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European Commission Short Selling Proposals - Right Intentions, Wrong Solutions

Short selling is no riskier than any other buying and selling of securities and does not warrant specific rules, says the Association for Financial Markets in Europe (AFME) in its response to a European Commission consultation on short selling, published today.

Short selling, including uncovered short selling, is a well-established, legitimate trading activity, essential for market making and widely accepted by investors and regulators as helping to enhance price discovery, counteract supply / demand imbalances and provide liquidity to the market.

Whilst AFME supports the Commission's objectives of harmonising rules across Europe, reducing systemic risk and deterring abusive short selling, it believes that the Commission has identified risks from short selling that do not exist.

AFME agrees with the proposal to prevent short selling where the seller has little or no intention of covering the sale. However, the Commission's proposed ban on 'uncovered' short selling will not succeed in its aim of reducing volatility and could have the opposite effect. Studies (see note 2) show that banning short selling can actually lead to wider bid-ask spreads and steeper price falls.

On short selling disclosure

AFME generally supports moves to greater transparency but agrees with the Committee of European Securities Regulators (CESR) view that firms which engage in market making should be exempt from disclosure requirements on uncovered short selling.

AFME believes, however, that CESR's proposal - that equity investors should publicly disclose their short positions to the market at very low thresholds - may expose them to unfair risks (see note 3). Despite this, it is recognized that regulators need information to supervise market activity and therefore AFME does support the principle of private disclosure of short positions to regulators.

To enhance marketwide transparency for equities on a basis that is fair to all investors, the regulator could then publish the aggregated reported short position of the market. This would provide more value to investors than a list of individual disclosures.

For fixed income, AFME strongly advises against similar aggregated disclosure measures, since the potential adverse effects of such transparency on government bonds are not yet well understood.

Mark Austen, acting CEO of AFME, said:

"We agree with many of the European Commission's objectives and believe that disclosure should be made in a way that providers regulators with the information necessary for them to mitigate systemic risk. However, market participants strongly believe that the Commission's recent regulatory proposals are disproportionate to the potential risks being addressed.

"Any regulation of short selling must also recognise the role played by banks and other liquidity providers that underwrite or sub-underwrite new share issues.

"In addition, we support the Europe-wide desire for a harmonised approach to regulation as the costs and increased complexity of complying with different regimes would be high and have a negative impact on market efficiency."

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Click here for the Joint Response to the European Commission's public consultation on short selling from the Association for Financial Markets in Europe, the International Securities Lending Association and the International Swaps and Derivatives Association

Contact

AFME
James White +44 (0)20 7743 9367

M:Communications
Ann-marie Wilkinson/ Andrew Benbow +44 (0)20 7920 2344

Notes to Editors

1. Uncovered short selling – any sale of the security which the seller does not own at the time of the sale and where a seller has not yet borrowed the security or ensured it can be borrowed.

2. See http://www.cass.city.ac.uk/media/stories/resources/the-impact-of-short-sales-restrictions.pdf

   Spillover Effects of Counter-Cyclical Market Regulation: Evidence from the 2008 Ban on Short Sales
   (http://papers.ssrn.com/sol3/papers.cfm?abstract_id+1571315

3. Public disclosure of long positions is only required for large holdings of shares, often where the shareholding exceeds 3 or 5% of a company's issued share capital. CESR proposes that public disclosure of short positions should occur at just 0.5% of issued share capital.

4. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as

well as key regional banks, brokers, law firms, investors and other financial market participants. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA). For more information, visit the AFME website, www.AFME.eu.