



Press Statement on IOSCO Short Selling Report

Paris, 11 May 2009

The World Federation of Exchanges (WFE) submitted its response to a March 2009 Consultation Report on the regulation of short selling issued by a task force of the Technical Committee of the International Organization of Securities Commissions (IOSCO). The report, produced in response to emergency short selling bans implemented on many markets last September, is expected to be acted upon by IOSCO at its annual conference in June.

A full copy of the WFE's response letter is attached. William J. Brodsky, Chairman of the Board of Directors of the WFE and Chairman and CEO of the Chicago Board Options Exchange (CBOE), signed the comment letter on behalf of WFE.

In its response, the WFE concurs with IOSCO that prohibitions against abusive short selling should be rigorously enforced, but that legitimate short selling plays an important role in the market in terms of providing more efficient price discovery, mitigating market bubbles, increasing market liquidity, facilitating hedging and other risk management activities. Further, WFE believes that to restore investor confidence it is important that regulators and governments are involved in dispelling myths about short selling and re-affirming the importance of short selling to the efficient and effective operations of markets.

WFE believes that short selling should be subject to principles-based regulations in order to maintain the efficient and effective operation of markets. WFE finds the principles espoused by IOSCO to be sound, and generally supports their adoption. In the attached comment letter, WFE specifically responded to the following four principles as set forth by IOSCO:

IOSCO Principle 1 – Short selling should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets.

Principle 2 – Short selling should be subject to a reporting regime that provides timely information to the market or to market authorities.

Principle 3 – Short selling should be subject to an effective compliance and enforcement system.

Principle 4 – Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

The WFE response also includes a final comment regarding securities lending practices: WFE would suggest that IOSCO pay even closer attention to practices involved in securities lending, as short selling and securities lending cannot be disassociated. Over this decade, this has become a very large and beneficial financial service; according to a research report commissioned by WFE, revenues associated with it in 2007 were estimated at U.S. \$8 billion, which was very nearly equal to the trading revenues generated on WFE member exchanges.

WFE is the association of 51 regulated exchanges around the world. It develops and promotes standards in markets.

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07 May 2009

Mr. Greg Tanzer
Secretary General
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Public Comment on Regulation of Short Selling

Dear Mr. Tanzer,

On behalf of the World Federation of Exchanges Board of Directors, thank you for giving us the opportunity to comment on this important policy matter.

In its March 2009 *Consultation Report* the IOSCO Technical Committee stated the basic belief “that short selling plays an important role in the market for a variety of reasons, such as providing more efficient price discovery, mitigating market bubbles, increasing market liquidity, facilitating hedging and other risk management activities.”

The WFE concurs in this belief. We further believe that to restore investor confidence it is important that regulators and governments are involved in dispelling myths about short selling and re-affirming the importance of short selling to the efficient and effective operations of markets.

The IOSCO Technical Committee further expressed the concern “that especially in extreme market conditions, certain types of short selling, or the use of short selling in combination with certain abusive strategies, may contribute to disorderly markets.”

The WFE concurs in this concern. In order to maintain the efficient and effective operation of markets, short selling should be subject to principles-based regulations. The principles espoused in the *Consultation Paper* are sound, and WFE supports their adoption. Prohibitions against abusive short selling should be rigorously enforced.

The IOSCO Task Force has identified the potential risks associated with short selling, including the possible contribution short selling might make to disorderly markets. This provides a good starting point for a careful and deliberate evaluation of any new controls. These controls should be evaluated in the context of what investors can reasonably expect from the regulatory framework.

In our view, investors should be confident about the reliability of information reflected in the prices at which transactions occur. These information expectations are directly relevant to how short selling controls might be devised. They point to the importance of constructing any data

collection, aggregation and dissemination obligations in a way that enhances, rather than detracts from, market efficiency and investor protection.

Outlined below, are the WFE's further remarks in response to the specific principles the IOSCO Technical has proposed for the regulation of short selling.

Principle 1 - Short selling should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets.

From our perspective, IOSCO's priority of "orderly and efficient functioning and stability of financial markets" is critical. Regulation of short selling should have the objective of maintaining fair and orderly markets, not of preventing downward price adjustments. Regulations should not be expected to protect issuers and investors from price declines. Regulation is about fairness, not about market direction. Nor should it be expected to provide market users with information about the trading intentions of other market users unless this is necessary to assist in achieving a clearly identifiable objective.

