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AMF

Working group on short-selling: Report

Working group led by
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CONTENTS

INTRODUCTION

The AMF Board announced on 6 November 2008 that it was forming a working group to revisit the regulation of short-selling in France. The Board's decision followed on from the exceptional measures it introduced on 19 September 2008. In the wake of similar provisions adopted the day before by the Securities and Exchange Commission and the Financial Services Authority, the Board at that time decided to prohibit the "unsecured" (uncovered) sale of equity securities of credit institutions and insurance companies traded on French regulated markets and to require disclosure of short positions in such securities[1]. The Board did not decide to prohibit short selling *per se*: short sales were permitted where the seller ensures timely delivery at T+3 under a securities lending agreement[2]. The Board also decided to forbid establishing a net short position using derivatives. This measure appeared in the document of 23 September 2008 titled "Frequently asked questions about the AMF News Release: *Short-selling: Ban on unsecured transactions and transparency of short positions in financial sector securities"*[3].

In forming the working group, led by two of its members, Marie-Ange Debon and Jean-Pierre Hellebuyck, the Board's intent was to obtain as thoroughgoing an analysis as possible of adjustments that could appropriately be made to the permanent regime for normal times, once the exceptional measures adopted in September 2008 for a period of at least three months have been lifted. The mission statement to the group's two leaders asked for answers to the following questions:

- What transactions would be covered by the new regulatory framework?
- What requirements would apply respectively to the investor, the financial intermediary responsible for transmitting or executing the order, and the financial intermediary acting as custodian?
- What requirements would there be in terms of transparency on net short positions?
- What requirements would there be for disclosure of securities lending transactions to the regulator and the market?

The charge to the working group also specified that their work should be able to serve as the basis for an approach that could provide as much consistency as possible between the Paris marketplace and major foreign financial centres, in particular those that are home to markets operated by Euronext.

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[1] Point 3 of the AMF's news release on these measures reads as follows: *In reference to Article 570-1 of the General Regulation, any investment service provider receiving a sell order for one of the securities concerned must require its client to deposit the securities to be sold on its account with the investment service provider before the order is executed. If the investment service provider is not the custodian of its client's assets, it must obtain assurance from its client that the client holds the relevant securities.*
Point 4 of the news release reads as follows: *Any person holding a net short position that represents an economic interest of one quarter of one percent or more of the capital of one of the companies concerned must disclose it to the AMF (Market Surveillance Unit) and the market by any appropriate means on the following day, at the latest.*

[2] However, point 6 of the news release goes on to say: *Financial institutions are requested to refrain from lending any of the securities concerned in order to reduce the causes of market disruption. This does not apply to securities lending to cover existing positions, to meet commitments made before these measures were implemented or, more generally, to transactions that are not related to creating short positions.*

[3] To question 8 of this document, *Is an investor allowed to create a short position in one of the securities concerned by using derivatives? Can the financial intermediary acting as the investor's counterparty hedge its position on the market?* the answer was, *No, investors are not allowed to use derivatives to create a short position; they may only use derivatives to hedge long positions. In this case, the financial intermediary acting as the investor's counterparty must ensure that the investor does not create a net short position.*
When carrying out its own trades to hedge such transactions, a financial intermediary acting as a liquidity provider, in accordance with a/ of Point 7, is not required to own the securities at the time they are sold. Once again, however, in accordance with the provisions of Point 6 of the News Release, the AMF requests that financial institutions abstain from lending the securities concerned.

At its meeting on 18 December 2008, the Board decided to keep in place the exceptional measures ordered on 19 September 2008. It said it would re-examine the issue during February 2009 on the basis of the recommendations of the working group and other work on the same subject within CESR and IOSCO.

This report will begin by summarising the applicable regime in France, both during normal times and under the rules on short-selling of financial sector securities adopted last September. This first part will highlight the qualities as well as the limitations of the regime as revealed by recent events. The second part will analyse the kinds of adjustments that could be made, making a distinction between permanent measures and measures that it could be desirable to be able to put in place in times of market crisis. The proposals advanced will naturally be chosen with a view to securing the support of the main foreign regulators, since any hope of effective regulation at a purely domestic level would be frustrated by the globalisation of financial markets.

PART ONE: CURRENT REGULATORY PROVISIONS IN FRANCE

I.- REGIME APPLICABLE IN "NORMAL TIMES"

A) It is important to clearly define the term "short-selling"

a) General definition

It should be noted that notion of selling short has different meanings in different situations. One approach is to define a short sale as a sale of securities that exposes the seller to a risk of gain or loss depending on whether the price of those securities falls or rises after the sale. In this sense, a short sale is the opposite of a covered sale, where there is no gain or loss for the seller after the sale.

Note also that in the great majority of situations, the short seller simultaneously enters into an agreement to borrow the securities to be sold, so that the seller is actually the owner of them. Under French law, lending of securities entails a transfer of ownership to the borrower. A short sale can also be effected by means of an option position, as indicated in point c) below.

b) Special case: seller does not have the securities to be delivered on T+3

In this situation, one special case of short-selling as described above should be pointed out. This is where an investor sells securities, speculating that they will fall in price, and then fails to deliver them on the normal settlement date, generally T+3 where T is the trade date. The seller, deliberately or accidentally, does not borrow the securities, either because he wants to avoid the cost of borrowing them or because he is unable to borrow them. This case can be illustrated in the following simple, not to say simplistic, fashion: On day T, an investor gives an order to a broker to sell a certain quantity of securities. On T+3, the seller, or more precisely, the custodian of the seller's account, does not deliver the securities because they are not in the seller's account. This can happen for technical reasons or because the seller has deliberately failed to provide them. In the latter situation, the seller is hoping that the securities will decline in price and that he will be able to buy them later for much less than the price at which he sold them. The moment he can make this purchase, he will (at last) be able to provide the securities and honour his commitment to deliver after the sale – and he will have incurred no cost to borrow them. Some regulatory regimes tolerate situations of this kind to a greater or lesser degree. As will be seen, this is not the case under French regulation.

Short-selling of this kind is called "naked shorting". At the moment of the sale, the seller is naked in that he does not have the securities to deliver for settlement. There are, however, a number of variants of naked shorting. To illustrate, one can imagine the following cases:

- The seller does not have the securities in hand on day T, and he does not have them to deliver on T+3 either. This is indeed naked shorting.
- The seller does not have the securities in hand on day T, but he gets them on T+3 and is thus able to deliver. This is naked shorting from T up to but not including T+3, but in the end, the securities are delivered on the settlement date. This is only partially naked shorting, or, strictly speaking, not naked shorting at all.
- The seller does not have the securities in hand on day T, but he has reasonable certainty of being able to get them in time for delivery on T+3, for instance because he has an agreement with a counterparty that is structurally a lender of securities. Here, one can argue that the short-selling does not warrant the qualifier "naked".

c) From the concept of a short sale to the broader concept of a short position

In the real world, the meaning that is currently closest to regulators' concerns about short-selling goes beyond sales of borrowed securities and applies to any way of taking a position in order to make an economic gain on the fall in price of a given security. Such a position is called a short position. By definition, a short position is one that generates a gain if the security falls

and a loss if it rises. A short position can be held directly (conventional short sale) or created by using a derivative, for example, by acquiring a put option. It is the taking of short positions – betting that securities prices will fall – that is drawing scrutiny from concerned regulators, who must determine whether behaviour of this kind is harmful to orderly markets. Taking a short position can generate of stream of sale transactions that one could reasonably suppose would not have occurred if that short position had not been taken. This stream of securities sales happens regardless of whether the short position is taken directly (via securities lending) or through derivatives. The buyer of a put option[4] is buying from a seller on the other side of the transaction. That seller, one can reasonably suppose, will hedge his downside risk in the event the buyer exercises the option. Depending on the circumstances, he will do so by selling some or all of the underlying securities, which he too will have to borrow for this purpose. This is not invariably what happens, however. The seller of the put option may deliberately take a long position, in which case he will not hedge the option by borrowing securities in order to sell them.

