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Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.
The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

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Response to the European Commission's public consultation on short selling

Key Points

- The regulatory approaches to short selling should by fully harmonised across at least the European Economic Area.
- Short selling must not be confused with market abuse. Some of the potential concerns mentioned by the Commission are already covered by the Market Abuse Directive.
- The EBF would support many of the specific proposals which the European Commission is currently considering. Nevertheless, the EBF notes that little evidence and research is available about the effects of short selling and naked short selling. The Federation would strongly encourage that more factual information is gathered before a final policy decision is taken.
- Banks would not support a general ban on short selling. Neither does the EBF believe that a ban on naked short selling is necessary. At least in Europe, the theoretical risk of settlement fails resulting from naked short selling has not proven to be significant in practice.
- Market makers should be exempted from any requirements around short selling.
- In terms of transparency, the EBF supports a requirement for investors to report short positions above a certain threshold to regulators. On the other hand, there are major concerns around a potential requirement for the public disclosure of short positions.
- 'Naked CDS' are fundamentally different from short selling, as far as the underlying transactions are concerned. Derivatives regulation is currently under preparation in a range of areas, but no specific requirements would be appropriate in the context of short selling.
- Nevertheless, should the Commission consider a broader scope appropriate, this should also be fully harmonised across the EEA.

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Related documents: European Commission consultation document:
http://ec.europa.eu/internal_market/consultations/docs/2010/short_selling/consultation_paper_en.pdf
EBF position on CESR's proposal of a harmonised short selling disclosure regime: http://www.ebf-fbe.eu/uploads/documents/positions/FinMark/16-June%2010-D1291D-2009-%20short_selling_disclosure.pdf

General remarks

The European Banking Federation (EBF) welcomes the European Commission's consultation on an EEA-harmonised short selling regime. At the same time, the Federation regrets the short time frame for this consultation. This adds to a situation where already little information about the effects of (naked) short selling on the financial markets is available. European banks would strongly warn against any rushed policy decisions, but would rather recommend that further factual information is gathered.

The EBF also notes that in spite of having recently recognised that possible speculation in credit default swaps (CDS) - or, in other words, naked CDS - raises different issues to short selling, the Commission is presenting a consultation paper that bundles issues related to these two topics, thus making the commenting process more complex.

Certainly, the founding premise to address CDS and naked short sales together rests on the 'so-called' net economic effect (i.e. economic net short positions). Indeed, short positions on any given financial instrument are calculated not only by looking at the operations on that financial instrument but also to the positions obtained through the use of derivatives relating to that instrument, including CDS, both for hedging and non-hedging (i.e. naked CDS) purposes.

In that regard, in order to better present our comments, this general section is split into two sub-sections: a) short selling (i.e. short positions) and b) naked CDS.

a) Remarks on short selling (i.e. net short positions)

The EBF has in the past repeatedly regretted the inconsistencies of approaches taken at national level, which both led to significant legal uncertainty and allowed for regulatory arbitrage, as rightly mentioned in the Commission's consultation paper.

At the same time, little information continues to be available to allow a judgement as to whether the alleged negative effects of short selling on the capital markets do actually exist, or whether share price declines would have happened anyways and were potentially simply accelerated through short selling activities. Available evidence rather seems to imply that recent bans of short selling proved counterproductive.[1] Short selling does on the other hand have positive effects. Notably, it increases liquidity. Related to this, markets adjust quicker to new information.

As a general starting point, past discussions have shown that there is broad agreement that a) short selling plays an important role in the financial markets and is overall contributive to market efficiency; and b) that a regulatory approach should be harmonised on the highest possible level, at a minimum at EU level.

[1] Cf. for example: Hanssson, Fredrik and Erik Fors, 2009: Get shorty? Market Impact of the 2008-09 U.K. Short Selling Ban. Unpublished working paper, University of Gothenburg.

The EBF has repeatedly expressed its support for a regulatory solution at EU level and continues to support the European Commission's work in this respect. European banks indeed believe that short selling rules should be subject to maximum harmonisation at EU level.