Exchanges strongly support the priority given to imposing strict settlement rules as a requirement to achieve orderly and efficient functioning of the market processes versus other initiatives, such as price restriction rules. The regulatory framework for short selling should include anti-fraud/anti-manipulation provisions, delivery and closeout requirements. A robust settlement regime, including a short settlement cycle, will go a long way to eliminate short sales being effected without due regard to the need to be able to settle the transaction. A buying-in or close-out regime and/or a settlement penalty regime for failed deliveries on trades can provide useful additional safeguards. The potential for achieving a greater convergence in market practices should also be considered.

Principle 2 – Short selling should be subject to a reporting regime that provides timely information to the market or to market authorities.

Reporting regimes should be based on a material benefit to a fair and orderly markets with due consideration being given to the costs, complexity, enforceability and market impact of implementing a reporting regime. The primary objective of any short selling reporting regime should be to supplement efforts to deter market abuse. Therefore, we urge IOSCO to consider dropping the words "to the market or" from the proposed principle. We would envisage IOSCO still acknowledging that, in some circumstances, making information publicly available may help deter abusive activity. However, data on all, or a majority of short positions is not regarded as a prerequisite of a fair, efficient and orderly market. WFE would note that the primary objectives can be achieved via private disclosure to the regulator rather than public disclosure to the market.

We urge IOSCO to encourage national regulators to carefully consider and make clear the objectives of any reporting regime for short selling. If a reporting scheme is to be implemented, the required level and the characteristics of the reporting regime (e.g. thresholds for disclosure, public disclosure versus disclosure to the regulator only) will ultimately depend on the regulator's policy objectives.

IOSCO should make it clear that a regulatory commitment to “fairness” and “transparency” does not equate to giving any participants or investors a free ride on the proprietary information or investment strategies of others. A more realistic expectation of the regulatory framework’s contribution to “fairness” and “transparency” is that sufficient information will be available to enable all market users to be confident that prices obtained on the market are a reflection of genuine supply and demand.

IOSCO should emphasize that mandatory reporting is seen by the regulator as an adjunct to policies directed at surveilling for and penalizing abusive short selling and is not intended to provide information to assist other investors’ trading decisions.

Suggestions also have been made that reporting thresholds for short selling disclosures should be aligned with reporting thresholds for disclosure of long positions. There are different investment purposes and strategies at work behind investors going long or short. Those different purposes necessitate distinct regulatory responses.

Most of the objectives identified in the Task Force's commentary under principle 2 would be advanced by reporting to the market authorities or, to a lesser extent, by reporting to the market of aggregate anonymous short positions above a pre-determined threshold. It does not seem likely to WFE that this objective would be further advanced by more comprehensive reporting to the market involving reporting of all transactions without reference to a threshold. The establishment of any thresholds would most sensibly be left to each regulator and its corresponding market, as listing requirements and trading conditions vary greatly.

Principle 3 – Short selling should be subject to an effective compliance and enforcement system.

We agree with the principle and commentary put forward by IOSCO. Regulations put in place to deter abusive short selling must be supported by effective compliance and enforcement. To this end, there must be surveillance to detect unlawful trading practices – such as market manipulation and abusive short selling. Vigorous enforcement action must be taken against those who engage in such practices.

In addition, international coordination of the regulation of short selling is critical to the avoidance of regulatory arbitrage not only across jurisdictions but also across various types of trading venues. This is particularly true with respect to appropriate exemptions, settlement discipline and disclosure requirements.

WFE recognizes that reporting through an entity licensed in the jurisdiction of the market authority receiving the short selling data is likely to be a pre-requisite to effective enforcement of any reporting obligations.

Principle 4 - Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

WFE supports the Task Force’s recognition of the need of flexibility in the application of short selling regulation to market makers. If price restrictions are part of an overall regulatory scheme, they should be limited in scope and targeted to address abusive short selling. These

schemes should include appropriate exceptions that ensure the efficient and effective functioning of the market, and should include exceptions for market makers in both cash and derivative markets, particularly where there is a significant obligation to maintain continuous two-sided markets.

As a final comment, WFE would suggest that IOSCO pay even closer attention to practices involved in securities lending, as short selling and securities lending cannot be disassociated. Over this decade, this has become a very large and beneficial financial service; according to a research report commissioned by WFE, revenues associated with it in 2007 were estimated at US\$ 8 billion, which was very nearly equal to the trading revenues generated on WFE member exchanges.

Thank you for considering our comments. We would be pleased to discuss them with you if that would be helpful.

Sincerely yours,

William J. Brodsky
WFE Chairman
Chairman and Chief Executive Officer of the Chicago Board Options Exchange

Copies: WFE Board of Directors and Regulation Committee