May 5, 2009

*Via Electronic Filing*

Stephen Sie and Don Groves
Market Monitoring
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

**Re: Discussion Paper 09/1 Short Selling**

Dear Mr. Sie and Mr. Groves:

The Investment Adviser Association[1] appreciates the opportunity to comment on the Short Selling Discussion Paper (09/1) issued by the Financial Services Authority (FSA) in February 2009.[2] IAA members manage assets on behalf of their clients, and many of our members invest in UK issuers for their clients.

In the Discussion Paper, the FSA proposes a permanent regime for disclosing short positions in UK securities to follow on temporary measures that were introduced in September 2008 when the markets around the world experienced significant financial and market turmoil. The IAA fully supports efforts by regulators, including the FSA, to address unusual market volatility as well as to eliminate potentially abusive short selling practices that may have contributed to the destabilization of the financial markets. Specifically, the FSA identifies four potential problems with short selling, which include: (1) market abuse; (2) disorderly markets; (3) transparency deficiencies; and (4) settlement failures.

The IAA supports the laudable goals of the FSA of reducing or eliminating potential problems with short selling. We respectfully request, however, that the FSA's regulatory response be balanced against the potential cost or harm to market participants. In this regard, we believe that public disclosure of short positions will seriously harm investment managers

[1] The Investment Adviser Association (IAA) is a not-for-profit association that represents the interests of SEC-registered investment adviser firms. The Association's membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment companies, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

[2] FSA Discussion Paper 09/1 *Short Selling* (Feb. 2009).

by exposing their proprietary trading information to others who may attempt to mimic their investment strategy or use the information for their own benefit without cost. We discuss these concerns in more detail below.

Short Positions Should Be Disclosed to the FSA on a Non-Public Basis and the FSA Should Disclose Aggregated Information to the Market

In the Discussion Paper, the FSA concludes that the benefits of having public disclosure of significant short positions outweigh the costs and justifies the short selling disclosure regime on this basis. The FSA, in our view, underappreciates several major costs on market participants in connection with the proposed disclosure regime. Public disclosure would substantially harm investment managers by potentially exposing their investment strategy to those who hope to misappropriate the intellectual property of investment managers without having to pay for developing an investment strategy. Moreover, as recognized by the FSA in the Discussion Paper, the proposed disclosure obligation may reduce the transparency regarding short selling by encouraging those selling short to stay under the disclosure threshold and may make market participants vulnerable to being squeezed by competitors when it comes to covering their short positions.[3] The disclosure also could result in the "herding" effect as noted by the FSA where short sellers may follow influential market participants' decision to sell short and thereby exacerbate a downward price spiral.[4]

Paired against these costs are, in the FSA's view, two specific benefits. One benefit is that enhanced transparency of short selling (by disclosing the size of the significant short positions and the identity of significant short sellers in the relevant stocks) can provide insight into short sellers' price movement expectations and can improve pricing efficiency. Second, increased transparency could help to detect short selling that is being used to commit market abuse, and tackling market abuse remains one of the FSA's top priorities.

The IAA is of the view that both of these two benefits can be obtained from a combination of market participant disclosure to the FSA with public disclosure by the FSA of the aggregated positions for individual securities. We believe this approach can maximize the benefits sought by the FSA while minimizing the negative effects on market participants.

First, disclosure of short positions above the specified threshold to the FSA would certainly provide the regulators with the relevant information to combat market abuse. We believe that the FSA would be in the best position to tackle market abuse, and the information should be provided to the FSA.

In addition, if aggregated information about short sale positions in a particular stock is provided to the market (even if that information is provided for those positions above a particular threshold), it would provide significant information to the markets and provide insights into short sellers' price movement expectations and improve pricing efficiency. It is unclear why short positions broken down by investor would be more helpful. The FSA, in the

[3] *See supra* note 2 at 5.11 and 5.30.

[4] *See supra* note 2 at 5.12.

Discussion Paper, acknowledges that "aggregate short position in a single stock could help the market judge the extent to which short selling is driving down the price of that stock . . ." and notes that some market participants took the view that knowing the "aggregate number of shares that have been sold short for a particular stock is more important than knowing who actually holds those short positions."[5]

The benefits described by the FSA – the ability to make more informed decisions and constraining aggressive large-scale short selling leading to disorderly markets – can be readily achieved by providing the information to the FSA and making the aggregate information public. The information that there is significant short selling in a particular stock would provide as valuable information to the market as if that information was separated out by each market participant. Moreover, we believe that the disclosure provided to the FSA would constrain market participants from behavior that might threaten disorderly markets. The FSA should carefully review the disclosures that it receives to see if a particular market participant exhibits any pattern of abusive behavior.