B) Outline of French regulations applicable in "normal times"

In normal times, French regulations do not prohibit taking a short position on a security. They do not as a matter of course forbid using derivatives to take a net position that stands to gain from a fall in price of a given security. They do not require that the seller have in hand, at the moment of the transaction, the securities he is selling This is obviously the case for over-the-counter transactions, which take place under an freely entered agreement between the parties. It is also the case for transactions on a regulated market or multilateral trading facility (MTF)[5].

French regulations (Article 521-1 of the AMF General Regulation) do, however, require the seller to have the securities in his account for delivery on the normal settlement date, in principle T+3[6]. There is no question of permitting an investor who wants take a short position selling securities and waiting for their price to fall without delivering the securities on T+3. Nor is there any question of a custodian drawing on the pool of securities deposited with it by other investors in order to deliver securities on behalf of a client who has made an uncovered short sale. French regulations ban delivery "fails", although admittedly fails do occur regularly for technical reasons and for a very limited number of securities. The same regulations place an absolute ban on diverting securities held in custody for settlement purposes[7].

C) Necessity of T+3 delivery of securities sold on day T affirmed as a principle

When an order has been executed on a regulated market or multilateral trading facility, the buyer is definitively bound to pay, and the seller is definitively bound to deliver financial instruments at the normal settlement date, T+3.

Under Article 570-1 of the General Regulation of the AMF, mentioned above and reproduced in the footnote, the investment services provider (ISP)[8] to which the order is transmitted may, upon receipt of the order or as soon as it is executed, require that a guarantee provision be

[4] The buyer of a put option buys the right to sell a given number of securities at a given price, either on a given expiry date or during a given period. In return, the buyer pays a premium to the seller (writer) of the option. The buyer hopes to be able to buy the securities in question at a price lower than the exercise price of the option, thereby realising a net gain in excess of the premium paid for the option.

[5] In this regard, it can be observed that any restrictions that might be imposed or contemplated on transactions in a market, relating to the taking of a short position and requiring reporting of that position to the regulator or public disclosure thereof, ought to take over-the-counter transactions into account as well.

[6] Article 570-1 of the AMF General Regulation states: "As soon as an order is executed, the buyer is definitively bound to pay for, and the seller is definitively bound to deliver, the financial instruments at the date mentioned in Article 570-2." [Article 570-2 specifies that, barring exceptions, that date is three trading days after the execution date.]
"The service provider to which the order is transmitted may, upon receipt of the order or as soon as it is executed, require that a guarantee provision be made in its books, in cash in the case of a purchase and in financial instruments in the case of a sale."

[7] This practice is known as *tirage sur la masse.* A custody account-keeper engages in *tirage sur la masse* when it uses securities held in custody for other clients to settle trades of a defaulting seller.

[8] Orders from retail clients are generally transmitted to the clearing broker by the investor's custodian. In contrast, orders from institutional clients are generally transmitted directly to the clearing broker by the investor. These are called direct orders.

made in its books, in cash in the case of a purchase and in financial instruments in the case of a sale[9]. It should be observed that in practice, if the financial intermediary to which the order is sent is also a custodian of the client's assets, the intermediary will normally debit the client's cash account (for a purchase) or securities account (for a sale) at the time the trade is executed.

Where the financial intermediary in charge of executing a sale order is not a custodian of the client's assets – which is usually the case for orders from institutional investors[10] – the transfer of securities from the seller's account with his custodian to the intermediary responsible for delivery will generally take place after execution, that is, between the trade date and the settlement date. As will be seen later, if the seller does not have the securities to be delivered in his account on the settlement date, the regulations do not deal clearly with a situation of this kind.

Regardless of whether the intermediary receiving the order is a custodian of the client's assets, nothing prevents the client borrowing the quantity of securities he intends to sell. What matters is that he has the securities on T+3 for timely delivery.

D) Consequences of the T+3 delivery obligation for intermediaries

Although short-selling is thus not banned under French regulation, the rules do confine its scope quite strictly, notably by requiring financial intermediaries to meet settlement obligations.

a) Intermediary trading for its own account

Any failure to deliver is in principle illegitimate, since the intermediary may not be ignorant of its own inability to honour its obligation to make delivery on a timely basis. The AMF General Regulation requires the custodial administration of an investment service provider's own account to be supervised systematically so as to ensure that following any proprietary trade, the ISP is not at risk of defaulting on that trade on T+3. The relevant provision reads: "If sufficient financial instruments are not available in that account, the custody account-keeper must resort to borrowing the instruments in question". Resort to borrowing is not merely an option; it is an obligation. The Regulation goes on to state that the delivery resulting from the borrowing must coincide with the date on which the ISP is committed to deliver. The Enforcement Committee has already sanctioned an ISP trading for its own account for failure to deliver on time (see Enforcement Committee decision regarding Banque d'Orsay, 4 September 2008).

b) Intermediary trading for the account of a client

If the client has not delivered the securities by the scheduled date, the regulations require the intermediary to call for the client to provide them as soon as possible, whether or not the intermediary is a custodian of the client's assets. At the same time, the intermediary must provide for the missing securities, by either borrowing or purchasing them. The fact of "undergoing" a delivery fail does not relieve the intermediary of the responsibility to remedy it as quickly as possible. It is obviously easier to take steps to this end in the case of a retail client order where the order transits through the intermediary that has custody of the client's account. In the case of a direct order, though, what happens in practice is that intermediaries do not consider it to be their job to keep track of the state of the investor's account at its custodian.

[9] When it comes to the relation between the principal originating an order and the financial intermediary to which the order is sent, a special regime applies to *"deferred settlement orders"* on the most active stocks traded on Euronext Paris. If the intermediary agrees to offer such a service to a client, the intermediary will buy or sell on the market and settle the trade on T+3 itself, taking the client's place. At the end of the calendar month, the client will then settle the net balance on his trades with his intermediary. Under French regulations, intermediaries offering this service must require the client to post collateral before the order is executed. The AMF sets rules for the composition and minimum margin ratio of this collateral, and in exceptional circumstances it can raise the margin ratio to 100%.

[10] In this case and in practice, the intermediary responsible for order execution does not require a book-entry deposit of collateral to cover the securities sold.

The purpose of the current regulatory provisions on internal controls of custody account-keeper ISPs is to proscribe any laxness in the matter – in particular, as already indicated, any *tirage sur la masse*, which implies a ban on debit balances in any custody account.

c) Special action by the clearing house

Trades on an organised market that are handled by the clearing house (LCH.Clearnet SA) are settled by the operator of the securities settlement system (Euroclear France). The operating rules of these two institutions – approved by the AMF – set forth measures that apply to financial intermediaries which have not remedied delivery fails within the prescribed time limits[11]. Under these rules, the clearing house initiates a procedure to buy in securities when a clearing member has been unable to remedy a settlement fail within seven days after the normal settlement date. The buy-in is made at the risk and expense of the defaulting clearing member, which can pass the impact back to the originator of the order that led to the default. Note that the time period allowed under the clearing house's rules is appreciably longer than the T+3 period specified in the AMF General Regulation. In principle, the clearing house buy-in procedure is used only where the market for the securities in question is too illiquid to permit the usual procedure of borrowing the securities needed to remedy the fail. For this particular situation, the additional time allowed by the clearing house is reasonable. The cost of default borne by the seller responsible for it is likely to be very high.