In addition, the EBF would support work by CESR / ESMA to monitor and analyse assumed systemic effects on the markets. The EBF appreciates, furthermore, that there is a general public interest to understand better the functioning of the financial markets, including in respect of short selling. A transparency regime could be helpful also in this respect.

The EBF also welcomes the balanced starting point of the European Commission's consultation and especially its explicit acknowledgement of the positive role of short selling in the financial markets.

In principle, the EBF furthermore finds appropriate the European Commission's proposed approach of regulating short selling as an activity, whatever the party undertaking the transaction. However, this should not go as far as implying an extra-territorial scope of the EU rules. The EU rules should be limited to transactions with a clear link to Europe, either through the trading venue or through the underlying product.

In addition, the EBF strongly supports the Commission's proposal that the requirements would for the most part apply to the person who enters into a short sale or has a net short position, rather than to the intermediary executing the transaction.

As regards the alleged abusive use of short selling, however, the EBF would welcome clarification whether the Commission considers short selling activities as such to be abusive, in certain instances; or whether short selling can be used abusively if combined with other, clearly market-abusive practices such as the spreading of false rumours or effecting transactions which secure the price of a security at an abnormal or artificial level. The EBF's view, *a priori*, is that short selling activities in themselves are not abusive of the market.

Also, abusive behaviour is of course already covered by the Market Abuse Directive. One of the tools to help detect market abuse are the transaction reports, whose implementation has been very costly for the industry. On the basis of the information gathered by the competent authorities through these systems, it would be useful for the further discussion to get an understanding of the extent of abusive short selling that the authorities have discovered during the financial crisis.

More generally, a clear distinction should be made between short selling and market abuse, and the EBF welcomes the Commission's decision to treat short selling in a separate piece of legislation from the Market Abuse Directive.

Finally, the EBF notes that there remains uncertainty around the precise definition of short selling. The detailed comments below include an additional section with specific examples of certain trading activities. The Federation would invite clarification as to which of these examples would be considered (naked) short selling.

b) Remarks on naked CDS

'Naked' CDS are a subset of CDS and, therefore, of derivatives instruments. The Commission's envisaged proposals on short selling - commented above - would, therefore, be of general application to CDS transactions (as CDS would impact the calculation of net short positions). The European Commission is, nonetheless, envisaging a more stringent regime for naked CDS whose underlying is a sovereign debt instrument. This regime would be triggered in situations of emergency.

The EBF notes that the European Commission's primary objective, in considering the introduction of such a special regime, is the suspicion that CDS trading on debt instruments may have had an adverse effect on government bonds, this being defined as 'an unjustified widening of the spreads'. The European Commission has conducted research that has not been formally released (and, therefore, questioned by market participants). In the absence of public information on the results of such analysis, the EBF does not believe that European regulation on short selling should include any restrictions on derivatives trading. Should the Commission nevertheless consider policy intervention necessary, intervening in the markets might be more appropriate than restricting market participants' trading activities.

Should the Commission opt for a broader scope of the short selling regime than just equities and bonds, it will moreover be important to carefully consider the appropriate definition of 'naked CDS'. Not all underlyings can be hedged directly. Instead, an investor might choose to buy a CDS on a similar but different underlying. Frequent examples for positions that are hedged in this way include trade receivables, SME loans, derivative counterparty exposure and other illiquid positions. European banks strongly believe that such positions, which are acquired for pure hedging reasons, should not be considered 'naked CDS' even if there is a technical difference between the long financial instrument and the CDS' underlying.

Detailed comments

<u>Definition of short selling</u>

There remains uncertainty about what exactly the Commission understands to constitute short selling. The EBF would request further clarification of the definition of short selling, and notably whether the following examples would be interpreted as (naked) short selling:

- A person sells a security on trade day X in the morning and buys the same security on trade day X in the afternoon. If the trade takes place on an exchange cleared by a CCP, netting at the end of the trade day will result in the fact that no securities transaction will take place, but only cash movements.

