September 29, 2009

Via Electronic Mail

Mr. Carlo Comporti
Secretary General
Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 Paris
France

Re: CESR Proposal for a Pan-European Short Selling Disclosure Regime

Dear Mr. Comporti:

The Investment Adviser Association ("IAA") appreciates the opportunity to comment on the consultation paper proposing a pan-European short selling disclosure regime ("Consultation Paper") issued by the Committee of European Securities Regulators ("CESR").[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 the recent market disruption and turmoil, 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. To formulate some pan-European standards in the area and to respond to concerns of market participants regarding the burdens of complying with a number of different national requirements, CESR has undertaken a review of short selling policy. To this end, in the Consultation Paper, CESR proposes a uniform short selling disclosure regime in Europe, which it believes would help to address the potential for market abuse and disorderly markets.

[1] CESR Proposal for a Pan-European Short Selling Disclosure Regime (July 8, 2009.)

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

The IAA fully supports CESR's efforts to reduce or eliminate the potential for abuse associated with short selling. With the benefit of reflection in the aftermath of the market turbulence last fall, however, we recommend that CESR request EU Member States to study closely whether an individual position disclosure regime is the most effective method to achieve CESR's goals. We respectfully suggest below that CESR should re-evaluate whether "flagging" short sale orders may be a better approach.

If CESR concludes, however, an individual position disclosure regime would be more effective, we believe CESR is correct to introduce a harmonized European regime. As noted below, we believe 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. Although we commend CESR in its efforts to implement harmonized regulation, we have particular concerns, which are discussed in more detail below.

CESR Should Re-evaluate the Approach of Flagging Short Sale Orders

In the Consultation Paper, CESR states that transparency of short selling would provide early warning signs of a build up of large short positions and alert regulators to potentially abusive behavior enabling them to monitor and take action more effectively. CESR also believes that facilitating ready access to information on short selling would provide informational benefits to the market, improving insight into market dynamics and making available important information to assist price discovery. To obtain these benefits, CESR notes two basic approaches to enhance transparency. One approach would be "flagging" of short sales orders, which requires a marker to be put on each individual short sale order. Aggregated information about the level of short interest in each security also may be published to the market. The other approach would be to require reporting of individual significant short positions whether to the regulator and/or to the market.

CESR is proposing to require reporting of individual short positions because it is of the view that the flagging approach would not provide data on the outstanding short positions in the market or assist in the identification of large short positions. We respectfully question why aggregated information about the level of short interest in each security published by each relevant market would not assist the regulators to monitor for abuses or provide informational benefits. We submit that data on aggressive selling activity rather than the outstanding positions may be more helpful to regulators in monitoring for abusive behavior. If a significant amount of short selling was occurring in a particular security, the information would either provide insights to the market that could assist in price discovery or alert regulators that there may potentially be abusive activity.

In addition, some international regulators, including the SEC, have decided to increase transparency of short sales by disclosure of transactional-type information, such as the flagging approach that was discussed in the Consultation Paper. Instead of permanently adopting its temporary requirement for certain market participants to disclose short positions to the SEC, the SEC announced that it will work to increase substantially the public

availability of short sale-related information through other means.[3] The SEC will work with self-regulatory organizations (SROs) to increase public availability of short sale-related information through daily publication of short sale volume information by SROs, disclosure of individual short sale transaction information by SROs on a one-month delayed basis, and twice monthly disclosure of fails data by the SEC. The SEC was of the view that these actions would provide a wealth of information to the SEC, "other regulators, investors, analysts, academics and the media." We believe adoption of a similar type of disclosure regime in the European Union may help address potential market abuse and disorderly markets in furtherance of CESR's goals while moving toward a uniform global response to potential short selling abuses.

We appreciate the consideration that CESR has given to the relative costs and benefits of the different approaches through which enhanced transparency of short sales might be achieved. We agree that the majority of the temporary disclosure regimes introduced by CESR members involve the disclosure of substantial short positions and therefore market participants should be familiar with this type of reporting regime. However, in its cost-benefit analysis of position disclosure against a flagging regime and consequent recommendation of the disclosure of substantial short positions on an individual basis,[4] we believe that CESR has underappreciated several major costs to market participants that would be incurred under the proposed approach. Given the attendant issues involved in the disclosure of individual short positions discussed in more detail in the next section of this letter, we request that CESR, in consultation with Member States, determine whether the ongoing collection of short sale data in this manner would be the most effective way to achieve the goals articulated in the Consultation Paper.

