

July 8, 2010

Via Electronic Mail

Commissioner Michel Barnier
Internal Market and Services
European Commission
B-1049 Brussels
Belgium

Re: EU Commission's Consultation Paper on Short Selling

Dear Mr. Barnier:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on the consultation paper on short selling (Consultation Paper) issued by the Commission of the European Union (EU).¹ The IAA is a not-for-profit US association that represents the interests of investment adviser firms that are registered with the US Securities and Exchange Commission (SEC). The IAA's membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations, and many of our members invest in EU issuers for their clients.²

In response to market disruption and turmoil in the fall of 2008, individual EU Member States have taken various actions to restrict or impose conditions on short selling in an effort to minimize the potential for market abuse and disorderly markets. In 2009, the Committee of European Securities Regulators (CESR) proposed a uniform short selling disclosure regime in Europe to develop pan-European standards on short selling and to respond to concerns of market participants regarding the burdens of complying with a number of different national requirements.

The IAA believes that a unified approach to the regulation of short selling globally, as well as across the European Union, represents the most effective way to prevent abuse and maintain orderly markets. We are pleased that the EU Commission is continuing this effort to adopt a uniform approach to short selling across the European Union. In the Consultation Paper, the EU Commission states that it intends to propose rules to increase transparency of short positions, to reduce risks of uncovered short selling, and to provide emergency powers

¹ Public Consultation on Short Selling (June 14, 2010).

² For more information, please visit our web site: www.investmentadviser.org.

for Member State authorities to impose temporary short selling restrictions. Given the very short period of time for public comment, we provide briefly our views on several issues with respect to the Consultation Paper. We hope to work with the EU Commission as it develops a final proposal for comment later this year.

EU Commission Should Propose a Modified Two-Tiered Approach to the Transparency Regime

With respect to the transparency of short positions, it appears that the EU Commission will propose a two-tier regime of both public and private disclosure of net short positions (similar to the model proposed by CESR). We remain concerned that if short positions held by market participants are made public, there is a significant risk that they could be used to appropriate the legitimate intellectual property of market participants, such as investment managers, by those hoping to mimic their investment strategies without having to pay for their development.³ We hope that the EU Commission will reconsider this approach and propose private disclosure to a regulator followed by public disclosure by each regulator of aggregated short sale positions as deemed appropriate.

Moreover, we recommend that the EU Commission's proposal require private disclosure to regulators at a .5% threshold.⁴ If the thresholds are too low, the disclosure of small short positions would only serve to detract from useful information that would indicate impending disorderly markets or market abuse. An initial threshold of .2% for disclosure to regulators as suggested by CESR is too low, resulting in more frequent but less useful information to be provided to regulators. For small and even mid-cap securities, the .2% threshold could be reached easily and capture insignificant short positions. Consequently, regulators would be overwhelmed with information that is not indicative of abusive activity while market participants would be subject to an unreasonable compliance burden.

EU Commission Should Extend the Time Period for Disclosures

In the Consultation Paper, the EU Commission suggests that, in a transparency regime, once the short sale threshold is met for EU shares and EU sovereign bonds, the notification or disclosure of net short positions would need to be made no later than 3:30 p.m. on the next trading day. We appreciate that it may be important for regulators to receive information about potentially abusive short selling practices as quickly as possible and that aggregated information about short selling should be disclosed to facilitate an informed decision making process by the markets. We believe, however, that it is essential to balance this need against the time necessary to verify the accuracy of the information and the undue burden on the market participants making the disclosures.

³ The IAA discussed these issues in more detail in comments to CESR last fall. See Letter to Mr. Carlo Comporti Secretary General, CESR, from Jennifer S. Choi, Assistant General Counsel, IAA, dated Sept. 29, 2010.

⁴ In Discussion Paper 09/1 *Short Selling* (Feb. 09), the U.K. Financial Services Authority recommended a threshold of .5% for the disclosure of net short positions, noting that a threshold that is set too low would impose prohibitive compliance costs and produce data that was of questionable value to the market. See http://www.fsa.gov.uk/pubs/discussion/dp09_01.pdf at 5.38 to 5.45.

In a global economy, holders of short positions are not necessarily based in the same country or time zone as issuers for which they hold short positions. Moreover, market participants may be required to make multiple disclosures of short positions to different regulators. In light of the global nature of the securities markets, the IAA believes that requiring disclosure of short positions on a T+1 basis would not allow market participants sufficient time to calculate their short positions (particularly if they are located in a different time zone) and imposes an unreasonable administrative burden on market participants. Under the timeframe contemplated by the EU Commission, for example, if a US investment manager was required to report by 3:30 p.m. on the next trading day to a regulator in continental Europe, the US manager would have to make such disclosures by 9:30 a.m. EST (the start of the work day in the United States). A US manager located in the Pacific time zone, would have until 6:30 a.m. to make the required disclosures. As a result, US investment managers would be required to work during the night to make timing notifications to European regulators.

