosure Regime

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 32-09
SEC RULES MEMBERS No. 74-09
ETF ADVISORY COMMITTEE No. 20-09
EXCHANGE-TRADED FUNDS (ETF) COMMITTEE No. 5-09
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 12-09 RE: CESR ISSUES
CONSULTATION PAPER ON SHORT SELLING DISCLOSURE REGIME

The Committee of European Securities Regulators (“CESR”) has released a consultation paper seeking comment on its proposal for a pan-European short selling disclosure regime. [\[1\]](#) In the Consultation Paper, CESR states that implementing uniform short sale reporting requirements across the European Economic Area (“EEA”) should enhance supervisory convergence, foster market transparency, and improve market efficiency. [\[2\]](#) In particular, CESR maintains that greater disclosure of short positions should provide regulators with early warnings on a build-up of large short positions, and thereby alert regulators to potentially abusive behavior and enable them to monitor and take actions more effectively. In addition, CESR states that uniform disclosure rules should assist market participants that operate on a cross-border basis and currently must comply with a patchwork of short sale regulatory requirements.

Proposed Disclosure Requirement

The proposed disclosure regime would impose a two-tier system for the disclosure of meaningful net short positions [\[3\]](#) held in securities admitted to trading on an EEA regulated market or on a Multilateral Trading Facility (“MTF”). [\[4\]](#) It would operate as follows.

- When a short position reaches a specified initial threshold (proposed as 0.1 percent of the company's issued share capital), the short seller would be obliged to make a private disclosure to the regulator of the most liquid market for the share in which the position was held.
- If the position reached a second-tier threshold (proposed as 0.5 percent), the short seller would be required to publically disclose its position to the market as a whole. [\[5\]](#)
- Any further private or public disclosures would then be required if the short positions subsequently crossed an incremental threshold (proposed as 0.1 percent).
- A private or public disclosure also would be necessary if the positions fell below any of the trigger thresholds, including the initial trigger thresholds (proposed as 0.1 percent and 0.5 percent).

In the Consultation Paper, CESR sets forth two primary arguments for requiring public disclosure of significant short positions. First, CESR states that public disclosure of this information would provide the market with valuable information that a security of a particular issuer may be over-valued, allowing it to react rationally and in an orderly fashion. Second, CESR states that public disclosure should provide a measure of deterrence to aggressive short sellers beyond what would be gained from a requirement to disclose to the regulator alone. With respect to establishing a uniform threshold for all securities and markets within the scope of the proposed regulatory regime, CESR concludes that the benefits of harmonization outweigh the disadvantages.

Proposed Calculation and Reporting of Short Positions

In calculating whether a disclosure report would be required, the Consultation Paper provides that market participants would need to take account of any position that provided an economic exposure to a particular security. Accordingly, positions held in exchange-traded and OTC derivatives would be covered, as well as short positions in cash markets. Disclosure calculations and reports would have to be conducted on a net basis, [\[6\]](#) with any positions involving long economic exposures to a security to be subtracted from the short positions. [\[7\]](#) In addition, the netting calculation would be performed at the legal entity level (as opposed to the group level).

Disclosure reports of short positions, both to the regulator and the market, would have to be completed on the trading day following the day on which the relevant threshold had been crossed. There would be exemptions, however, from the private and public disclosure requirements for short positions resulting from bona fide market making activities. Proprietary trading would not fall within the scope of market making and would not be exempt.

Request for Comment

The Consultation Paper requests comment on a number of issues, including the following:

- Whether short position reporting is preferable to “flagging” short sales;
- Whether the scope of the proposed disclosure regime is appropriate;
- Whether the two-tier public and private disclosure regime is appropriate;
- Whether the proposed thresholds for disclosure are appropriate;
- Whether CESR should consider a method other than net basis for calculating short positions;
- Whether the proposed timeframe for reporting short positions is appropriate;
- Whether a market maker exemption is appropriate; and,
- Whether CESR should consider additional exemptions.

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endnotes

[1] Consultation Paper: CESR Proposal for a Pan-European Short Selling Disclosure Regime, CESR, July 8, 2009 (“Consultation Paper”), available at: http://www.cesr-eu.org/index.php?page=consultation_details&id=142. Comments on the Consultation Paper are due by September 30, 2009.

[2] In the Consultation Paper, CESR notes that it has decided to focus on short sale disclosure because it believes that enhanced transparency has real, justifiable benefits. Conversely, CESR states that other regulatory solutions, like bans or price restrictions, require further study.

[3] CESR considered enhancing disclosure through “flagging” of short sale orders but determined that such an approach would not provide regulators or the market with useful information as compared with short position reporting. Further, “flagging” would be more expensive and operationally difficult to develop than a short position reporting requirement.

[4] Under the European Union’s Markets in Financial Instruments Directive (“MiFID”), entities that offer multilateral trading for financial instruments (such as an order book) must be organized as either a regulated market or an MTF, with slightly different standards applying to each.

[5] The proposal includes one exception for rights issues. Specifically, the proposal would require a lower public disclosure threshold for rights issues to account for greater concerns regarding heightened vulnerability for companies raising capital using this method.

[6] CESR considered requiring calculation of short positions on a gross basis but determined that such information may not be that meaningful to market participants since there could be offsetting long positions and the disclosure would not reflect the true exposure.

[7] According to the proposal, intra-day positions that cross a disclosure threshold, but which return below that same threshold before the end of the trading day, will not trigger the reporting requirement.

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