



CESR Proposals for a Pan-European Short Selling Regime

The Committee of European Securities Regulators (“CESR”) has published its proposed model for a pan-European short selling disclosure regime.¹ These proposals follow a public consultation commenced by CESR in July 2009.²

Background

The CESR proposals follow the period since the onset of the financial crisis, of national regulators and legislators imposing restrictions and disclosure requirements on short selling. In some cases there have been prohibitions on any short selling of shares or shares issued by companies in certain sectors (*e.g.*, the financial sector). Some restrictions have applied only to “naked” short selling (where the short seller has not covered his short position, *e.g.*, by borrowing the shares) whilst other restrictions have applied to any short selling activity. Other jurisdictions have focused on requiring public disclosure of short positions. For example, in the UK, the FSA’s Market Conduct rules currently provide for public disclosure of net short positions in financial sector companies (or other companies subject to rights issues) where the net short position in the company represents 0.25% of the issued share capital of such company. Disclosure is also required where the net short position subsequently exceeds or falls below each 0.1% threshold above such level.³

The FSA in the UK have also conducted a public consultation related to short selling. In their Feedback Statement 09/4,⁴ the FSA stated it did not intend to introduce a general ban on naked short selling (although it expressed concern about any naked short selling carried out with no intent or reasonable plan for delivery of the shares on the relevant settlement date) or the short selling of financial sector stocks, although it reserved the right to reintroduce such bans in emergency situations. The FSA concluded, however, that there should be enhanced transparency by a general public disclosure requirement in relation to all equities and related instruments. The FSA also stated that they supported the CESR proposal of a 0.5% disclosure level for companies generally (with further disclosures at 0.1% thresholds above such level) with a 0.25% minimum threshold for companies subject to rights issues.

¹ Committee of European Securities Regulators, “Model for a Pan-European Short Selling Disclosure Regime,” CESR/10-088, March 2010.

² Consultation Paper (CP), CESR Proposal for a Pan-European Short Selling Disclosure Regime, CESR/09-581.

³ Financial Services Authority Handbook, MAR 1.9.

⁴ FSA Feedback Statement FS 09/4 “Short Selling: Feedback on DP09/1,” October 2009. *See also*, FSA Consultation paper 09/1 “Temporary Short Selling Measures,” January 2009 and FSA Consultation Paper 09/15 “Extension of the Short Selling Disclosure Obligation,” June 2009.

CESR's Proposals

CESR's proposals remain similar to those proposed in their previous consultation paper. The following sets out the principal features of its proposals:

- The disclosure regime should apply to all equities and not be limited by sector or the nature of the security.
- The regime should only apply to short positions creating an economic exposure to shares admitted to trading on an EEA-regulated market and/or an EEA Multilateral Trading Facility ("MTF"). The regime should also only apply to EEA issuers and those issuers whose shares are admitted to trading on an EEA regulated market and/or MTF.
- CESR proposes a mixture of private disclosure to regulators and public disclosure (at a higher threshold level).
- The private disclosure regime would have an initial threshold of 0.2% of the issued share capital of the relevant entity.
- The public disclosure regime would have an initial threshold of 0.5% of the issued share capital of such entity.
- For both the private and public disclosure regimes, there would be a requirement for additional disclosure if the relevant net short position goes above or below each 0.1% threshold level above the initial threshold level.
- CESR proposes no separate regime for companies subject to a rights issue.
- The disclosure requirements apply to a party's net short position, enabling long positions to be offset against short positions.
- In calculating a net short position, a party should take into account its position in derivative contracts and exchange-traded funds.
- CESR will publish further requirements on the mechanics of the disclosure requirements but believes disclosures should be made at a specified time before the end of the trading day following the day on which the disclosure obligation is triggered.
- CESR proposes that there should be a market-maker exemption to these requirements and proposes to publish further proposals in this regard in due course. It makes clear that it believes such exemption should only apply to parties genuinely acting in the capacity as a market maker.

CESR proposes that the proposals be introduced either through a new directive or regulation or through an amendment to the Transparency Directive.⁵ In any event, it appears from the CESR paper that its proposals are likely to be minimum requirements for the relevant EEA member states. Individual member states would therefore be able to impose additional disclosure requirements or to impose prohibitions on short selling activities, such as restricting short selling in financial stocks or banning naked short selling.

Implications of the Proposals

As highlighted above, the CESR proposals are broadly consistent with its earlier Consultation Paper and also bear significant similarities with the FSA proposals in their October 2009 Feedback Statement. The FSA did not, however, propose a private disclosure regime and instead proposed a lower 0.25% threshold for companies

⁵ Directive 2004/109/EC of the European Parliament and of the Council of December 15, 2004, on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

subject to rights issues. It will be interesting to see whether the FSA continue with the separate threshold in relation to rights issues or consider that the private disclosure regime provides sufficient transparency in this regard.

The proposals are therefore unlikely to come as any great surprise to market participants in the EEA. Concerns have however been raised, including by the Managed Funds Association (“MFA”), that public disclosure of short positions has led to higher costs for investors, a decrease in liquidity and trading volumes, and an increase in bid-ask spreads. These findings are supported by an Oliver Wyman report commissioned by the MFA.

As we have highlighted in recent client alerts, short selling has also been subject to recent changes in the U.S. with the introduction of the “alternative uptick” rule in February 2010 and the SEC making permanent Interim Temporary Rule 204T of Regulation SH seeking to prohibit abusive naked short selling.⁶

For a detailed discussion of issues relating to short selling in the US and the EU, please consult our Client Alerts posted in the Short Selling Reform section of our Financial Crisis webpage located at <http://www.mofo.com/resources/financial-crisis/>.

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

⁶ “The Alternative Uptick Rule,” February 24, 2010, and “Interim Temporary Rule 204T is No Longer Temporary,” July 29, 2009.