We respectfully request that the disclosure regime allow at least T+3 for holders of short positions to provide disclosure to regulators and the market so that information can be gathered, calculated, and appropriately verified before dissemination. We believe this relatively short period of time would still provide regulators early notification of positions as well as provide the market with timely information. This additional time would greatly alleviate the compliance burdens that would otherwise be imposed on market participants. We hope that the EU Commission will recognize the global nature of the European securities markets and that the regulatory requirements will take into consideration the international investor-base of EU securities.

EU Commission Should Include a Provision Confirming That Affiliates That Do Not Share Information about Investment Decisions Do Not Need to Aggregate Short Positions

When the EU Commission publishes its proposal this fall, we respectfully request that the EU Commission incorporate the principle that has been recommended by CESR with respect to aggregation of short positions within a corporate group. On May 26, 2010, CESR published its report on the technical details for implementing the short selling disclosure regime in Europe.⁵ CESR's overriding principle in netting and aggregation is that the calculation and disclosure of net short positions should take place at the level of the person that is making the relevant investment decisions. This principle appears to permit investment managers within the same corporate group that do not share information about investment decisions for business purposes not to be required to aggregate short positions for purposes of reporting.

The concept of "disaggregation" is provided explicitly in the Transparency Directive for the disclosure of shareholdings for both EU managers and non-EU managers, and the Directive allows groups of affiliated investment managers to disaggregate shareholdings when

⁵ CESR Report, Technical Details of the Pan-European Short Selling Disclosure Regime (May 2010).

complying with the relevant thresholds.⁶ We recommend that the business reality of separation among affiliates within a corporate group that has been recognized by the EU specifically in the Transparency Directive also be reflected in a proposal for disclosure of short positions. Thus, we suggest that the EU Commission incorporate this principle into a proposal for short selling disclosure through a provision explicitly providing for disaggregation of short positions for EU as well as non-EU investment managers that do not share investment decisions within a corporate group.

EU Commission Should Impose a Uniform Disclosure Regime and Not Allow for Local Member State Variations

The IAA strongly recommends that the EU Commission adopt a harmonized regime that would permit the fewest variations as possible among the Member States. Monitoring the various different rules and threshold levels for initial and subsequent reporting in multiple jurisdictions can be extremely costly. Different requirements can cause investment managers to have to implement compliance with these multiple rules manually and fewer of the compliance systems can be automated. We firmly believe that the high costs and complexity of tracking multiple thresholds in Europe call for a uniform standard that would be appropriate in most circumstances.

Recalled Securities That Were Out-on-Loan Should Not be Considered a Short Sale for Purposes of Rules on Buy-Out Procedures

In the Consultation Paper, the EU Commission is considering requiring a trading venue to have, or to ensure that the central counterparty or settlement system that provides clearing or settlement services for the trading venue to have, rules on adequate measures for buying-in of shares if a short sale results in a settlement failure. We request that the EU Commission confirm that the sale of a loaned security for which a bona fide recall has been initiated will not be treated as a short sale for purposes of any rules on buy-out procedures. Sales of securities out on loan should be treated as a long sale and any rules or procedures to buy-in the shares after a specified period of trading days should not include recalled securities out-on-loan.⁷

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⁶ See Transparency Directive, 2004/109/EC (Articles 9.5, 12.4, 12.5, and 23). We note that the European Securities Market Expert Group found that various EU Directives take inconsistent approaches to disaggregation and recommended that certain Directives be amended to “bring them into line with the disaggregation rules in the Transparency Directive.” European Securities Market Expert Group Opinion on Disaggregation of Shareholdings (June 18, 2009) at 6.

⁷ In addressing failure to deliver securities, the SEC has imposed a requirement on broker-dealers to promptly purchase or borrow securities for failure to deliver on a short sale. In situations in which a person has loaned a security to another person and sells the security but a bona fide recall of the security is initiated within two business days after trade date, such a sale will not be treated as a short sale. See Amendments to Regulation SHO, Rel. 34-60388 (July 27, 2009).

The IAA strongly supports the EU Commission's efforts to introduce a harmonized approach to short selling in Europe. We look forward to working with the EU Commission as it develops a final proposal for short selling. We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Jennifer S. Choi

Jennifer S. Choi
Associate General Counsel

cc: Director General Jonathan Faull, DG Internal Market and Services