- A person sells a security on trade day X, and the intended settlement date for this trade is X+3. The person will borrow the security from entity E and the trade will settle on the intended settlement date X+3.

In this example the legal owner of the security is the selling person (there is no impact on the outstanding shares of the issuer) and entity E has a claim on the lent securities against the selling person.

- A person sells a security on trade date X and the intended settlement date for this trade is X+3. On the intended settlement date the final settlement fails because the seller cannot deliver the security.

- A person has a long position in an option of a security. On trade date X the person exercises the option right, expecting delivery of the security on trade date X+3. The person does not await day X+3 but rather sells the security on trade date X. If both the derivatives market and the cash market are cleared by a CCP, there will be no securities to settle as the exercise of the call option will be netted by the selling. There will only be a cash movement.

- A person sells a multi-listed security on trade date X on Exchange A, where a settlement cycle of X+2 is market practice. The person buys the same multi-listed security on trade date X on Exchange B, where a settlement cycle of X+3 is market practice.

Essentially, the question in the above examples is whether short selling can or should be determined in relation to the settlement date. The EBF's view is that settlement should be considered in isolation from short selling. Whether or not a transaction is 'short' should only be related to a person's trading activities.

Further examples that require clarification, in the view of the EBF, include the following:

- A pension fund changes the duration of a bond portfolio by selling futures of a certain bond to match the duration of the pension fund's assets with its liabilities. The pension fund does not own the specific bond that the futures relate to.

- An investor owns a portfolio of German corporate bonds. To eliminate country risk, he buys protection in the form of a CDS on Germany. He does not own any government bonds.

- An investor owns a bond in a French perfume manufacturer. He now wants to reduce his exposure. Selling would be too costly and the investor uses derivatives instead. However, he only finds a counterparty that is willing to buy futures of a similar bond from a direct competitor of the French perfume manufacturer.

- An investor owns a non-delta-1 Exchange-Traded Fund that gives him inverse exposure to a European index.

- An investor owns a widely diversified portfolio of European stocks in the form of an index position. He believes that Chemicals will outperform Industrials and accordingly reduces his exposure in Industrials by selling a European industrial index. The two indices do not exactly cover the same industrial stocks.

Scope of financial instruments covered

Question 1: Which financial instruments give rise to risks of short selling and what is the evidence of those risks?

Question 2: What is your preferred option regarding the scope of instruments to which measures should be applied?

As a general remark, the EBF believes that short selling normally contributes to efficient markets. The expression of 'giving rise to risks of short selling' does therefore not seem appropriate to the EBF.

While all kinds of securities can be sold short in theory, the EBF is not aware that this is of any practical relevance for instruments other than equities and sovereign bonds. European banks do therefore not believe that there is a need to subject other instruments to the rules currently under consideration by the European Commission.

Should the Commission nevertheless opt for a broader scope of the rules, care should be taken to ensure full harmonisation of the respective rules across the EEA.

Question 3: In what circumstances should measures apply to transactions carried on outside the European Union?

The EBF believes that the rules should not have extra-territorial reach, as a matter of principle. To be effective, they should nevertheless apply to all transactions that have a clear link to Europe either through the trading venue or through the underlying product.

Specifically:

- All transactions carried out on a European trading platform should be covered.
- In the case of OTC trades of instruments that are covered by the rules, only those parties with a legal establishment in the EU should be covered.
- In the case of European instruments or derivatives deals with a European underlying, however, it is desirable that the deal would be covered by the EU rules, wherever it is agreed or executed. The EBF recognises that the enforcement of this principle can be difficult in many cases. Nevertheless, deals in European instruments or in derivatives with European underlyings will have a direct impact on the European markets. Not covering them whenever they are transacted outside the EU would mean to allow for a major loophole.
- Special attention has to be paid to issuers with multiple listings.

Transparency

European banks would support a requirement on parties holding significant short positions to report such positions to regulatory authorities. Most EBF members are however strongly opposed to a requirement whereby individual short positions must be disclosed to the markets. Furthermore, in the view of the EBF 'significant' would typically lie well above the suggested threshold of 0.2%.

