European Principal Traders Association

15 March 2013

Dear Sirs,

FIA European Principal Traders Association (FIA EPTA) welcomes the opportunity to submit comments on the ESMA Call for Evidence on the evaluation of the Regulation (EU) 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps. FIA EPTA is an association of European principal traders formed in June 2011 under the auspices of the Futures Industry Association (FIA). FIA EPTA represents more than 20 principal trading firms that, on a combined basis, are responsible for significant volumes of trading in many asset classes on European-regulated markets and multilateral trading facilities (MTFs). On average across the main trading venues in Europe, one in two transactions in futures and one in three transactions in equities are very likely to have a FIA EPTA member firm on one or both sides of the transaction.[1]

Transparency and reporting requirements

Q1 Do you consider that the initial and incremental notification/publication thresholds for net short positions in shares and sovereign debt have been set at the correct levels? If not, what alternative thresholds would you suggest and why?

Equities: The threshold itself has had no material impact on the businesses of FIA EPTA members because our members' position-taking tends to be modest in size. Members rely on transparency in order to value the securities within which we provide liquidity and it is in our interest to have more transparency. Having acknowledged this lack of impact on our firms, we do believe the public reporting threshold of 0.5% has been set too low and, in some cases, created unnecessary downward pressure on individual stocks.

Consequently, these new short positions by so-called 'smart money' are often considered newsworthy which in turn discourages potential buyers from buying but encourages potential sellers to sell. Unfortunately this dynamic has been evident in the recent past and we believe that this unintended effect is completely at odds with the intent of the Regulation itself. The low threshold and subsequent attention attributed to the disclosures made has the perverse effect of facilitating a self-fulfilling prophecy in relation to these short positions simply by their very disclosure. It is an excellent example of unintended and undesirable consequences resulting from some regulatory initiatives. Therefore, we believe that the thresholds should be set at materially higher levels, perhaps at the same levels as the disclosure of long positions. In the same manner, we recommend that the incremental threshold levels should also be set higher. In addition to the thresholds, we find it is difficult to see what use competent authorities make of this disclosure on net short positions.

Sovereign Debt: Our members do not trade sovereign debt instruments so we have no feedback to add in this regard.

Q2 What use are you currently making of information made available by competent authorities or the central website operated or supervised by the relevant competent authority on public disclosures of net short positions in shares?

[1] These ratios are based on estimates of the association and the understanding that each transaction has two sides.

Our members continuously monitor published short interest as this tends to have a negative price impact on the securities being reported, as stated above.

Q3 If you had taken short positions in shares and sovereign debt before the Regulation applied, what impact have the notification/disclosure requirements had on your trading behaviour since 1 November 2012?

The notification/disclosure requirements have had no material impact on our members' trading behaviour as our positions tend to be moderate in size. However, this low level of public disclosure potentially discouraging short selling by other participants in the market which, in our opinion, contradicts and run contrary to the aim of promoting deep and liquid markets. This is another reason why we believe the level should be set materially higher.

Q4 Do you have any comments on the method of calculating net short positions in shares and sovereign debt (e.g. the requirement to duration adjust cash positions in sovereign debt)?

No comment.

Q5 What is your view of the decision to adjust the monetary trigger thresholds for reportable short positions in sovereign debt every three months? Is there an alternative you would favour and if so please explain why?

No comment.

Q6 Do you consider that reporting mechanisms are operating efficiently? If not, explain why and how they could be improved.

Given the trading behaviour of our members' disclosures reporting mechanisms have not had a material impact on us, as stated above. Nevertheless, we do note that the lack of a single central website to report pan-European notifications to is causing considerable inefficiencies and operational difficulties for disclosing firms. We invite ESMA to fulfill its coordinating role so that all competent authorities agree on a single reporting platform to which disclosures of all net short positions can be made which can in turn redistribute to the relevant competent authorities.

Q7 Do you have any other comments on the reporting and transparency requirements or on their operation since 1 November 2012?

No comment.

Restrictions on short selling of shares and sovereign debt

Q8 Have you observed any improvements in settlement performance (either your own or that of counterparties) since the Regulation became applicable?

We have not observed any material change in settlement performance in the market. This has typically not been an issue for our members as most of the settlement failures arise out of client businesses, which very few of our members operate. However, we are aware that the few firms with client businesses have had to manage the increased buy-in risks.

We have observed that brokers are exposed to greater buy-in risk as a result of the Regulation. The Regulation covers 'on-exchange' settlement from a buy-in point of view. Prior to the Regulation coming into force, most market member firms had fails-coverage or other stock borrowing arrangements in place already. We believe the Regulation has resulted in increased risk for brokers who have a 'on-exchange' settlement obligation on one side (subject to mandatory buy-in under the regulation) and an OTC (client) settlement on the other (not subject to mandatory buy-in under regulation). We are focused on managing this risk but we are unable to see any tangible improvement in settlement performance.

Q9 Have you noticed any impact on the cost or availability of securities lending since the

Regulation has applied? Please specify any effect you have seen.

Some of our members have observed a material impact on the availability of stock given the higher level of certainty required for locate purposes and this availability is also dependent on the stock in question. Other members have not observed this material change in the availability of stock borrows or on the cost of borrowing.

Q10 Have you observed any improvements in reducing the risks of volatility, downward spirals or settlement problems (e.g. inflation of shares) since the Regulation became applicable?

No.

Q 11 Has the locate rule requirement affected the way you conduct short selling?

Most of our members have either enhanced their procedures in relation to arranging and agreeing stock borrows prior to short sales and/or have made use of the various services offered by their GCMs or Prime Brokers.

Q12 Has the definition of 'third party' in the implementing technical standards limited or constrained the operation of the locate confirmation or other arrangements? If so, please specify in what ways.

