

EUROPEANISSUERS' COMMENTS
ON
CESR'S CALL FOR EVIDENCE (REF CESR 08/1010)
"REGULATION OF SHORT-SELLING BY CESR MEMBERS"

11 February 2009

EuropeanIssuers welcomes this initiative of CESR's to contemplate on how to bring convergence at a European level in the measures taken by the various CESR members to regulate short-selling.

A. Comments

The comments that we raise hereinafter are not so much related to practical issues stemming from temporary measures but are rather a contribution to the preparatory debate on permanent measures. These measures should aim at preventing abusive short-selling practices: practices that are built only on speculations that the price of a given share will fall while such speculations are being supported and fulfilled by intentional practices to effectuate the very downward price movement of the share.

As the representative organisation of listed companies in the European Union, our comments are inspired by a wish to protect the interests of both the (co-) investors and the issuing companies. The former because they see the value of their portfolio's deteriorating for reasons that have nothing to do with the inherent economic value or sound market practices on which they have based their own investment decisions. The latter because of the possible detrimental effect on the market capitalisation of the investee company and all negative consequences derived thereof. **We believe indeed that the debate on short selling should not be limited to the shorting of securities of financial institutions only, but should include securities issued by listed companies in general. In addition, this debate should not only have eye for possible consequences for market integrity and market stability but for all stakeholders, not in the least the issuing companies.**

Indeed, it cannot be ignored that especially in times of grave uncertainty short selling may worsen downturn trends in stock prices that in turn have further negative consequences for the respective issuers and the economy as a whole. For example, access to financial markets usually depends on the level of share prices. Therefore any pressure imposed upon share prices by

short selling may worsen (re-)financing conditions even for companies which are basically economically sound and solvent. This is why regulators imposed constraints on short selling – at least for some shares – during the financial crisis.

But short sales may be problematic even in less turbulent times as they may be linked with market manipulation. By selling shares short and subsequently floating rumours about an unsustainable overvaluation in the market the short seller can extract enormous private profits from a later decline of share prices in a very short period of time. Manipulative behaviour of that kind not only seriously damages market efficiency and integrity, but also the issuing company. The problem is that such practices cannot be easily detected.

The danger of market manipulation is particularly virulent with so-called naked short sales which are not covered by ex-ante stock lending, so that risks clearly exceed benefits for this kind of short selling. Naked short sales may lead to an over-supply of shares in the sense that the number of shares on the supply side of the stock market exceeds the number of shares economically available or even the number of shares that are booked into securities accounts. Thus due to market mechanisms (“supply and demand”) a “fake” increase on the supply side will lead to a fall in the share price. As a consequence, naked short sales should be prohibited internationally and any violation of this prohibition should be sanctioned appropriately and effectively.

As a side comment, we would like to stress that stock lending operations are a source of concern on their own for listed companies. EuropeanIssuers is of the view that the European legislator should create clarity on the legal qualification of stock lending so as to avoid any misunderstanding on the impact of such operations on the corporate rights of the shareholder. In addition there should be no stock lending without the shareholder’s explicit consent. The shareholder’s rights, including and especially the right to vote and the right to control this voting right, should at all times be safeguarded and specific measures should be foreseen to that end. Finally there should be complete transparency towards all concerned parties, including the issuer.¹

B. Some suggestions for possible measures

Considering the above EuropeanIssuers believes that the following should be part of the concrete measures that should be considered, while encouraging CESR to explore other measures to fully address the issuers’ concerns as explained above:

¹ For more information on our position on stock lending, see our comment paper dated 23 July 2007 following the European Commission’s Third Consultation regarding a possible Recommendation with a view of complementing the Shareholder Rights Directive: http://www.europeanissuers.eu/_mdb/position/71_COMRecommendConsult-EALICFinalPosition-20070723.pdf.

1. Strengthening transparency

- a) EuropeanIssuers believes that both the market and the issuer should be aware of any investor's open and/or uncovered positions (both on voting rights and/or other economic positions) to a specific issuer's securities, individually and collectively that exceed specific thresholds. Positions of entities of the same group, or affiliated parties or of parties acting in concert should be aggregated.
- b) In case the aforementioned threshold is reached and the relevant notification is made, the issuer should be able to ask from the holder of the disclosed short position to make his/her intentions public.
- c) Regulated entities (investment firms, credit institutions, UCITS etc) should disclose to the relevant authorities their short to long positions ratio on their total portfolio basis or per issuer, or their client's portfolios ratios that exceed specific thresholds and/or short positions that exceed specific thresholds on absolute terms.
- d) The above thresholds must be lowered in special circumstances for instance when a takeover is announced or a rights issue undertaken.

2. Enhancing market integrity

- a) EuropeanIssuers believes that although not all short-selling practices amount to market abuse, current short selling practices need a closer attention from a market abuse viewpoint. More precise rules need to be introduced in this area. An EU wide accepted market practice on short selling could be helpful to that effect, imposing all other practices that do not confront to such requirements to greater scrutiny by the relevant authorities.
- b) Stock lending should also be regulated as the other side of the same coin. To that effect special attention should be given to the ability of investment firms to use a client's assets upon his/her prior approval as authorised under Art. 19, par 1 of the Directive implementing MiFID that allows any custodian to use its clients' assets for his own account or the account of other clients provided the depositing client agreed thereto.²

² Art. 19, Par. 1 of the Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Text with EEA relevance), O. J. L 241, 02/09/2006, P. 0026-0058 provides that:

"1. Member States shall not allow investment firms to enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of another client of the firm, unless the following conditions are met:

(a) the client must have given his prior express consent to the use of the instruments on specified terms, as evidenced, in the case of a retail client, by his signature or equivalent alternative mechanism;

3. Improving coordination

- a) EuropeanIssuers is of the opinion that a database similar to T.R.E.M should be maintained at EU level for all notifications under list 1 above.
- b) A common notification form should be proposed by CESR for all member states.
- c) Communication between regulatory authorities should be established in case short selling activities of an investment firm of one member state exceed specific thresholds in an issuer listed in another member state.

EuropeanIssuers is a pan European organisation set up to promote the interests of issuing companies. Its members are national associations and companies from 15 European countries counting together some 9.200 listed companies with a combined market value of some € 8.500 billion. As such it represents the vast majority of publicly quoted companies in Europe. The members of EuropeanIssuers come from various sectors including automotive, nutrition, energy, health care, construction, financial services and many more. What brings them together in EuropeanIssuers is that they are all owned by the public, making them subject to an impressive set of complex and stringent rules and regulations. Through EuropeanIssuers listed companies can engage in direct discussions with the decision makers at European, trans-Atlantic and global level. Typical areas of interest include shareholder rights, corporate governance, transparency, clearing and settlement as well as financial reporting and auditing. Our ultimate goal is to achieve fully integrated, liquid and well functioning European financial markets. More information can be found on www.europeanissuers.eu.

(b) the use of that client's financial instruments must be restricted to the specified terms to which the client consents."