The Federation is aware that there is already some limited experience with such a disclosure requirement, which indicates that at least some market participants continue to hold short positions above the disclosure threshold. Nevertheless, banks generally are concerned about the expected deterring effect of public disclosure. Such an effect would reduce the benefits of short selling and especially that of providing a counterweight to possible market over-valuation. Indeed, the dangers of a bubble are at least as great as the dangers of a temporary under-valuation of some instruments, as could well be observed in the recent financial crisis.

There is furthermore a concern about the signalling effect of the disclosure of short selling positions, and about possible misinterpretation: the isolated disclosure of certain short positions held by market participants would likely be interpreted as a sign that this market participant considers the respective share or bond to be over-valued. Other market participants might be influenced by this interpretation, even though the respective position might serve hedging purposes rather than a desire to take a genuine short position in the underlying instrument.

In particular a general transparency requirement for sovereign bonds and CDS on sovereign bonds would risk having a market impact and could be harmful not only to the person holding the short position on these instruments, but also to the respective debt issuer.

Question 4: What is your preferred option in relation to the scope of financial instruments to which the transparency requirements should apply?

The EBF would have a preference for option B, i.e. limiting the scope of the regime to shares and sovereign bonds.

Nevertheless, as noted above should the Commission opt for a broader regime, the EBF believes that this should be subject to full harmonisation across the EEA.

Question 5: Under Option A is it proportionate to apply transparency requirements to all types of instruments that can be subject to short selling?

So far, there are no indications that there is a need for transparency requirements on instruments other than equities, sovereign bonds and CDS. Unless a convincing case can be made about the additional value of a broader scope, the EBF suggests that the additional transparency requirements should be limited to the above-mentioned instruments.

Question 6: Under Option B do you agree with the proposals for notification to regulators and the markets of significant net short positions in EU shares?

As noted above, the EBF would support reporting requirements to regulators but not disclosure requirements to the markets.

The Federation would also underline that any transparency regime should be as consistent as possible with the requirements under the Transparency Directive, notably as regards the calculation of positions, exemptions, the denominator and other specificities.

Question 7: 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 EBF considers the particular debate about sovereign bonds problematic. It must be noted that the recent price falls in the sovereign debt markets reflected according market fundamentals, rather than being indicative of excessive speculation.

Should a disclosure requirement for significant short positions of sovereign debt be introduced, the EBF all the more believes that such information must only be communicated to supervisory authorities, for the pure purpose of market oversight. No information about positions held by individual investors should become available to the finance ministries, in order to avoid any political intervention. In any case, there should not be any public disclosure of significant short positions, neither for sovereign debt nor for other financial instruments.

Furthermore, there needs to be agreement as to which denominator to use in the case of government debt.

Question 8: Do you agree with the methods of notification and disclosure suggested?

Most EBF members are strongly opposed to any requirement for the disclosure of short positions to the market. Instead, competent authorities could publish some aggregated data in order to inform the wider markets.

As regards reporting to regulators, European banks believes that the appropriate modalities of the reporting requirement are closely linked to the scope of the regime, the way of calculating positions, the level within financial groups at which positions will have to be aggregated, and other specificities of the regime. In any case, the EBF would reiterate that the modalities of the short selling rules should be as harmonised as possible.

Question 9: If transparency is required for short positions relating to sovereign bonds, should there be an exemption for primary market activities or market making activities?

Market making activities should in any case be excluded from the short selling regime. Possibly, this would also require the relaxation of some of the proposed rules for business conducted on behalf of clients.

Question 10: What are the likely costs and impact of the different options on the functioning

of financial markets?

The proposed reporting requirements would certainly be costly and burdensome for firms, with costs varying in relation with firms' internal structures, business models, and the modalities of the rules such as the level at which positions will have to be calculated. Some indirect cost in terms of reduced market efficiency is also likely, as a reporting requirement is expected to function as a deterrent to short selling. This is especially relevant in times of bull markets, where short selling is particularly helpful to act as a counterweight.

