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Public Comment on Regulation of Short Selling: Consultation Report OICV-IOSCO

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The Zentraler Kreditausschuss¹ welcomes the opportunity to comment on the consultation report of IOSCO regarding the regulation of short selling. Fundamentally, we consider a coordinated approach to the supervisory authorities' handling of short selling to be sensible. This is appropriate against the background of identical competition conditions for the capital markets as for the capital market participants and is important as a practical aspect - referenced in Margin No. 3.3 - of the simplification of the compliance processes in the international business of our companies.

We emphasise the implied positive assessments of the function of short selling in the market process (Margin No. 3.2) and would like to see them taken more into account in the regulatory approach (see below). Furthermore, the position taken by IOSCO that the specific measures should be left to the relevant supervisory authorities as part of their legal environment and to limit itself only to minimum standards is consistent, but in our opinion does little to contribute to the actual solution to the problem of uniform supervisory practice.

Definition of short selling

We can understand the difficulties mentioned in Section 3.6 in defining the subject of regulation, namely the short selling, and agree that a strictly transaction-related view can lead to the desired results in regulation. At the same time we strongly recommend providing the market with more clarity and guidance, at least on a domestic basis. The emergency measures taken by many regulators in September 2008, for example, confronted market participants with the fact that central concepts were defined in different ways across jurisdictions. The key determinants to be unambiguously defined, preferably on an international level, include: naked/covered, physical (cash)/ economical (including derivatives), exchange/OTC, net/gross, special situations (sale of loaned-out stocks, synthetic shorts via Index and basket structuring, cross-border arbitrage, etc.).

Regulatory tools to control short selling activity

We agree with the assessment of the Technical Committee that short settlement cycles and processing discipline limit the risks of short selling.

Short positions reporting

¹ The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (VdP), for the mortgage banks. Collectively, they represent more than 2,200 banks.

However, in contrast to the Technical Committee, we believe that a general (minimum) regulation for short selling is wrong. It is not clear why short selling should trigger disclosure and/or reporting duties, even if it is covered and thus risk-free. At best the harmonisation efforts of the regulatory authorities could focus on naked short selling, although this must not be classified as "harmful" per se. Rather, the objective here is initially to identify the issues requiring regulation, e.g. those in which the amount of short selling transactions actually exceeds the securities in circulation.

In general, in the case of a reporting obligation this should be an obligation to report to the supervisory authority, but not an obligation to publish, as such market transparency is also connected with a series of negative consequences (cornering or the reinforcement of a downwards trend in the selling phase). Consequently, the aspects of short selling designated as positive and useful for the market by IOSCO would be realisable only in restricted form.

Furthermore, we would like to draw your attention to the necessity of an adequate balance between providing meaningful additional information and high costs due to implementation of reporting tools and the above-mentioned negative consequences encumbering both market participants and regulators excessively.

With regard to the question of including derivatives in a possible reporting requirement, we think the Technical Committee is right in pointing out the considerable difficulties and costs associated with such a step. If this is considered further, it should be subject to a thorough cost-impact assessment.

Our criticism applies primarily to the formulation of the second principle of regulation, while the other principles appear to be plausible. We request that the Technical Committee review this principle critically with regard to its necessity and if necessary to restrict it to a context that serves the intended purpose.

Appropriate exceptions for certain types of transactions

In accordance with our above comment on the definition of short selling, we would like to recommend clear definitions of market transactions which are exempt from regulation on an international basis in order to establish market confidence and to prevent possibilities of circumvention.

In our concluding paragraph we wish to point out once more that short selling is an established market practice and vital to market efficiency. This has been underlined by recent academic

research which showed that short selling cannot be seen as a driver for market turbulences and that imposed restrictions failed to have the desired stabilising effect. In our view, it would thus be especially conducive to achieving the desired goals if the definition of the cases of short selling that are actually harmful to the capital market could be taken several steps further towards a common understanding of the supervisory authorities by the work of the Technical Committee. This would ensure more security among capital market participants with regard to the use of short selling. To provide a specific contribution to the issue of regulating short selling, we are attaching to this commentary our response to CESR's call for evidence on the "Regulation of Short Selling by CESR Members" from January of this year. Here you will find further references pointing in the direction indicated above.

Appendix