The imposition of an individual short position disclosure regime would result in both direct and indirect costs to market participants. Market participants would be subject to direct costs incurred in implementing or updating their monitoring and compliance systems to achieve initial compliance with the regime. In addition to these implementation costs, market participants would be subject to ongoing monitoring costs, which would involve calculating net short positions at the initial threshold level and at increments of .1% as discussed in more detail below. The implementation and ongoing costs can be substantial in light of the multiple reporting thresholds, as a result of the low initial threshold, and the proposed requirement for market participants to take into account transactions in all financial instruments that create an economic exposure to the issued share capital of the issuer.

Moreover, although CESR does not specifically recommend a method for making disclosure to the market, it believes that the costs of making these disclosures are "relatively small."[5] We respectfully disagree with this assertion, and believe that given the criteria used

[3] *See SEC Takes Steps to Curtail Abusive Short Sales and Increase Market Transparency*, SEC Press Release 2009-172, available at http://www.sec.gov/rules/final/2009/34-60388.pdf.

[4] *See supra* note 1 at paragraph 23.

[5] *See supra* note 1 paragraph 69.

to determine a net short position, and the frequency of both private and public disclosures, direct compliance costs to market participants will be significant.

In addition, market participants may be subject to a variety of indirect costs. As noted by CESR,[6] these costs would include "short squeezes" (*i.e.*, increased costs of closing a short position if other market participants are alerted to the need to close out a position), a lack of liquidity in the event that market participants are discouraged from engaging in short selling activities, and the potential over-reaction of the market to the public dissemination of short selling data resulting in excessive sales of shares and price declines. However, a key concern that we would urge CESR to consider more carefully is the potential harm and costs that market participants may incur in the event that their proprietary investment strategies are misappropriated following public disclosure of short selling data. Not only would this result put market participants at a significant competitive disadvantage, but it could also lead to the type of aggressive short selling that the proposed regime intends to avoid. Accordingly, CESR should re-evaluate its decision to choose the individual position disclosure approach over the flagging approach.

CESR Should Revise Aspects of Proposal if It Selects the Individual Short Position Disclosure Approach

If, after evaluation of a transactional regime to monitor short selling, CESR determines that the European Union should proceed with the implementation of a permanent regime requiring the disclosure of individual short positions, we agree with CESR that a uniform standard across the European Union would help alleviate some of the costs and burdens that would be imposed on investment managers and other entities required to submit the information. We recommend below some additional modifications that we believe are critical to minimize the potential negative impacts of a permanent disclosure regime in the European Union.

CESR Should Recommend that the European Union Impose a Uniform Disclosure Regime Through a Separate Regulation or Directive or Through Amendments to the Transparency Directive and Not Allow for Local Member State Variations

In the Consultation Paper, CESR was of the view that the benefits of harmonization will outweigh the disadvantages of having a uniform threshold. CESR asked commenters to consider whether a uniform regime is more advantageous than one that would allow for local variations. We strongly agree with CESR and support a harmonized regime that would permit the fewest variations as possible. 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 recognize there may be differences among securities, such as market capitalization and daily turnover, that make determination of a single threshold challenging and may not result in the

[6] *See supra* note 1 at paragraph 72.

most meaningful information in all circumstances. We agree with CESR, however, that given a choice between the "complexity of the requirements and the extent to which they are tailored to the circumstances of particular markets," the benefits of harmonization outweigh the disadvantages.[7] 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.

To achieve this type of disclosure regime, we believe either a separate Regulation or Directive or amendments to the Transparency Directive would be appropriate. If CESR determines to recommend a separate Regulation or Directive, we ask that the concept of disaggregation in the Transparency Directive discussed below be incorporated into a regulation or directive on short position disclosure.