Uncovered short sales

Question 11: What are the risks of uncovered short selling and what is the evidence of those risks?

The EBF appreciates that uncovered short selling carries with it some settlement risk, which does not exist for covered short selling. However, in the experience of the European banking sector these risks have not in practice caused any considerable concerns in Europe. Those Member States that have not imposed a ban on naked short selling still see the vast majority of their transactions settle on time.

Furthermore, fails-to-deliver can occur for a number of different reasons and are not necessarily the result of naked short selling.

Question 12: 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?

The EBF notes that little evidence with respect to the perceived negative effects is available in respect of all types of transactions. Even less information is available for the specific case of uncovered short sales for financial instruments other than shares.

Conceptually, some settlement risk can be assumed to exist for bonds and sovereign bonds in the same way as for equities, but not for CDS.

Question 13: 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?

The settlement risk which the European Commission has identified is rather low. The EBF does not believe that it necessitates the proposed restrictions on uncovered short selling. The trading venues also have their own mechanisms in place to mitigate the settlement risk arising from uncovered short sales.

Besides, the EBF believes that a situation where a market participant enters into a naked short sale without a plausible plan to complete the order can be considered to be market abusive. It should therefore be covered by the Market Abuse Directive.

The Commission should furthermore consider that naked short selling can have benefits for the markets more widely. In particular, the ability to enter into an uncovered short position in stocks with little trading activity or which are difficult to borrow adds to market liquidity. This is of particular significance for less liquid markets, such as smaller ones which would be particularly concerned by a ban on naked short selling. The same is true for intra-day naked short selling by day traders, which is generally accepted as legitimate and does not pose significant settlement risk. The Federation believes that further analysis about the effects of naked short selling should be carried out before taking any policy decisions.

However, if the Commission continues to believe that the proposed restrictions are necessary, the EBF would suggest that a number of exemptions be applied. The Federation also believes that the evaluation about whether the person entering into the sale of an instrument has borrowed the share, has entered into an agreement to borrow the share or has evidence of other arrangements which ensure that it will be able to borrow the shares at the time of settlement should be made at the end of the trading day, rather than at the time when the instrument is sold.

Question 14: 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 EBF believes that the requirements suggested by CESR, applied at the end of the trading day, would imply a far-reaching ban on naked short selling and would be sufficient to reduce potential settlement risks. No further-going restrictions are necessary, in the view of the European banking industry. Rather, a general ban would prohibit some of the transactions outlined above under 'Definition of short selling'.

Question 15: 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)?

As noted above, trading venues already have mechanisms in place to deal with settlement fails. Nevertheless, a buy-in requirement could be considered further. As a general rule, buy-in should however only be initiated two or three days after the intended settlement date.

In addition, the EBF is concerned about the proposed role of settlement systems in the buy-in procedures. The implementation of the proposals would require substantial changes to the operational processes across trading, clearing and settlement venues, and in the role and responsibilities of settlement systems.

The consultation document starts from the (wrong) assumption that settlement systems can identify which transactions/settlement fails are resulting from short sales. This is not the case as the settlement system merely receives instructions for settlement from a trading venue, a Central Counterparty, the parties to the trade or their agents. It has no insight in the trading

position of the person that entered into the trade. Even where a trade is done on behalf of a client, the settlement system or CCP might not be aware whether it leads to this client taking a net short position.

The reason of a settlement fail is not necessarily short selling. Settlement will take place if sufficient securities and cash are available in the counterparties' accounts. Such securities or cash positions can of course be the result of cash or securities borrowings. If cash or securities are not available on the intended settlement date, this results in a settlement fail. The settlement system cannot identify the reason why cash or securities were not available at the time of settlement. This could be the result of operational errors such as wrong or late input of instructions, back-to-back transactions in which one settlement fail can give rise to settlement fails in the whole back-to-back chain, or other reasons.

