



EUROPEAN COMMISSION
IMPACT ASSESSMENT BOARD

Brussels, 31 AOUT 2010
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Opinion

Title **DG MARKT - Impact Assessment on the: Proposal for a
Legislative Initiative on Short Selling and Credit Default
Swaps**

(draft version of 29 July 2010)

(A) Context

This impact assessment accompanies a proposal to introduce new legislation with respect to short selling and credit default swaps (CDS). For both activities, some Member States introduced restrictions in an uncoordinated manner during recent episodes of financial turmoil: in autumn 2008 due to the fear that short selling was contributing to undermine the financial stability of systemic banks and in March 2010 due to concerns about CDS role in the negative price developments on the Greek sovereign bond market.

For both types of activities, there is no specific EU legislative framework at present although a number of other proposals are relevant, for instance, the proposal for a Directive on Alternative Investment Fund Managers, the proposed Regulation establishing a European Securities and Markets Authority (ESMA), the proposed legislation to improve the functioning of derivatives markets, and the planned proposals for improving the Markets in Financial Instruments Directive and the Market Abuse Directive.

(B) Overall assessment

The report presents the available evidence base for action in this field but should be improved in the following areas. First, the report should bring to the fore the impact that diverse national responses to the risks of short-selling and CDS can have on the functioning of the single market and the resulting value-added from developing an EU framework. This should be given a more central role in the problem definition. Secondly, the report should specify more clearly when action with regard to short selling/short positions is justified on the basis of evidence of objective problems or rather on the basis of a precautionary approach. Thirdly, the report should better explain the nature of EU co-ordination and the role of ESMA in the different options. Fourthly, a more comprehensive analysis should be provided of the preferred options, in particular with respect to the proportionality of the measures on transparency and settlement. Finally, the analysis of compliance

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costs should be deepened by clarifying which costs have been included in the estimates and providing, where possible, a qualitative indication of the magnitude of other cost components.

(C) Main recommendations for improvements

(1) Highlight the value added of an EU solution in the face of diverging national approaches. The report should bring to the fore the impact that diverse national responses to the risks of short-selling can have on the smooth functioning of the single market and the resulting need to develop an EU framework.

(2) Clarify the reasons for action. The report should specify more clearly whether the problems arising from short-selling and CDS activities are identified on the basis of hard evidence (as in the case of lacking or asymmetric information) or on the basis of precautionary concerns (as in the case of negative price spirals for which little hard evidence exists). It should also strengthen the case for dealing with settlement issues in this initiative given the lack of agreement among stakeholders on the extent to which short selling creates problems in this area.

(3) Discuss more extensively the nature of EU co-ordination and the role of ESMA in the different options. The report should explain what the respective roles of national regulators and ESMA would be in implementing the preferred options, particularly in the case of the "circuit breaker" and "emergency restrictions". The analysis of the options should also clarify how the approach would allow ESMA to provide the necessary level of coordination while permitting national authorities to act quickly in situations that may be uncertain and fast-moving.

(4) Provide a more comprehensive analysis of the options. For each of the options, the report should explain which financial instruments would be covered and why. Also, given that "market makers" account for up to 25% of short sales, the report should explain more fully why exempting them from certain provisions is necessary. The report should also clarify how co-operation with non-EU authorities would ensure effective implementation and compliance. Finally, the need for further implementing measures (e.g. for the definition of emergency situations) should be explained along with the process for developing them.

(5) More clearly highlight the proportionality of the preferred options. The report should better highlight the proportionality of combining flagging of short sales with disclosure regimes given that the Committee of European Securities Regulators recommended only the latter. It should also explain the proportionality of the locate rule given the uncertainties about the magnitude of the settlement problem and about the cost of the proposed solution.

(6) Clarify and, to the extent possible, strengthen the analysis of compliance costs. While the report presents estimates of both one-off and ongoing compliance costs (roughly 137 and 16 million euro respectively), it should clearly indicate that these figures do not include three important components: the costs of flagging which are thought to be potentially significant, and those for locating assets for settlement and for disclosure on sovereign bonds on which there is little or no information. The report should give broad orders of magnitude for these costs or explain why this is not possible.

Some more technical comments have been transmitted directly to the author DG and are expected to be

incorporated in the final version of the impact assessment report.

(D) Procedure and presentation

The report respects the standards set out in the IA guidelines but its length could be reduced. To facilitate reading by non-experts the report would benefit from simplifying the presentation and analysis of some options (which appear to be partly overlapping in the case of bans - § 6.1.1.4 and 6.1.1.6 – and disclosure - § 6.1.2.4 to 6.1.2.6). The report should also correct the definition of 'naked short sales' provided in annex 1 and extend the glossary to include a short explanation of credit default swaps and an overview of technical acronyms. To avoid misunderstanding, the term 'administrative burdens' should be replaced by 'compliance costs' or 'administrative costs ' wherever appropriate in the text, headings and tables (see § 6.3). Finally, a table providing an overview of the scope of the various measures could be usefully annexed for transparency.

(E) IAB scrutiny process

Reference number	2010/MARKT/023
External expertise used	No
Date of Board Meeting	30 August 2010