E) Unanswered questions raised by the regime for "normal times"

Even though the current regulatory regime in France has doubtless proved to be one of the more suitable ones in Europe, it still leaves unanswered a number of questions surrounding the general issue the working group was asked to examine – assuming the end result of the analysis developed below in this report is a determination that there is no cause to proscribe or restrict all forms of short-selling in normal times. These questions are the following.

a) Necessity of having securities on T+3 after a short sale on day T – Scope of the regulatory requirements: applicability to direct orders and orders executed outside France

When a financial intermediary receives a sell order from a client for which it is not a custodian, it cannot know whether or not the client has the securities it is selling. It is only between T and T+3 that the intermediary will learn, through the securities settlement system, that the securities it must deliver on the client's behalf have or have not been transmitted for delivery and, if not, that it will have to take the necessary steps to mitigate the situation. One must also ask whether it is appropriate here to require the originator of the order to warrant to the intermediary, at the time it transmits a direct order, that it has the securities it intends to sell, either because it has previously acquired them or because it is certain of being able to acquire or borrow them by T+3 so that timely delivery can take place.

An approach of this kind poses the more general question of cross-border enforceability of the regulations. In other words, what means does the regulator have to ensure compliance with a set of requirements meant to apply to a client outside France sending an order to an intermediary that is likewise outside France?

If the trade is executed in France, it will pass through the clearing house. The non-resident intermediary will have a clearer that is a member of the clearing house, and it will therefore be "caught" by the clearing rules mentioned previously.

But if the intermediary is trading on a market or MTF other than the regulated French market or a French MTF cleared by the French clearing house, regulatory provisions will not be effective unless there is international harmonisation of the rules. The increasing fragmentation of

[11] In some countries, the rules on how fails are handled by the clearing house are not made by the market authority. In the UK for one, these rules are made by the market operators.

markets and clearing houses would then be likely to prompt a shift in trading in favour of the loosest regulatory regime.

b) Necessity of having securities on T+3 after a short sale on day T: sanctions on sellers

As explained previously, the current regime relies mainly on compliance with the normal settlement deadline, so that short-sellers who do not have the securities to deliver on T+3 are compelled to bear the cost of the borrowing made necessary by their default.

In reality, the situation is more complicated. To be sure, the cost of borrowing securities can be significant or even prohibitive. In the end, though, it is primarily the financial intermediaries that are accountable to the regulator for the obligation to honour settlement dates and subject to sanctions for failing to meet their obligations. Assuming the intermediary buys back the position of a client who defaults on delivery, or borrows securities in order to be able to make delivery, and provided the costs incurred by the intermediary are actually passed back to the client, the client will be subjected to an "economic" sanction. But today there is no true sanction imposed by the AMF on the defaulting seller. The only sanction borne is the economic one, and it is hard to tell how effective it is as a deterrent. Thus, one might ask whether there are other ways and means of making the client bear the consequences of his default.[12].

c) Regulator's ability to adopt exceptional measures in times of crisis

The current regulations give the regulator only limited legal means of adopting a stricter regime for exceptional circumstances, excepting the highly specific case of deferred settlement orders and except when the breach of obligations has elements of market abuse. Clearly, market circumstances have shown the necessity of having a weapon in the regulatory arsenal more specific than simply invoking market abuse, if the ability to adopt an exceptional regime when needed is deemed to be necessary.

[12] In this regard, it can be observed that any restrictions that might be imposed or contemplated on transactions on a regulated market or MTF, relating to the taking of a short position and requiring reporting of that position to the regulator or public disclosure thereof, ought to take over-the-counter transactions into account.

II.- EXCEPTIONAL REGIME ADOPTED IN SEPTEMBER 2008 FOR FINANCIAL SECTOR SECURITIES

The measures making up this regime were mentioned at the beginning of this report. An assessment of the reach of this set of measures is offered in this section.

A) Difficulty of the impact study

The objective of the impact study is to assess how effective the exceptional regime was. This entails determining whether the stocks "protected" by the provisions of the regime would or would not have fallen significantly more than they did, had those provisions not been in effect. Ideally, one would want to measure how much the stocks in question would have fallen in the absence of the exceptional regime.

The difficulty is considerable, since how can one realistically imagine the course that the stock prices would have taken in the absence of those measures? One solution would be to look at stocks that could be considered comparable to the stocks in question, but were not also protected. In the case at hand, it seems practically impossible to assemble a sample of French stocks suitable for such a comparison. The set of financial sector stocks is a highly specific one; no other sector can easily be considered comparable to it by assumption.

The work done on this subject by the AMF's Surveillance Department has shown a rather small impact for the exceptional measures that were taken. A comparison of key variables over five days preceding the announcement of the measures by the AMF on 19 September and five days after it shows only a few significant differences. (A comparison over a longer period gives even less in the way of results, no doubt because exogenous factors were also dragging down prices.)

In these studies, the statistically observable but hardly pronounced effects were on:

- the variation in prices, which shows a slightly weaker decline after the measures than before;
- the volume and value of trading, which fall after the measures are imposed;
- the volatility of financial sector stocks, which is unchanged, whereas volatility on other CAC 40 stocks increases over the period.

There is no observable effect on bid-ask spreads.

Lastly, it should be noted that if one attempts to include the day of September 19 itself in either of the two sub-periods – with the five days before, or with the five days after – the results change dramatically. This confirms the analytical finding that the market made most of its adjustment on the day of the announcement.

Another method is to gather the testimony of market professionals who were directly impacted. The working group did this, not only by having its members relate what they saw but also by hearing first-person reports from outside parties.

B) Greater difficulty in borrowing the stocks in question: the exceptional regime may have been effective in curtailing short sales of the stocks in question, but it brought with it negative consequences. General impression: scepticism.

That the measures made potential lenders of securities less inclined to lend them out does not appear open to dispute. According to the feedback received by the working group, some potential lenders among institutional investors even decided to stop lending, because they believed they could not know with certainty how borrowers would use the securities if they were made available. Having no certainty, these institutions refused to run the legal and reputational risk of incurring criticism from the AMF. They did not want to be reproached for failing to heed its request not to help others take short positions. Because taking short positions, whether by selling short or using derivatives to the same effect, depends on borrowed securities being made available, one can reasonably conclude that the exceptional regime was in large measure effective in deterring downside speculation.

That the exceptional regime did not prevent a decline in prices of the stocks in question is not a relevant observation, nor is the oft-heard claim that a very sharp decline proves the regime to be ineffective. The exceptional regime was not intended to prevent a decline in general. That is obviously beyond its reach. Rather, it was aimed more narrowly, at limiting only the downward pressure from short-selling. A general fall in stock prices during the period covered by the exceptional regime is, unfortunately, entirely compatible with a regime that is effective in limiting the development of speculative short positions.

It could be argued that the exceptional regime actually did hold back the development of speculative downward pressure on the stocks in question, because the securities lending that fuels such pressure was probably curtailed considerably. However, one should not overlook the likely fact that securities lending conducted outside of France was less constrained than it was within our borders. At this stage, though, it appears impossible to provide further details in this regard. Furthermore, as has often been emphasised, although the tensions that affected securities lending activity probably slowed the development of downward pressure, they are also likely to have had undesirable collateral consequences. By way of illustration, two examples of negative effects are described below.

