



ASSOCIATION FOR  
INVESTMENT MANAGEMENT  
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5 February 2003

Ms. Margot Marshall  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS  
United Kingdom

*Re: Discussion Paper 17 – “Short Selling” (Ref. FSA DP17)*

Dear Ms. Marshall:

The European Advocacy Committee (“EAC” or the “Committee”) of the Association for Investment Management and Research (“AIMR”)<sup>1</sup> is pleased to comment on the Financial Services Authority’s (“FSA” or the “Authority”) discussion paper, *Short Selling* (“DP 17” or the “Paper”). The EAC is a standing committee of AIMR charged with reviewing and responding to major new regulatory, legislative, and other developments that may affect investors, the investment profession, and the efficiency and integrity of European financial markets.

### **General Comments**

The Committee strongly supports the FSA’s views that short selling is a “legitimate investment activity.” Likewise, the Committee agrees that through this investment strategy markets are able to quickly and accurately adjust securities prices to reflect investor opinions about valuation.

The Committee also agrees with the FSA’s goal of collecting better information about short selling activity and disseminating that information to the public. Increased transparency helps to promote efficient markets and the Authority’s efforts to publish short interest data should enhance investor understanding of the forces affecting securities prices and, ultimately, create a more level playing field for all types of investors.

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<sup>1</sup> The Association for Investment Management and Research is a global, non-profit organization of over 62,000 investment professionals from more than 113 countries. Through its headquarters in the U.S. and 125 Member Societies and Member Chapters worldwide, AIMR provides global leadership in investment education, professional standards, and advocacy programs.

## **Specific Comments**

### **Stock Lending Information is Preferred Proxy**

Of the options suggested by the FSA, the Committee strongly prefers the use of securities lending as a proxy for short interest data, and urges the Authority to adopt this alternative. The Committee believes this to be the best way to collect the desired information. Also, use of this method should enable the Authority to quickly launch its collection efforts.

Professional investors already use similar information from securities lenders to determine the level of short selling in a security. They can determine whether a large percentage of a company's shares are already sold short by checking on the borrowing costs for that stock. By charging more for stocks with significant short interest, lenders provide these investors with information that enables them to determine the risk of a market squeeze.

Nonetheless, the EAC does not believe it is feasible for the FSA to use borrowing costs as a proxy for short interest. First, the information is proprietary to the specific lenders and, in some cases, derives from the institution's access to securities in a client's portfolio. Second, borrowing costs are affected by numerous factors and cannot be regarded as a reasonable proxy for short interest alone. And third, the information is dynamic and can change quickly based on market events or on lenders' assessments of individual borrowers' creditworthiness.

Therefore, we believe the preferable proxy for short interest is information about stock lending, aggregated at the level of individual securities.

### **How to Collect the Information**

As stated in the Paper, CRESTCO – the primary securities settlement system in the U.K., including the London Stock Exchange – already collects much of this information. While the current system double counts many short sales, CRESTCO is working to improve the value of the data. Ultimately, this system will not only have the information that investors need, but in a format that is useful and in a time frame that is well ahead of other options.

### **Preferred Frequency of Publishing Short Interest Information**

The Committee believes the Authority's ultimate goal should be to make information about short interest available on a daily basis as soon as possible. However, we recognize that frequency of reporting must be weighed against the costs and availability of technology. Consequently, consistent with discussion provided by the Paper, it appears unlikely that daily reporting is feasible at this time.

This limitation aside, daily reporting would eliminate many informational advantages professional and institutional investors have over less well-connected retail investors. Therefore, the Committee urges the FSA to require reporting at the shortest time intervals currently possible

and to continually encourage information providers like CRESTCO to reduce those reporting intervals.

### **When Anonymity is Appropriate**

Notwithstanding its views on the need for increased transparency about short-selling activity, the Committee supports the Authority's views about the need to keep anonymous those short sellers not affiliated with the subject company. Such anonymity would keep short-interest rules consistent with rules for long investors, whereby buyers remain anonymous unless they acquire 3% or more of a company's voting interests.

At the same time, naming short sellers could expose the individuals or firms involved in shorting – including those lending the shares – to additional market risk. Such disclosures might make investors less willing to sell short, with negative repercussions for price-determination.

Some members also expressed concern that exposing the names of short sellers could mislead some retail investors about the pricing of specific securities. If, for example, a well-known fund shorts certain stocks to gain from relative price differences, naming that investor may lead less-sophisticated individuals to see the short position not as part of a larger strategy, but as an indication of an expected price decline.

### **Short Selling by Insiders**

Despite its views on the need for anonymity for most short sellers, the Committee believes it is imperative to publicly disclose the names of directors or company executives who short their companies' shares. These disclosures also should indicate the dates and amounts of such trades and do so by the close of business on the day of the trades.

However, the Committee believes such activities are more appropriately regulated through conduct of business rules than by short selling regulations.

### **Aggregation of Short Selling Information**

Based on the foregoing arguments about anonymity, the Committee supports the Authority's proposal to collect short-interest information on the basis of the subject stock rather than by the prime broker, the depository or the custodian effecting the transactions. Reporting in this way achieves transparency without putting institutions that enable or engage in short selling at risk of market squeezes.

### **Short Volume**

Increases in short volume, together with declines in certain share values, are often attributed to the actions of hedge funds. It is no secret that these institutions use short selling more frequently

than managers of traditional long-only funds. But the question is whether the hedge-fund industry has taken advantage of this flexibility in recent years to increase their short selling and, in turn, make markets more volatile.

### **Tick Rules**

The Committee believes up-tick rules are a useful tool in preventing market abuse. By hindering the ability of naked short sellers to act, they may serve to reduce the manipulation of share prices.

While this view contradicts the FSA's view about tick rules – namely that such rules did not limit price declines in markets where they are used – the Committee believes evidence in other global markets suggests up-tick rules may be useful in preventing abusive market behavior without disrupting the legitimate short-selling activities of the majority of investors.

### **No Need for Guaranteed Delivery**

The Committee does not believe requiring short sellers to guarantee delivery of securities at settlement is necessary. We observe that investors engaged in this activity already are required to pledge delivery in their agreements with securities lenders. Such a rule, therefore, would replicate an existing market practice that works to the same effect and it, therefore, is unlikely to do anything more than add to the regulatory burden of market participants.

### **Shortened Settlement Timeframe is Better**

The Committee believes that regardless of the activity, reducing the settlement period for securities transactions would help U.K. markets to reduce disruption in the settlement of less-liquid securities. Nonetheless, the Committee believes that it is up to the counterparties to make such decisions because they are the entities directly at risk. The Committee believes this solution will achieve the goal of quick settlement more efficiently than if the FSA were to create new regulations dealing with these issues.

### **Marking and Reporting Short Sales**

The Committee urges the FSA to adopt that portion of Option 1 – "Marking and Reporting Short Sales for Cash Equities" – that would require firms to note on trading tickets transactions that involve short selling. Such information would provide important information not only to the institution lending the stock – if they are not already doing so – but to the FSA in its regulatory efforts, as well.

### **Closing Remarks**

The EAC appreciates the opportunity to comment on the FSA discussion paper 17 on *Short Selling*. If you or your staff have questions or seek amplification of our views, please feel free to contact James C. Allen, CFA, by phone at +1.434.951.5558 or by e-mail at [james.allen@aimr.org](mailto:james.allen@aimr.org).

Sincerely,

*/s/ Frederic Lebel*

Frederic Lebel, CFA  
Co-Chair  
European Advocacy Committee

*/s/ James C. Allen*

James C. Allen, CFA  
Associate, AIMR Professional Standards &  
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