In the Discussion Paper, the FSA briefly considers the possibility of requiring disclosure of individual positions to the regulator and then the regulator publishing aggregated information about those positions. The FSA states that this option only gives "partial and arguably misleading information about the extent of short positions in individual stocks."[6] The FSA provides no reasons, however, to support this assertion. On the contrary, the information would reveal the amount of short selling activity in individual stocks, which would provide short selling information to the market and improve pricing efficiency. Again, we do not believe that disclosure of short positions on an individual investor basis would result in increased information about short selling activity on a particular stock or improve pricing efficiency of that stock. On the other hand, our recommended approach would provide the benefits that the FSA seeks without the harm described above to market participants. Indeed, our approach provides the FSA with effective enforcement tools, while preserving the benefits of legitimate short selling, whether by hedge funds or other market participants.[7]

IAA Supports Other Aspects of the FSA's Proposal

We support the FSA's proposal to raise the threshold for reporting net short positions from .25% as in the temporary measures to .5% of a company's issued capital. We believe significant short positions should be reported and that smaller positions would only act as "noise" to the useful information. Disclosure of significant positions would focus attention on the short selling that may have detrimental effects on a particular stock and could potentially lead to market abuse.

[5] *See supra* note 2 at 5.20.

[6] *See supra* note 2 at 5.33.

[7] This is consistent with the FSA's views on short selling and hedge funds and the role they play in the UK economy. *See* European Commission Consultation on Hedge Funds: Response by HM Treasury and the Financial Services Authority (Jan. 2009) ("FSA Response on Hedge Funds").

We also support the FSA's proposed requirement to require disclosure if a short position is increased or decreased by .1% after reaching the initial threshold. Again, we believe the .1% increments will permit significant movement in short positions to be highlighted rather than become buried with minor changes in short positions.

Threshold for Disclosure of Short Positions During Rights Offerings Should Be the Same Threshold as for the General Disclosure of Short Positions

The FSA introduced in June 2008 an obligation to disclose short positions that were held in companies undertaking rights issues (separately from the emergency measures). In this proposal, the FSA is proposing to retain a lower threshold of .25% of a company's issued share capital for rights issue situations because it believes that companies undertaking rights issues are more vulnerable to short sellers. The FSA believes short sellers deliberately target these companies to drive the price below that at which new securities are being issued to further depress the share price. This lower disclosure threshold is "intended to mitigate the potentially abusive effects of short selling by increasing transparency."[8]

Although we appreciate the FSA's concerns, we are not convinced that requiring disclosure of positions smaller than .5% would be the most effective means of curbing abusive short selling by those intent on taking advantage of companies conducting rights offerings. Moreover, it is not readily apparent why a stricter disclosure standard in cases of rights offerings would materially enhance the FSA's supervisory or enforcement powers, particularly, as noted below, because the UK would appear to be the only significant jurisdiction in the world with such differentiated disclosure requirements. We believe that the FSA should actively monitor and investigate abusive behavior, and those activities that amount to market abuse should be stopped and addressed immediately by the FSA.[9] The uniform disclosure of short positions would adequately provide the increased transparency needed for the FSA to address abusive practices in connection with short selling.

In addition, market participants that are short selling a security for legitimate purposes may not even be aware that the company is conducting a rights offering. We understand that it is often difficult to determine when a company is engaged in a rights offering in some circumstances. For example, there may be confusion regarding whether a company is offering new shares or conducting a rights offering. Firms may have to conduct extensive research to determine whether a company is engaged in a rights offering, and the due diligence may include detailed review of regulatory news announcements and of prospectuses that are issued. Moreover, because companies may conduct rights offerings after a market participant has already taken a short position, firms may need to monitor continuously the companies in which they have taken a short position to determine whether any of the companies are conducting rights offerings.

---

[8] *See supra* note 2 at 5.53.

[9] In this regard, we agree with the FSA's response to the European Commission's consultation on hedge funds. With respect to the EU Commission's question relating to short selling that leads to distorted price signals, the FSA was of the view that, "[w]herever possible, the supervisory response to market abuse should be detection of and enforcement action against the market abuse itself . . . ." FSA Response on Hedge Funds *supra* note 7 at 2.16.

Finally, we are not aware of any other significant jurisdiction that requires a lower threshold for reporting short positions of companies conducting rights offerings. This anomaly in the UK disclosure regime imposes additional compliance burdens on global firms. In fact, it is unlikely that automated means could be used and therefore manual methods would have to be employed to comply with this obligation. We applaud the FSA for working with other regulators to obtain the widest possible international consensus on a disclosure regime. We recognize that, given the differences in the various markets, agreement on every specific aspect of a disclosure regime may be challenging. In an effort to coordinate short selling disclosure framework on a global basis, we encourage the FSA not to have a separate threshold for companies conducting rights offerings, which has not been adopted by most jurisdictions.

In conclusion, for the reasons stated above, we believe a uniform disclosure obligation at .5% would make the FSA's disclosure regime workable. A uniform disclosure standard for all short positions regardless of the type of security would both provide the FSA with sufficient information to combat market abuse and minimize potentially negative economic effects of a disclosure obligation.

* * * * *

The IAA strongly supports the FSA's efforts to stabilize the securities markets and monitor for abusive practices. We respectfully request that the FSA not require that disclosure be made public on a market participant basis and raise the threshold level for reporting short positions in companies conducting rights offerings to the same level as for the general disclosure of short positions.

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
Assistant General Counsel