Securities lending has an important role to play in the general mechanisms of securities settlement. It frequently happens that expected flows of securities do not materialise because of various technical malfunctions. If settlement fails ensue, there is a risk of generating cumulative processes that spiral out of control, impairing the orderly functioning of markets. In this sense, settlement fail phenomena are considered dangerous. Securities lending is one of the key means of avoiding settlement fails and preventing cumulative processes from developing.

Similarly, short-selling does not necessarily fuel speculative movements. Securities lending and short-selling are important elements of smooth market operation for most transactions by issuers in their own securities, including capital increases, convertible bond issues, and leveraged offers to their employees. Thus, when a company issues shares and turns to an intermediary to underwrite the placing, that intermediary cannot guarantee the placing if short-selling is prohibited. To offer the guarantee, the intermediary must be able to hedge its position, and the hedge it must put on uses short-selling.

Incorporating the effects of all these mechanisms in a “scientific” way in an evaluation of the impact of the exceptional regime is at this stage impossible. Although all these elements must indeed be taken into account, the overall sentiment that emerges from examining the exceptional regime is one that tends towards scepticism. This is so particularly because the positive aspects seem to be more than counterbalanced by the inadequacies and hindrances that have been mentioned.

C) Reporting of positions

The number of short positions declared to the AMF (7) was quite low. Even so, drawing any precise conclusion from this fact is not straightforward. Is it because short-sellers were deterred by having to report both to the AMF and to the market, over and above the difficulty of borrowing the securities in question? Is it because some short-sellers outside France did not declare positions they had taken, in violation of the regulatory requirements? Can intermediaries clearly and uniformly determine what the aggregate net short position is? Is it because the exceptional regime was effective and therefore very few short positions above the reporting threshold were actually taken? All in all, from the opinions gathered from market professionals, it would seem that the number of short positions above the reporting threshold was indeed small.

D) Limited harmonisation with other regulatory authorities

The exceptional regime was adopted on an emergency basis, in response to exceptional circumstances and in the absence of any pre-established framework for acting in concert with other regulatory authorities on measures of this kind. For this reason, there could be only limited harmonisation with other regulators in Europe.

This low degree of harmonisation undeniably has negative consequences. For one thing, it introduces a risk of inconsistency between different regimes; for another, it creates lack of understanding and implementation difficulties on the part of market participants.

This said, there are two sets of questions to be asked:

- Is there good reason to make the “normal” regime more strict?
- What regime should be adopted for exceptional circumstances?

PART TWO: ADJUSTMENTS THAT COULD BE CONSIDERED

I.- REGULATION OF SHORT-SELLING OUTSIDE PERIODS OF EXCEPTIONAL MARKET TURMOIL

A) Should all forms of short-selling be prohibited at all times?

Under the most radical approach, the only investors who would be allowed to sell financial instruments on the market would be those who had previously acquired them, and borrowing would be excluded as a mode of acquisition.

a) Main arguments in favour

- Short-selling necessarily puts downward pressure on asset prices.
- The seller who sells short can cause the price to move down and then profit from that move by buying at a lower price. This technique is especially pernicious when it gives rise to collusion between sellers with the aim of provoking such a move, possibly amid a context of rumours.
- The cost of borrowing securities to meet the delivery obligation is often too low to discourage or limit this kind of downside speculation.
- Some consequently believe that the practice of short-selling is not compatible with business ethics.
- The securities lending market is an informal market with little transparency, where prices are set without a full matching of supply and demand.

b) Main arguments against

- Prohibiting short-selling would be detrimental both to market liquidity and to the efficiency of the price discovery process[13].
- Prohibiting short-selling would prevent – or significantly raise the cost of – a whole series of transactions by financial intermediaries for the benefit of issuers (convertible bond issues, tender offers, capital increases reserved for employees, etc.).
- If short-selling were forbidden, several market techniques, notably those using derivatives, would still enable investors anticipating a decline in a given stock to achieve the same objective without directly selling that stock short. To take a very simple illustration, buying a put option enables the buyer to speculate on a decline in the underlying security in the same way as selling that security short. It is true that on the other side, the seller (writer) of the put may have difficulty hedging his position if he cannot sell the underlying short. Writing put options could thus be made significantly more difficult and costly than it is when the writer can freely cover himself.
- Selling borrowed securities would not seem to be fundamentally different from buying securities with borrowed cash[14]. No one has ever asked to outlaw the borrowing of cash to buy securities, although buying on margin tends to drive prices up and can thus help to feed a speculative bubble. The regulator has no business favouring those investors who anticipate a rise in prices over those who anticipate a fall.
- No regulator of any major financial centre is today intending to recommend such an approach.
- Short-sellers are perhaps the only market participants who can detect overvaluation of a stock, given that sell-side analysts, for one reason or another, have not often been in a position to make a Sell recommendation even when one is justified.
- Prohibition of short-selling in France would have the consequence of driving offshore not only those trades that would become illicit but also other indisputably legitimate transactions.

[13] It should be borne in mind that a short sale necessarily obliges the seller to make a repurchase, at one point or another. There is thus a rebound effect that can be very costly if the seller is wrong about the stock and the price trend.
[14] From a technical standpoint, on the other hand, the procedures involved in borrowing securities are quite different from the procedures involved in borrowing cash.

c) Summary

- On balance, it appears neither justified nor appropriate to propose prohibition of all forms of short-selling.
- It is quite true, however, that short-selling requires a minimum of regulatory constraint to deter behaviours that hinder orderly functioning of the market. Indeed, it is evident that short-selling without minimal rules can generate an artificial imbalance in the market that hinders normal price discovery. When combined with rumours, short-selling can also foster market abuse. The need, then, is to define the harmful behaviours at issue and identify how to avoid them.

B) Should all financial intermediaries receiving a sell order be required to obtain assurance from the client, on the day of the trade (T), that the client will indeed be able to deliver the securities on T+3?

The measures that might be contemplated in this area must be looked at from various angles. The first concerns the goal of minimising the risk that sellers of securities will be unable to honour their delivery obligations on T+3.

The second angle to consider is the collateral effects of the contemplated measures. Measures of this kind would have to apply to all orders to be executed on a French regulated market or MTF, regardless of the nationalities of the client originating the order and the intermediary to which it is sent. It would probably be possible to make the measures applicable to any order transmitted to a French ISP, regardless of the execution venue (a foreign MTF, for example). The measures could not be applied, however, to orders transmitted to a non-French intermediary for execution on a foreign market – even orders to trade in French stocks. For this reason, it is important to ensure that the measures do not entail major adverse consequences. If they do, a high number of market participants could be induced to operate outside France.
A balance needs to be found, with measures that are effective in terms of preventing settlement fails but do not create harmful rigidities in the way markets operate.

1) Require prior provision

Under this approach, no one could sell securities without having them in his account beforehand, regardless of where the securities in the account came from. In particular, a seller could obtain the necessary securities by borrowing them. In the case of a seller sending orders directly to a broker that is not a custodian for the seller, the broker would have to have assurance of prior provision. To this end, the seller would have to produce a declaration from the custodian.

a) Main arguments in favour

This is a simple measure that is effective in preventing fails because it makes them impossible.

b) Main arguments against

This approach is simple, but it would introduce substantial rigidity in the way markets operate. Market traders legitimately reckon in terms of settlement dates. On any given trading day, they routinely need to sell before having bought or borrowed what they are selling. To require prior provision of securities on day T would constitute a seemingly disproportionate burden – unless one imagines comparable rules being in place in all the main countries harbouring financial markets. This is so unrealistic an assumption that it is difficult to defend. A rule of this nature confined to one country would act as a repellent driving market participants away from that country.

c) Summary

On balance, for the reasons given above, it does not seem that this approach is practical, even if it were thought desirable.