Short Positions Should Be Publicly Disclosed Only on an Aggregated Basis

In the Consultation Paper, CESR proposes a two-tier regime of both public and private disclosure of net short positions.[8] The IAA agrees with CESR's proposal of private disclosure because we believe that regulators are in the best position to analyze market data and combat market abuse. However, we believe 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. In addition, and as noted by CESR in the Consultation Paper, increased transparency has the potential to result in short sellers being vulnerable to a "short squeeze" and also may lead to increased "herding" activity whereby short sellers follow influential market participants' decisions to sell short and thereby exacerbate a downwards price spiral.[9]

CESR sees the potential costs of public disclosure as being outweighed by two significant benefits. First, such disclosure would provide the market with valuable information that a particular security may be over-valued, allowing it to react rationally and in an orderly fashion. Second, public disclosure would help to combat market abuse and disorderly markets.[10]

The IAA is of the view that these benefits would be achieved more effectively through private disclosure to a regulator followed by public disclosure by each regulator of aggregated short sale positions, and that such a regime would reduce negative effects on market

[7] *See supra* note 1 at paragraph 37.

[8] *See supra* note 1 at paragraph 29.

[9] *See supra* note 1 at paragraphs 31 and 32.

[10] *See supra* note 1 at paragraph 30.

participants.[11] We believe that regulators are best placed to react swiftly to short position data and introduce measures to deal with the problems of market abuse and disorderly markets.

Moreover, the provision of information to the market regarding over-valued securities can be achieved as readily through the disclosure of aggregated short sales information, as it would through the disclosure of individual positions. We believe this approach would still allow the market to react in an orderly fashion to any pricing information, and would have the additional benefit of minimizing the potential harm to legitimate short sellers.

CESR Should Raise the Initial Disclosure Threshold

The Consultation Paper proposes that .5% would be the appropriate threshold for public disclosure and that .1% would be the appropriate threshold level for a private disclosure to the regulator. We agree with CESR that it is important to identify a disclosure threshold that will generate meaningful information and allow regulators to act in an appropriate manner to combat the problems associated with short selling.[12] 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.

The IAA is of the view that an initial threshold of .1% for disclosure to regulators is too low, resulting in more frequent but less useful information to be provided to regulators. Although we appreciate the need for regulators to be informed "at a relatively early stage"[13] about short selling in a particular security, disclosing short positions comprising .1% of a company's issued share capital could generate an excessive number of notifications to Member State regulators. For small and even mid-cap securities, the .1% threshold would be reached easily and would capture insignificant short positions. Consequently, regulators would be overwhelmed with information that is not indicative of abusive activity while market participants would suffer an unreasonable compliance burden.

Regulators need useful information and not just an immense volume of information. We recommend that the proposal require private disclosure to regulators at .5% threshold.[14] Moreover, regulators should then aggregate that information and publish the information on an aggregated basis as soon as possible.

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[11] Not only is private disclosure of individual positions more effective, but public disclosure may ultimately be detrimental to the market. If investment managers are no longer able to operate short selling strategies without the significant risk that their strategies will be misappropriated, there is a risk that they will eventually stop using these strategies and the pricing efficiencies that CESR identifies as a benefit of short selling would be lost.

[12] *See supra* note 1 at paragraph 35.

[13] *See supra* note 1 at paragraph 42.

[14] 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.

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

In the Consultation Paper, CESR proposes that short sellers taking a position in a company that is involved in a rights issue be required to make a public disclosure of their short position once it reaches a threshold of .25% of the issued share capital of that company. CESR believes that companies raising capital through a rights issue are more vulnerable to abusive short selling than in other circumstances, and accordingly a lower disclosure threshold is required to discourage such behavior.[15]

The IAA appreciates the concerns of CESR and agrees that companies involved in rights issues should not be subject to exploitation. We, however, do not believe that imposing a more stringent disclosure threshold (either public or private) to short positions in companies involved in a rights issue would be the most effective means of preventing abusive short selling. Regulators in each Member State are most appropriately placed to deal with such market abuses. It is not clear that their ability to do so with respect to companies involved in rights issues would be materially improved by the imposition of a lower public disclosure threshold. Moreover, it is the view of the IAA that any deterrence that public disclosure may provide to those seeking to abuse short selling would be outweighed by the negative aspects of public disclosure on market participants discussed above.