Settlement systems are not parties to the trade like CCPs and will therefore generally not have a role as buy-in agent. Giving them a role as buy-in party is contrary to the role of the system and the risk profile. It may be more appropriate that the CCP, which is counterparty to the trade, would initiate the buy-in.

In any case, and as for other aspects of the short selling rules, it is essential that harmonised rules and procedures be applied across markets in Europe so as to avoid competition between markets in this respect.

Question 16: 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.

No. For a start, the EBF is confused as to the placing of this question in this section. Possible provisions on uncovered short sales are aimed at addressing perceived risks of settlement failure. As described above, the assessment over limitations or a ban on entering into naked credit default swaps relating to EU sovereign issuers is connected to adverse effects on government bonds / concerns over unjustified widening of spreads. There is no settlement risk for CDS. Indeed, the two concepts of 'naked short selling' and 'naked CDS' are fundamentally different, as far as the underlying transactions are concerned.

The EBF does not believe that any restrictions on CDS at this point would be appropriate. As with any other instrument, CDS are traded only where there is a buyer and a seller – i.e., divergent interpretations about the value of the CDS. If an agreement is reached as to what can be the adverse effects of naked CDS trading and evidence showed that such an effect was indeed taking place, then the EBF may reconsider its position. That said, the EBF notes that the rationale that would apply to sovereign debt issuers could, for the same token, apply to other issuers (i.e. corporates). If sovereign authorities have access to capital markets on similar conditions to private parties, the expectation would be that they too, are subject to similar market-driven considerations.

The Commission is right to point out that there is a correlation between CDS spreads and equity prices. In theory, this means that traders could attempt to manipulate CDS spreads in order to potentially profit from short equity positions. However, such manipulation is already

prohibited by the Market Abuse Directive (MAD). The MAD applies to typical Credit Default Swaps which include publicly traded securities (including EU sovereign bonds) as deliverable obligations.

The EBF furthermore notes that some European supervisors already receive CDS transaction reports. Those that do not are expected to start collecting this information in the near future. The Committee of European Securities Regulator's recent consultation on guidance on how to best report OTC derivative transactions already included some considerations in this respect.

The short position reporting requirements which the Commission is currently considering will also make it easier for competent authorities to monitor which parties are active in both markets, the derivatives one and that of the underlying security; and to thereby identify parties that might be trading in a market-abusive manner.

Should the Commission nevertheless consider appropriate to apply the short selling rules to 'naked CDS', the EBF would request that at a very minimum, the definition of CDS be clarified to the extent that a CDS held against a corresponding position in a different but closely co-related instrument would not be considered a 'naked' CDS.

Question 17: 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 requirement to report significant short positions should clearly lie with the investor. The intermediary does not have all relevant information to know whether a certain transaction undertaken by a client results in a net short position. Individual orders should therefore not need to be flagged.

Question 18: What are the likely costs and impact of the different options on the functioning of financial markets?

As a trade association, the EBF cannot provide estimates in this respect but believes that a thorough impact assessment will be necessary.

Question 19: Do you agree with the proposed exemption for market making activities? Which requirements should it apply to?

The EBF agrees that market making activities should be exempted from the requirements. The EBF would add that a wide definition should be applied to market making. It should for instance not be necessary to have an agreement with the issuer to prove that certain transactions serve market making activities.

The exemptions should most importantly cover the conditions for uncovered short sales and for buy-in procedures. While most EBF members generally oppose a possible requirement of public disclosure to the market, it is of equally great importance that market making would not be subject to such a disclosure requirement.

Question 20: 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?

As noted under Question 3 above, the EBF believes that the EU rules should cover all deals in EU financial instruments or where the principal underlying is an EU financial instrument. Typically, the principal market for these instruments would lie in the EU.

Question 21: What would be the effects on the functioning of markets of applying or not applying the above exemptions?

It must not become possible for other market participants to guess market makers' positions, whether positive or negative. Otherwise, market makers could be 'cornered', meaning their activities would become uneconomical.