2) Systematically require the seller, as soon as he is committed to provide securities for delivery on T+3, to enter a binding agreement with his intermediary to have the intermediary borrow the securities if the seller is unable to meet his commitment

a) Main arguments in favour

This approach is less restrictive for the seller, in that it stops short of requiring prior provision. It guarantees that the securities will indeed be delivered on T+3, by virtue of the contract between the seller and the broker.

What must be agreed between the seller and the intermediary – in particular when the intermediary is a broker, not a custodian – is that if the seller is unable to have the securities in his account with his custodian on T+3, and is thus unable to send a delivery instruction to the custodian to meet his commitment, then the broker will have to borrow the securities for delivery. In the event of technical difficulty in the securities lending market, the broker must buy the securities. In order to do this, the broker must monitor the transaction after the sale.

Although the broker, as broker, cannot shed responsibility for the outcome of the sale transaction it has initiated, the broker need not be the one actually performing this monitoring. The broker can delegate the tracking of the trade settlement account to its clearer, if it is not itself a clearing broker. The clearer will then be the one doing the post-trade monitoring. If there is a problem, the clearer will alert the broker, which continues to have the commercial relation with the seller.

If the securities are not present in the seller's account for delivery on the scheduled settlement date, the financial intermediaries are the ones that must procure them in one way or another, either by borrowing or by buying them on the market. For purposes of deterrence, the regulations would of course provide that the resulting costs are borne by the defaulting seller.

b) Main arguments against

The requirement that a broker have the securities to deliver if the seller is not able to meet the delivery obligation puts the intermediary in a difficult situation. The situation is difficult from an economic standpoint because the intermediary must at all times be prepared either to lend the missing securities or to borrow them on the market. It is especially difficult from a commercial standpoint because the client will prefer to use other intermediaries, in countries other than France, operating under more flexible rules. Here again, a measure of this kind is not practical unless it is adopted by all countries, at least in Europe.

c) Summary

At this time, this approach appears to entail a degree of rigour disproportionate to what is at stake. In terms of curbing the incidence of settlement fails, the French financial centre appears to functioning in a generally satisfactory fashion. Taking measures of this kind would seem to bring with them unwarranted risks for the financial centre and its participants.

3) Require the seller to commit to the financial intermediary that the seller will be in a position to deliver on T+3

Here again, the issue relates mainly to direct orders to sell securities transmitted to a broker by an institutional investor. In principle, the broker has no information on the seller's ability to meet the delivery obligation, if only because the broker is not privy to the seller's securities account with its custodian. One could conceivably require the seller to provide a declaration from the custodian to the broker proving that the securities are indeed present in the account, or are expected to be there on the settlement date because they were bought just before the sale or on the same day. Also conceivable, and less restrictive, would be to demand a warranty only from the client that the securities will be there for timely delivery, without going so far as to require a declaration from the custodian.

a) Main arguments in favour

This approach would appear to achieve the objective in a satisfactory fashion. Under the first variant, the seller could obtain either a declaration from the custodian on a case-by-case basis or a blanket warranty by the custodian that it will honour its client's delivery obligations in a timely fashion.

Alternatively, under the second, less restrictive variant with only the seller's warranty, the seller would have to see to it that no settlement fail occurs. If a fail nevertheless occurs, it will then be clear either that it was due to a technical issue of no particular seriousness, or that it was deliberate. If an audit of the fail finds the latter to be the case, the seller would be liable to sanctions.

b) Main arguments against

Obliging the custodian to provide a declaration is generally held to be a rule that would generate great rigidity. As indicated previously, there would be a not inconsiderable risk that clients would turn away from brokers operating in France and instead do business with foreign brokers not subject to such a restrictive rule.

Obliging only the client to warrant delivery does not present this drawback. To be sure, it does represent a constraint, especially for non-resident sellers, but one that is generally considered to be readily bearable, provided it is also applied in other countries of the European Union.

c) Summary

Requiring that the client warrant delivery of the securities appears to be a supple provision, one that could be adopted without difficulty in all European countries and one that on balance would be effective, since it would make it possible to identify clearly those cases where the seller has deliberately misled the intermediary.

C) Should there be a rule on the price at which short sales can be made?

In a number of countries, short sales are allowed only when certain price conditions are met.

The purpose of such a rule is to slow downward movements in which short-sellers are playing a role. More specifically, the aim is to prevent (i) a fall in the price of a stock resulting exclusively from orders issued by short-sellers, and (ii) a short-term market overreaction to a downturn prompted by, for example, bad news. With these aims in mind, the lowest price at which short sales are allowed is set with reference to the last traded price or, in a dealer market, the highest bid price[15].

a) Main arguments in favour[16]

- A price test rule does seem to reduce intraday volatility.
- A price test rule does not seem to affect market liquidity.

[15] A rule of this kind is in effect in Canada, Mexico, Japan and Australia. One was introduced in the United States in the 1930s, but it was gradually loosened and then eliminated in 2007 following a large-scale economic study directed by the SEC of the rule's effects on the market. Before it was eliminated, a short sale had to be made at a price greater than the last traded price, or equal to the last traded price if that price was in turn greater than the previous different price on the NYSE ("uptick rule" or price test").

[16] The indications given regarding the effects of the US rule on volatility, liquidity and price distortion summarise the conclusions of the economic analyses conducted by the SEC staff and are presented in the SEC Release No. 34-54891, Amendments to Regulation SHO and Rule 10a-1 (December 2006). As presented in this document, the conclusions of the studies, which were conducted either by the SEC or by various groups of academics, are not decisive. They are generally nuanced (see, for example, the wording on page 29: "empirical results indicate that the observed effect of a price test may have a larger negative than positive impact on markets") and sometimes contradictory. Furthermore, the studies were all done in the middle of a strong bull market.

b) Main arguments against

- It is possible that short-sale price test rules distort market prices to some degree.
- A price test rule creates problems of implementation in an environment where there are multiple trading platforms[17].
- To avoid unduly hindering several kinds of manifestly legitimate trading activity (market-making, arbitrage, hedging, etc.), a number of exceptions turn out to be necessary, and these exceptions complicate matters considerably for market participants.

c) Summary

Despite the intrinsic attractiveness of a price test rule, notably a degree of short-term effectiveness in stabilising markets, a price constraint on short sales does not appear desirable in the presence of competing markets for the same security, owing to the resulting complexity.

D) What transparency should there be on short-selling?

The current regime provides no form of transparency on short sales. Recent events have highlighted this omission and prompted the AMF, like its counterparts in Europe, to require disclosures on net short positions. It seems widely agreed today that the opaqueness of short-selling not only arouses doubt and mistrust but also impedes orderly market functioning. Thus, the questions go less to the principle of transparency than to possible ways of achieving it.

Several forms of transparency can be contemplated.