No.

Q13 Are there any changes which could be made to the conditions for entering into a short sale which would improve the efficiency of the arrangements without undermining the purpose of the measures? Please explain any changes you would propose.

We welcome further clarity concerning the definition of 'locate'. We especially welcome clarity in relation to instances which include 'rights issues' where there is uncertainty with regards to whether the allocation of stock meets the requirements set out under the agreement or arrangement definition.

Q14 Do you have any other comments on the existing restrictions or their operation since 1 November 2012?

No.

Restrictions on entering into uncovered sovereign credit default swap positions

Q15 Have you noticed any effect of the prohibition on entering into an uncovered sovereign CDS transaction on the price and on the volatility of the sovereign debt instruments?

No comment.

Q16 Have any elements of the prohibition on entering into an uncovered sovereign CDS transaction had a noticeable effect on your ability to hedge your exposures? If yes, please quantify the impact and explain where the issue arises.

No comment.

Q17 Have the restrictions on entering into an uncovered sovereign CDS led you to use any alternative methods for hedging your exposures? If so, please elaborate.

No comment.

Q18 Do you have any other comments on the requirements concerning uncovered sovereign CDS positions or on how they have operated since 1 November 2012?

No comment.

Settlement discipline including buy-in procedures

Q19 What is your assessment of the effect on settlement discipline in shares since the application of the Regulation?

FIA EPTA understands the Regulation has had some positive influence on settlement discipline and procedures coming out of this Regulation. However, as mentioned in Q8, we believe that 'on-exchange' settlement was already largely efficient. We are of the view that a greater problem exists for firms with client businesses.

Q20 What effect, if any, do you consider this provision of the Regulation has had on liquidity in shares since its application?

The Regulation has unfortunately had the unintended consequence of reducing liquidity for small cap stocks. Market participants, in particular market makers, are less able and less willing to provide liquidity to the market in light of the unavailability of stock borrows in less liquid names and/or the buy-in risk arising from the potential of 'recall' by the stock lender.

In addition, the onerous and 'per instrument' procedure in place to obtain a market making exemption has resulted in fewer market makers in these small cap stocks. The impact of the Regulation on providing liquidity is an important issue and requires significant attention. We recommend that this issue could be addressed through the relaxation of buy-in procedures for market makers and a change from the 'per instrument' to a 'per market' or 'per group of instruments' basis in relation to market making exemptions.

Q21 Do you have any other comments on the requirements of the Regulation concerning settlement discipline in shares or on how they have operated since 1 November 2012?

We have observed the sensible provisions and standards being set within the UK market for small cap shares which have been provided with extended 'buy-in' relief up to SD+10 through LCH. We would strongly recommend that such provisions should be applied consistently across *all* European markets.

Exemptions

Q22 Does the current definition and scope of the exemption for market making activities allow sufficiently for liquidity provision?

We believe that a market making exemption should be granted on a per market or per group of instruments basis. A broader, more flexible approach to market making exemptions would, in our view, increase liquidity especially in less liquid instruments.

The current quantifying criteria are too narrow in scope and overly prescriptive with the effect that strategies that are providing liquidity to the market do not meet the definition or are constrained in their ability to manage risk which in turn could destabilise such activity.

Q23 Is the process for obtaining the exemption for market making activities appropriate for timely provision of liquidity in all circumstances?

We note ESMA's final report and analysis of the 'per stock' exemption, however, we are of the opinion that the exemption should be applied more broadly and more appropriately defined by asset class or indeed a subset of an asset class. The exemption, as applied on an instrument basis is administratively burdensome for all parties involved and we believe this process is unlikely to pass any 'cost/benefit' analysis. Furthermore, it has resulted in fewer market makers for small caps and therefore less liquidity.

Q24 Is the current unavailability of the exemption for market making activities in third country markets having any impact?

No comment.

Q25 Do you have any other comments on the provisions of the Regulation concerning exemptions or on how they have operated since 1 November 2012?

We are concerned that the provisions established to process the exemption requirements have been evolving and this indicates to us that the implementation process itself has been somewhat hurried.

Intervention powers and emergency measures

Q26 What is your assessment of the effect of temporary restrictions imposed by competent authorities on short selling since the application of the Regulation? Please explain

In relation to the temporary restrictions announced we have observed inefficiencies and inconsistencies in the publication and communication of such restrictions. FIA EPTA believes that there is a strong need for consistency of instruction and dissemination of information to the market as well as between Competent Authorities and also from Regulated Markets to trading members. While Regulated Markets have mechanisms in place to enable them to communicate effectively with trading members as well as Competent Authorities, we fail to see such similar mechanisms in place with regards to Competent Authorities communicating efficiently to the market.

We recommend that a common set of standards be drawn up to aid efforts to have an efficient process in relation to dissemination. We believe that Competent Authorities should put mechanisms in place to communicate effectively and within a 'reasonable' time period between dissemination and effect. Furthermore, we believe that where such a security is also traded on alternative venues, these venues should also disseminate to their members.

Q27 In case of emergency bans,

a) Is the information to be published according to Art. 25 of the Regulation sufficient?

b) If no, please explain what other/additional information should be provided when introducing an emergency measure.

No comment.

Q28 Do you consider the current thresholds set to identify a significant intra-day fall in the price of financial instruments are appropriate for all instruments? If not, what different thresholds should be set and why?

No comment.

Q29 Do you consider thresholds should be set for significant price falls in UCITS and commodity derivatives? If so, how should they be set and at what levels?

No comment.

Q30 Do you have any other comments on the provisions of the Regulation concerning intervention powers and emergency measures or on how they have operated since 1 November 2012?

No comment.

Respectfully submitted,

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Chairman
FIA European Principal Traders Association