In any case, the EBF notes that the exemption criteria must be clear. This should ensure that business is not hampered by unclear or inconsistent regulation and related operational risk, while not however undermining the general rules. Clear rules should be accompanied by an effective regime to monitor the use of exemptions, both under the permanent regime and in emergency situations.

Emergency powers of competent authorities

As a general remark, the EBF strongly supports the Commission's view that emergency powers of competent authorities in respect of short selling should as much as possible be harmonised and actions taken by national authorities be well-coordinated. The EBF believes, indeed, that the rules should be entirely the same in Europe, wherever a transaction is executed. Failure to ensure this principle would undermine all actions taken on a national level and lead to greater confusion on the markets, rather than having a soothing effect.

The EBF is however concerned by the scope of the transactions that would be caught by the restrictions or prohibitions (letter b, page 12). Indeed, any persons could be prohibited from entering into a 'transaction which creates, or relates to, another financial instrument and the effect or one of the effects of the transaction is to confer a financial advantage on the person in the event of a decrease in the price or value of a share or bond'. It needs to be clarified whether the suggested definition of such transaction is consistent with existing definition in the *Acquis*, notably with that of derivatives instruments within the scope of MiFID.

Additionally, the EBF has noted that restrictions applying to instruments other than CDS would fall on the persons transacting those instruments. This may lead to certain market participants (i.e. non-regulated market participants) being excluded from operating in certain instruments. On the contrary, restrictions to enter into CDS would affect the scope of the instruments (i.e. naked CDS could be banned) and/or the value (i.e. position limits) of the CDS transaction.

Question 22: Should the conditions for use of emergency powers be further defined?

Yes. The EBF would support the identification of certain criteria under which a temporary ban of short sales or limitations on short positions would be justified. Such restrictions should then apply to all platforms where a security is traded, including regulated markets, MTFs, Systematic Internalisers and OTC trading.

Question 23: Are the emergency powers given to Competent Authorities and the procedures for their use appropriate?

As a general principle, the EBF believes that ESMA should have the power to ban certain transactions in emergency situations. It is also appropriate that ESMA should play a coordinating role in 'normal times'. Indeed, such coordination should lead to ensure that short selling transactions are treated the same, wherever in the EEA they are executed.

The EBF does not consider the proposed restrictions on CDS trading appropriate. As noted above, European banks do not believe that CDS trading normally poses any risks in terms of systemic stability. Rather, CDS prices are indicative of market fundamentals and should be seen as an important warning signal.

Question 24: Should the restrictions be limited in time as suggested above?

Yes. The potential restrictions should be limited to emergency measures, and be accordingly limited in time. A three-month period, as suggested in the consultation document, seems an appropriate timeframe.

Question 25: Are there any further measures that could ensure greater coordination between competent authorities in emergency situations?

The EBF believes that regulatory authorities themselves would be best-placed to consider this question.

Question 26: 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%)?

The EBF understands that this question refers to the regime that has recently been implemented in the US. The EBF is sceptical that this regime would make sense if added to the rules that the Commission is currently considering. Foreseeing possible bans on short selling for emergency situations would likely already include such extreme share price falls.

Rather, the EBF believes that the 10%-rule could be a viable alternative to the regime that the Commission is currently considering and deserves further consideration as such. It would also have the advantage of aligning the EU rules with the US rules, thereby leading to greater overall effectiveness of both regimes.

Nevertheless, some specific questions would have to be considered further, for example regarding the treatment of already existing short positions.

Powers of competent authorities

Question 27: Should the power to prohibit or impose conditions on short-selling be limited to emergency situations (as set out in the previous section)?

Yes.

Question 28: Are there any special provisions that are necessary to facilitate enforcement of the future legislation in this area?

Question 29: What co-operation powers should be foreseen for ESMA on an ongoing-basis?

The EBF believes that regulatory authorities themselves would be best-placed to consider this question.

Glossary of definitions

Question 30: Do the definitions serve their intended purpose?

The EBF does not have any specific comments on the proposed definitions.