1. Public disclosure of any economic net short position exceeding a given percentage of issued capital

The provisional regime in France calls for disclosure on the following trading day by any person holding an economic net short position equivalent to more than 0.25% of issued capital on any of the financial institutions covered. This requirement could be supplemented by a provision calling for disclosure of any increase above the 0.25% threshold, for example, for each step of 0.10 percentage point**.**

a) Main arguments in favour

- A measure of this kind ensures transparency for large short positions on a time scale that is useful, and it conveys information that is potentially of great interest to other market participants.
- Compliance with this disclosure obligation by holders of a large short position – in practice, institutional investors including asset managers – probably generates little in the way of incremental cost, given that the institutions in question are probably already calculating their downside exposures for purposes of managing their market risks[18].

b) Main arguments against

- There is no certainty that disclosure of large short positions only will give the market sufficient information on aggregate short positions, since positions below the 0.25% threshold would still be opaque.

[17] To mitigate the complexities and technical difficulties of the earlier regime, a uniform rule for all US markets has been proposed. It would allow short sales only at a price greater than the last highest bid price. (This is called a "passive tick test" because short-sellers would not be able to "hit" the last highest bid price and would in some cases have to sell at a higher "passive" price.)

[18] The calculations already being made by potential disclosers are not necessarily being done according to the method specified by the rule. The kinds of calculations most relevant for risk management do not necessarily agree with those that would seem desirable from a transparency standpoint. The technical details of the measure are important: gross or net size of the position; derivative positions included or not; certain types of activity (market-making, etc.) included or not; calculation method; level at which short and long positions are calculated (fund, fund manager, legal entity, group, etc.).

- The information is difficult to interpret owing to the diverse nature of the transactions behind a given published figure (securities/derivatives, arbitrage/hedging/market-making, directional bet based on medium-term fundamental analysis vs. short-term trading strategy, etc.).
- Disclosure of the holders of short positions by name may multiply the risk, either via copycat behaviour or via competitors of the disclosers taking positions on the other side.
- The risks that disclosers would incur – in particular, the risk of a squeeze – could encourage them either to avoid going over the reporting threshold (which is not the desired objective) or to ignore the disclosure obligation (with the result that the published data would be inaccurate because of omissions).
- It is difficult for the regulator to know whether certain persons, notably non-residents, are complying with the disclosure obligation.

c) Summary

Provided the relevance of the criteria (threshold value, calculation methodology, etc.) can be verified; given sufficient capacity to check the accuracy of the information that is supplied; and provided the measure is also adopted by France's main partner countries (which would in all likelihood increase the rate of compliance by non-residents), a transparency measure of this kind could be adopted. Even imperfect information can be useful to the market.

2. Reporting of all short positions to the regulator and publication by the regulator of aggregate short position data

A second approach is to require every person holding a short position to report it to the regulator, which then combines that information with other reported position data and publishes an aggregate short position. To reconcile the objectives of broad coverage and unburdensome implementation by smaller players, a suitable threshold could be set, such as 0.05% or 0.10% of issued capital.

a) Main arguments in favour

- The cost of such a measure would be relatively low inasmuch as only institutional investors' systems would be impacted, and those systems are most likely already calculating these positions for the purpose of managing market risk.
- One could consider requiring the net short position to be disaggregated into cash positions and derivative positions and possibly further, as between arbitrage, hedging and other.

b) Main arguments against

- As with every disclosure obligation falling on investors, many of whom are not regulated, checking compliance is difficult, especially with non-residents.
- Setting the disclosure threshold too high would entail a risk of not capturing information useful to the market.

c) Summary

Provided the parameters are set appropriately and the measure is adopted by France's main partners (to encourage compliance), published aggregate data on significant short positions could be useful, especially in combination with marking of orders to sell short.

3. Reporting to the regulator on flows (marking) and stocks

An alternative model used in several countries is periodic dissemination of aggregate information on short sales or short positions[19]. Collection of data on short sales generally

[19] The aggregate short position is made public in the United States, Australia and Canada (in the latter case, the 20 largest short positions). Short sales are publicly disclosed in Mexico; they are reported to regulators in the United States. In Hong Kong, both positions and sales are made public. In Japan, short sales and some information on positions are made public. In some countries (Brazil, Sweden, Mexico), securities lending transactions are made public as a proxy indicator of short positions; in other countries (United States), published data on net short positions are based in part on securities lending. The frequency of publication varies from daily to monthly, depending on the country.

entails a requirement that ISPs "mark" each order as long or short, based on information supplied by the originator. These data are communicated to the regulator[20] with the transaction reports made daily by each ISP. Collection of data on positions generally entails a requirement that ISPs in charge of order execution report their own positions and their clients' positions, separately for each security, to the regulator at specified intervals.

a) Main arguments in favour

- Aggregate information based on data collected with no cut-off for significance at the low end is inherently more complete than information based on large positions only (0.25% of issued capital, for example). For this reason, full aggregate data is much more useful to the market and to the regulator.
- Aggregate information does not reveal short-sellers by name and therefore causes no adverse consequence for declarers (holders of large positions).
- If the required information relates only to short sales of securities or positions resulting from such sales, errors are unlikely,[21] and the truthfulness of the data provided by ISPs is readily verifiable.
- As regards the order-marking requirement, the difficulties of verification by the regulator seem to be of a lesser order inasmuch as the vast majority of trades in stocks listed in France pass through either a French IPS or a remote member of the French regulated market[22].
- If the required information relates only to short sales of securities and positions resulting from such sales, it can be more readily understandable than information that includes transactions in derivatives as well as cash trades[23].

b) Main arguments against

- Obliging ISPs to report their clients' positions runs up against the problem that ISPs have difficulty knowing what those positions are, especially if the client sends orders to and/or deposits securities with multiple ISPs.
- Obliging ISPs to mark sales as long or short must likewise rely largely on assurances given by the client[24].
- Obliging ISPs to report to the regulator daily on long and short sales made by their clients and themselves would entail significant costs, since the IT systems would be impacted.
- Transparency on short sales alone would not provide information on short positions implemented by means of derivatives[25].

c) Summary

Provided that the implementation cost can be shown to be reasonable and the value added in terms of market transparency can be shown to be commensurate, a measure providing aggregate information on short sales and/or short positions could be adopted.

e) Should transparency be improved on securities lending?

Regulation of securities lending should be looked at from the transparency angle. Under the normal regime, any restrictions on such transactions would not appear necessary[26].

[20] The regulator in this context may be the public authority, a self-regulatory body or the exchange.
[21] To minimise errors and avoid publishing misleading information, however, one must have a clear and precise definition of what constitutes a short sale.
[22] Even so, it would obviously be desirable, if such a measure is adopted in France, that it also be adopted by France's main partner countries, so as to minimise difficulties in the order transmission chain.
[23] For derivatives traded on a regulated market, the market operator normally publishes relevant information (such as the number of puts traded) separately and with only a brief lag.
[24] Even so, marking of orders would be technically less complex to implement (disregarding the IT impact) than reporting of clients' positions.
[25] Some studies, however, give reason to believe that the size of the economic net short position on a stock (counting positions implemented with derivatives) is positively correlated with the magnitude of short sales of the same stock (see Report on Transparency of Short Selling, Appendix 1, p. 10, Brent et al, IOSCO, 2003).
[26] Under any assumption, it must be borne in mind that the management company of a UCITS bears full responsibility for any securities lent out by a Sicav or common fund that it manages.

At present, securities lending transactions do not have to be reported to the regulator, since MiFID excludes them from the scope of transactions on which ISPs must report. All the more, such transactions do not have to be disclosed to the market. But inasmuch as securities lending generally goes hand in hand with short-selling, whether the regulator and the market should have more information about it is a question that merits asking. If the answer is yes, the information would have to relate to both volume and quantity.

a) Main arguments in favour

- Reporting on securities lending would provide the regulator with useful data linked to the value of short sales and data on tensions detectable in the this market. Data of this kind would be invaluable in spotting attempts to corner a market and for adopting exceptional measures to limit or ban short-selling when necessary.