In addition, we believe that the proposal would be detrimental to legitimate short sellers. A market participant taking a short position in a company may not be aware that the company is conducting a rights issue. For example, a market participant may have difficulty in determining whether a company is involved in a rights issue or merely an offering of new shares. Further, market participants may already hold short positions in a company that conducts a rights issue. In each case, extensive due diligence and ongoing monitoring would have to be undertaken by short sellers.

We support the efforts of CESR to implement a regime that will safeguard vulnerable companies from being exploited by those looking to abuse the market. However, we believe that such entities would be protected adequately by the active monitoring and investigation of potentially abusive behavior by regulators. We urge CESR to weigh the economic harm that a more stringent public disclosure threshold would cause to market participants, against any perceived deterrent that such a requirement would provide.

CESR Should Confirm That Affiliates That Do Not Share Information about Investment Decisions Do Not Need to Aggregate Short Positions

The IAA agrees with CESR that, for determining reportable short positions, market participants should calculate their net short positions (short positions offset by long positions held) at the legal entity level if they are part of a corporate group. Similarly, the IAA requests that CESR confirm that the aggregation of short positions also should not occur at the level of the parent company or among affiliates where there is a group of affiliated investment managers. Investment managers within the same corporate group that do not share

[15] *See supra* note 1 at paragraph 45.

information about investment decisions for business purposes should not be required to aggregate short positions for purposes of reporting for several reasons.

First, requiring affiliated investment managers to aggregate short positions would force these managers to share information about investment decisions for purposes of disclosing short positions that they otherwise would not share. Requiring sharing of information for these purposes is at odds with the information barriers and other policies and procedures that are typically in place to ensure that affiliates do not have access to any non-public information regarding other affiliates.

Second, requiring affiliates to report positions that individually would not be reportable or requiring the holding company to report the aggregated position would present at best an inaccurate, and at worst a misleading, picture to regulators and to the market. This type of reporting also may lead the regulator or the market to view the short positions as being coordinated among affiliates in a group when that is clearly not the case. We believe aggregating in these situations – where investment decisions or information about investment decisions are not shared among affiliates – would send confusing and unhelpful information to regulators and to the market regarding short sales.

For these reasons, we believe investment managers with the same parent company should not have to aggregate short positions if they do not share information about investment decisions. Similarly, a subsidiary and a parent should not be required to aggregate holdings if they do not share information about investment decisions.[16]

This business reality of separation among affiliates within a corporate group has been recognized by the EU specifically in the Transparency Directive.[17] The concept of "disaggregation" is provided explicitly in the Transparency Directive for both EU managers and non-EU managers, and the Directive allows groups of affiliated investment managers to disaggregate shareholdings when complying with the relevant thresholds.[18] Similarly, we ask that CESR include in its proposals for short selling disclosure 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 the corporate group.

[16] Conversely, where information and processes are shared among affiliated legal entities (*e.g.*, where several legal entities share the same investment and trading process and are not subject to information barriers that prevent collaboration), these entities should aggregate holdings and submit a joint aggregated filing of their short positions.

[17] *See* Transparency Directive, 2004/109/EC (Articles 9.5, 12.4, 12.5, and 23).

[18] We note that the European Securities Market Expert Group recently 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.

CESR Should Extend the Time Period for Disclosures

CESR believes that information about short selling should be disclosed as soon as possible to facilitate an informed decision making process.[19] The IAA supports this view and believes that it is important that potentially abusive practices are exposed as quickly as possible. However, 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.

In a global economy, market participants are not necessarily based in the same country or time zone as the market in which they hold short positions. Under the proposed regime, a market participant may be required to make multiple disclosures of short positions to different regulators. Moreover, in accounting for synthetic short positions achieved through derivative transactions, market participants may be required to perform complex calculations to determine their net short positions. In light of the above, the IAA believes that requiring disclosure of short positions on a T+1 basis does 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.

We ask 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 large 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.

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The IAA strongly supports CESR's efforts to reduce the risks of market abuse and disorderly markets that may be caused by short selling. In particular, we applaud CESR's efforts to introduce enhanced transparency on a harmonized basis in Europe. If CESR determines that an individual position disclosure regime is indeed preferable than any other approach, we respectfully request that CESR revise the requirements as suggested above.

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

[19] *See supra* note 1 at paragraph 51.