



Paris, 9th July 2010

**ACI – The Financial Markets Association comments on  
EUROPEAN COMMISSION - Public Consultation on  
Short Selling**

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A - Background:

ACI focuses historically on FX (Foreign Exchange) and Money-Markets and all their kind of Derivatives but our members also cover all segments of the financial markets such as Fixed Income, cash or derivatives, being OTC or in regulated markets.

Founded in 1955 and located in Paris our association regroups today 13,000 individual members from 64 countries worldwide - all of them being market specialists (mainly traders). ACI built up strong market practices summarized at 'The Model Code', becoming *The International Code of Conduct and Practice for the Financial Markets*. Additionally ACI certifies some 1,400 persons a year (mainly traders, mid- or back office staff) through its exams program (ACI Dealing Certificate, ACI Operations Certificate and ACI Diploma). ACI was a co-founder of the Euribor ACI in 1999 and still runs actively working groups focusing at Money Market and Liquidity, Derivatives, Short Term Papers and Foreign Exchange.

ACI's contribution and goal is to support regulators and authorities with the knowledge and expertise from its members being the traders in the markets.

For more details on our association please refer to our Web: [www.aciforex.org](http://www.aciforex.org)

B - ACI replies

Referred consultation paper 'Short Selling' seems to focus more on securities instruments. This area is in fact treated within the environment of ACI's financial markets too but not covering ACI's main business. Nevertheless ACI is more than happy to contribute its perception to the examined topics.

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

- Generally all instruments with low liquidity, low volumes, traded by a limited number of counterparts offer risk on short selling.
- Securities (bonds, shares and derivatives) should be under closer review (referred to later several times)
- In particular CDS trading could dislocate/influence massively the underlying cash-market. Some kind of fairness at trading CDS on firms need to become implemented – at least (minimum requirement on ethics) an agreement by the affected firm has to be obtained.

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

- These measures could become considered for equities, bonds, CDS, commodities, energy and carbon contracts.

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

- In any market crisis, these measure should apply outside the European Union too in order to unify transactions and for not creating any discrepancy between market operators.

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

- We prefer Option B limited to EU shares and Sovereign Bonds

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

- We support transparency at a 'neutral' level – but we are against public disclosure of particular names.
- Referring to the question – we state no as it could cover a too large spectrum of instruments; for example FX products have to be excluded.

**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?**

- Yes we do support transparency and in particular notification to competent authorities;
- But we value any public disclosure very critical as it may create negative market effects (herd effects, un-liked transparency and exposure etc.)

**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?**

- Yes we believe in notification to regulators in EU sovereign debt (including CDS)

- But we value very critical any public disclosure (again risk of misuse by public, press and media etc.)

**8. Do you agree with the methods of notification and disclosure suggested?**

- Yes notification for definite period has to become institutional reporting.
- The definition of 'a person' is not well received as it never should be broken down to an individual name.

**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 makers have to report to regulators
- but these information should not be made public.

**10. What is the likely costs and impact of the different options on the functioning of financial markets?**

- Cost will depend on required format of reporting, but should be limited at lowest level.
- Any public disclosure is offended for market abuses and reputation risk.

**11. What are the risks of uncovered short selling and what is the evidence of those risks?**

- The risk depends on the instrument:
  - o equities (nearly) unlimited risk (contrary to being 'long')
  - o CDS limited to notional agreed

**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?**

- All short option contracts

**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?**

- No strong comment/recommendation from ACI:
- The critical point at securities might be the underlying names. Whilst trading in currencies or money markets (and their derivatives) the underlying instruments are 'neutral' with a mainly large and anonymous market depth, securities trading effects firm names or governments directly. As we do believe in the power and balancing of markets itself under special conditions positioning (long/short) might lead to unluckily market movements affecting unfair firms/governments etc. behind. Later

corrections might be too late as some damage already occurred (reputation, stop-losses etc.)

- Anyhow, particularly at securities trading some restrictions at 'short selling' would reduce the sensitive impacts for firms and governments.

**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?**

- In general we are against an upfront ban and permanent restrictions; it could be put in place during times of exceptional crisis and under certain conditions. Markets always do need have buyers and sellers.
- Considering our reply to pt 13 serious thoughts should evaluate again the 'short selling' in securities markets (again the markets are different to the mainly large and anonym currency markets).

**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)?**

- No comment

**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.**

- Moral and ethics changed a lot during the past ten years – everything became allowed and possible. Maybe the whole society has to re-change again.
- The question should not only relate to EU sovereign issuers it should be extended to firms too. In particular when a firm becomes involved we do hold the view the firm need to agree if CDS on it shall be invented! The same could be done for sovereign issuers too.
- Otherwise we would answer with a 'no' but only in times of exceptional crisis. We consider offering 'insurances' as a fruitful instrument for market participants.

**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, we are against of creating a two tiers market.

**18. What is the likely costs and impact of the different options on the functioning of financial markets?**

- No comment, just:
- We could consider direct IT cost on any reporting
- But also any restriction will increase prices (for hedging etc.)

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

- Yes, market making has to be exempted;
- Market making = liquidity providing, which keeps the markets on go and the spreads at reasonable prices

**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?**

- Yes; International cooperation is needed in worldwide markets; local regulation, restriction or ban will not be fruitful without global coordination.

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

- Risk of reduced liquidity
- Risk of widening spreads at price quoting (= > more expensive)
- Prevention of regulation arbitrage
- Markets do need market makers, they do provide liquidity and price quoting.

**22. Should the conditions for use of emergency powers be further defined?**

- Yes, these emergency decisions have to be taken in a clear framework and be public to avoid any markets panics

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

- Yes, they seem appropriate and useful

**24. Should the restrictions be limited in time as suggested above?**

- Yes, emergency decisions have to be put in place for a temporary period of time.
- Additionally we suggest some roll over procedure to assure a regular review and validation of the situation.

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

- Emergency situation needs strict organization, mandated people, restricted professional attendance;
- We suggest redacting rule book with all "actors" agreement, and regular update.

**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%)?**

- If we consider short selling as a pure speculative product we could support on such considerations.

**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, closing a market is a very strong signal and it has to be limited for very "special " situations.
- But the possibility to do so will create a balancing power to the markets.

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

- Any market participant and user has to know the rules ( rule book)

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

- No comment

**30. Do the definitions serve their intended purpose?**

- Yes, we do believe a global and coordinated regulation needs specific terminology to avoid any conflicts, but provides common knowledge and understanding. This glossary targets in particular towards the securities markets (equity and bonds) which are servicing a critical 'private/public' sector with quiet often direct impact on sensitive 'private' (firm's) environment.
- The goal of any regulation has to be to protect the financial and economic stability of a region (and even further).
- Additionally it has to encourage the 'free' power of markets and to recognize 'speculation' in general as a positive development and strong need to free markets: *to look into the future* from different angles. Speculation (or 'speculare') mainly discovers imbalances in markets which shall adjust itself.
- Free markets shall be encouraged – but under close supervision by regulators. Only a close cooperation between financial institutions, all kind of customers and regulators will be able to handle the very large environment in the financial industry.
- Moral hazard and reduced ethic understanding (driven by increased income pressure) maybe missed some points of well functioning markets. This *society problem* needs additionally become examined.

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