- The information received by the regulator could be released to the market in aggregate form, in ways that would have to be specified. This would be a quid pro quo for the freedom that investors would have during normal times to continue to engage in short-selling.

- Whereas the information on securities lending volume would likely be incomplete, on the assumption that non-residents could avoid this transparency obligation, the information on prices would be reliable because it does not require all parties to report: it does not need to be complete in order to be useful. Data on prices could be a mine of information, revealing quickly which stocks are likely to be coming under abnormal selling pressure.

b) Main arguments against

- Securities lending transactions serve multiple purposes. To be sure, they may result from a short sale, but quite often they are made necessary by a technical default along the securities settlement chain unrelated to any taking of a speculative short position on a given stock.

- In practice, if all securities lending transactions were reported to the regulator, it would difficult if not impossible for the regulator to distinguish them by cause and to isolate those related to taking a short position.

- If the market were to receive such comprehensive information, it would be all the more incapable of inferring from it any conclusion whatsoever.

- Reporting to the regulator on securities lending would impose systems costs that would be excessive in relation to the expected benefits.

c) Summary

- If what is desired is that, at the very least, the regulator should have reliable, usable information, it would be appropriate to provide that (i) the obligation to inform the regulator falls on the ultimate borrower, since the lender frequently does not know the cause of the borrowing, and the obligation applies only when the borrowing is intended to cover a short sale; and (ii) that the information is to be provided only for transactions exceeding an amount to be specified.

- Should the regulator publish the information it receives, even if only in aggregate form? The answer to this question seems to be linked to the answer to the question of publishing aggregate data on short sales or net short positions. If it were decided to make publication obligatory, the information on borrowings of securities linked to short sales would doubtless include far more data than is needed or useful.

If it were decided that data on securities lending should be published, any such publication should, at the very least and as a first priority, give data on the prices reported to the regulator.

II.- REGULATION OF SHORT-SELLING DURING PERIODS OF EXCEPTIONAL MARKET TURMOIL

The legislative and regulatory framework ought to arm the regulator with the weaponry needed to deal with a situation of exceptional market turmoil. If only on an emergency basis, the regulator must be able to adopt an exceptional regime.

Beyond this prerequisite, the question put to the working group was to determine whether the following should be established in principle:

- the criteria that would trigger a crisis regime,
- the nature of the decisions that would be adopted in a crisis context.

Upon reflection, embarking on one or the other of these paths would seem to entail more drawbacks than advantages.

For the triggering criteria, one could imagine using some threshold value, to be determined, for the net short position in a stock relative to the issuer's capital. If it were decided to take this path, it would probably be necessary to specify several different thresholds; the percentage that would apply to a stock traded on Eurolist C could hardly be the same as the percentage for a stock in the CAC 40.

Still on the subject of triggering criteria, one could also consider taking into account the observed price in the securities lending market for a given stock.

No matter what criterion is considered, the major disadvantage is that it will affect behaviour by market participants. They will take into account the likelihood of the crisis regime being implemented, either by positioning themselves just below the pre-established threshold or by anticipating the consequences of the threshold being exceeded for the stock in question.

For this reason, it appears preferable to leave the regulator completely free to assess whether and when a crisis regime should be implemented.

The same conclusion applies to the content of the regime itself: pre-determining it deprives the regulator of the freedom it ought to have to weigh the various elements of a crisis in circumstances that are by nature largely unforeseeable. Market participants must simply know that the regulator will have the capacity to adopt, when necessary, one or more measures to restrict or prohibit short-selling in one more stocks traded on the market.

It is therefore not desirable to establish beforehand what criteria will trigger a crisis regime. It is likewise not desirable to predetermine what kinds of measures would be adopted. However, if regulators could agree among themselves beforehand on a consultation procedure to precede adoption of an exceptional regime, that would represent a considerable accomplishment.

Given the globalisation of markets and the increasingly international nature of investors as well as intermediaries, the effectiveness of any such regime necessarily depends on cooperation between the principal market regulators. There is a need to provide a system of information exchange between regulators so that if one of them is compelled by circumstance to implement the exceptional regime, it can count on the help of its counterparts in ensuring compliance. This necessity can be illustrated by a few examples:

- If the French regulator were to conclude that short-selling needed to be restrained or temporarily banned on one of the stocks listed in Paris (and for which Paris is the reference market), the measure would have little effect if it were not applied on multilateral trading facilities abroad through which the same stock is traded. What is required here is a regime analogous to the one provided in MiFID for trading suspensions: when a regulator of a regulated market decides to suspend trading in a given stock, the other regulators concerned are bound, barring duly justified exception, to enforce that measure in their own markets.

- If the French regulator determines that securities lending in French stocks should be limited or prohibited, the measure would be completely ineffective if all a short-seller has to do to get round it is to borrow the securities abroad. Here again, for a measure of this kind in the increasingly international context of financial markets, cooperation among all the regulators involved is indispensable.

CONCLUSION

The mission statement from the AMF Chairman to the two leaders of the working group specified that: “The work you are about to conduct should be able to serve as the basis for an approach that could provide as much consistency as possible between the Paris marketplace and major foreign financial centres, in particular those that are home to markets operated by Euronext”.

It is in this spirit that the group, having completed its work, has formulated various proposals for a better set of rules governing the practice of short-selling. These proposals are intended not only to be put out for public consultation before the Board decides whether to make all or part of them its own, but also to contribute to the discussion now under way internationally, within CESR as well as within IOSCO. This report has addressed some measures that appear desirable at the national level under any assumption, such as strengthening the regulator’s power to deal with a market crisis by putting it on a more solid legal foundation than it has today, or amending the AMF General Regulation to better define and clarify the responsibilities of the various market participants with respect to the obligation to deliver securities on the scheduled settlement date. Going beyond the national level, it is also important to work as effectively as possible towards international harmonisation of the regulation of short-selling. In the main, this will entail:

Harmonisation during “normal” times:

- with an effective set of measures to ensure delivery on the normal settlement date,

- with a common set of regulatory reporting and market disclosure requirements for short sales or net short positions,

Harmonisation of a procedure for a given regulator to switch over to an exceptional regime. This procedure must feature a process of consultation with other regulators, to the extent that their cooperation will be necessary for application of the measures adopted.

In the increasingly international context of trading in financial instruments, harmonisation is desired by all market participants – and legitimately so. Moreover, it is a key determinant of cooperation between regulators, which is as indispensable in the domain of short-selling as it is in the domain of market abuse.

ANNEXES

ANNEX I:
MISSION STATEMENT

RÉPUBLIQUE FRANÇAISE

AUTORITÉ
DES MARCHÉS FINANCIERS
AMF

Réf : BG/DR/10-08-04
N° AMF :
011047

Le Président

Madame Marie-Ange DEBON
Monsieur Jean-Pierre HELLEBUYCK
Membres du Collège de l'AMF
17 Place de la Bourse
75002 PARIS

Paris, 30 OCT. 2008

Chère Madame, Cher Monsieur,

Comme vous le savez, le Collège a adopté le 19 septembre dernier, un certain nombre de mesures destinées – dans le contexte très perturbé que connaissent les marchés – à proscrire les « ventes non sécurisées » ou « ventes à découvert » portant sur les valeurs financières négociées sur les marchés réglementés français.

Ces mesures s'inscrivaient en cohérence avec les décisions que les autorités américaines et anglaises venaient de prendre dans ce même domaine ; l'ensemble des autres régulateurs européens ont tour à tour adopté des mesures similaires ou voisines.

Le nouveau régime arrêté par le Collège comporte une durée d'application de trois mois ; il a été précisé qu'à l'issue de cette période, l'AMF apprécierait « celles des mesures – notamment relatives à la transparence des opérations des ventes à découvert-, qui seront appelées à demeurer en vigueur ».

Vous avez accepté – et je vous en remercie – de co-animer un groupe de travail destiné à proposer au Collège le dispositif qu'au-delà de la période d'application de ces mesures exceptionnelles, il apparaîtrait souhaitable d'adopter de manière pérenne quant à la régulation des « ventes à découvert ».

En associant à vos travaux des représentants des émetteurs, des investisseurs et des intermédiaires financiers, il vous appartiendra de proposer les aménagements qu'il conviendrait d'apporter au dispositif prévalant en temps normal tel qu'il résulte des dispositions du règlement général. Dans ce cadre, il conviendra de répondre en particulier aux questions suivantes :

- quelles sont les opérations qui seraient visées par le nouveau cadre réglementaire ?

- quelles seraient les exigences respectivement applicables à l'investisseur, à l'intermédiaire financier en charge de la transmission ou de l'exécution de l'ordre, à l'intermédiaire financier teneur de compte conservateur ?

- quelles seraient les dispositions à prendre en termes de transparence sur les positions nettes économiques à la baisse ?

- quelles seraient les dispositions à prendre s'agissant de l'information du régulateur et du marché sur les opérations de prêt-emprunt de titres ?

Conformément à la loi n° 78-17 du 6 janvier 1978 relative à l'informatique, aux fichiers et aux libertés, les personnes physiques disposent d'un droit d'accès et de rectification aux données personnelles les concernant. Ce droit peut être exercé auprès de la Direction des Prestataires, de la Gestion et de l'Epargne.

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AUTORITÉ DES MARCHÉS FINANCIERS
AMF

Les travaux que vous allez conduire doivent être de nature à servir de base à une approche aussi homogène que possible entre la place de Paris et les principales places financières étrangères – et notamment celles qui abritent les différents marchés d'Euronext.

Je vous serais reconnaissant de bien vouloir saisir le Collège des propositions résultant des réflexions du groupe de travail d'ici l'échéance des mesures exceptionnelles adoptées le 19 septembre dernier.

Je vous prie de croire, chère Madame, cher Monsieur, à l'assurance de tous mes sentiments les meilleurs, et de mes ind remerciements.

Michel PRADA

ANNEX II:
WORKING GROUP MEMBERS

COMPOSITION DU GROUPE DE TRAVAIL « VENTES A DECOUVERT »

❖ **Présidents** :

- Marie-Ange Debon
- Jean-Pierre Hellebuyck

❖ **Membres** :

- **Emetteurs** :

- Virginia Jeanson (Air Liquide)
- Julian Waldron (Technip)
- Philippe Marien (Bouygues)

- **Sociétés de gestion :**

- Paul-Henri de la Porte du Theil (CAAM)
- Jacques Joakimides (Acropole)
- Didier Le Ménestrel (Financière de l'Echiquier)
- Erich Bonnet (ADI)

- **Autres intermédiaires financiers :**

- Jean-Pierre Mustier (Société Générale)
- Philippe Sanlaville (Exane)
- Romuald Orange (HSBC)
- Monique Veillerobe (Calyon)
- François Artigala (BNP-Paribas)

- **Entreprise de marché :**

- Roland Bellegarde (Nyse Euronext)

- **Avocat :**

- Benjamin Kanovitch (Cabinet Bredin Prat)

- **Trésor :**

- Gilles Petit

ANNEX III:
PERSONS CONSULTED BY THE WORKING GROUP

PERSONNES CONSULTEES

- **F. Artigala, membre du groupe (BNP-Paribas)**
- **R. Bellegarde, membre du groupe (Euronext-Paris)**
- **D. Ceolin et J.-M. Bonnichon (ABC Arbitrage)**
- **J. S. Chanos (Kynikos Associates)**
- **R. Fuller, S. Arnott, P. Montpeyrou (Citadel Group)**
- **R. Ketchum (NYSE Regulation et FINRA)**
- **P.-H. Leroy (Proxinvest)**
- **C. Neuville (ADAM)**
- **Al. Pochet (BPSS)**
- **P.-D. Renard (LCH Clearnet)**
- **Ch. Roupie, responsable prêts-emprunts de titres (Axa-IM)**
- **Mary Richardson, Alternative Investment Management Association (AIMA)**

ANNEX IV:
SHORT-SELLING – COMPARISON OF MEASURES IN FORCE IN MAIN COUNTRIES

Dispositifs en vigueur dans les principaux pays concernant les ventes à découvert

Pays	Interdictions/Restrictions	Règlement-livraison	Déclaration au régulateur	Publication
Etats-Unis	Interdiction des ventes à découvert sur les valeurs financières (assortie de dérogations pour les teneurs de marché etc.) prononcée le 18 septembre et levée le 8 octobre 2008	Depuis septembre 2008 livraison à J+3 puis rachat/emprunt obligatoire (pour le broker-dealer ou compensateur responsable) à partir de J+4 en cas de suspens (J+6 pour les teneurs de marché et toute vente longue) à défaut de quoi le broker-dealer/compensateur est interdit de vendre à découvert le titre concerné sans emprunt préalable (dispositions sous revue à la suite d'une consultation publique achevée en décembre 2008)	Déclaration hebdomadaire à la SEC par les gérants d'actifs américains (fonds de pension, OPC, hedge funds…) des ventes à découvert et des positions courtes par titre (dispositions sous revue) Déclaration quotidienne aux SRO (FINRA, NYSE Regulation, NASD) des achats, des ventes longues et des ventes courtes	Données agrégées rendues publiques mensuellement par les SRO sur les positions courtes par titre à partir des déclarations faites par les broker-dealers sur leurs propres positions et celles de leurs clients
Royaume-Uni	Interdiction de toute prise de position courte (ou augmentation d'une telle position) sur les valeurs financières prononcée le 18 septembre 2008 et levée le 16 janvier 2009	Livraison à J+3. Rachat possible par LCH. Pénalité financière potentiellement applicable par Crest au vu du taux mensuel de suspens attribuable à chaque participant	La déclaration des transactions par les intermédiaires à la FSA ne distingue pas les ventes à découvert	Publication de toute position courte nette supérieure à 0,25% du capital des valeurs financières jusqu'au 30 juin 2009 sauf prorogation Le document mis en consultation le 6 février propose la publication de toute position nette supérieure à 0,50% du capital de toute société cotée
Pays-Bas	Interdiction de toute prise de position courte sur les valeurs financières jusqu'au 28 février sauf prorogation	Livraison à J+3 puis rachat par LCH Clearnet en cas de suspens à J+10	La déclaration des transactions par les intermédiaires à l'AFM ne distingue pas les ventes à découvert	Publication de toute position courte nette supérieure à 0,25% du capital des valeurs financières (même durée)

Belgique	Interdiction des ventes à découvert sans emprunt préalable des titres pour les valeurs financières jusqu'au 20 mars sauf prorogation	Livraison à J+3 puis rachat par LCH Clearnet en cas de suspens à J+10	La déclaration des transactions par les intermédiaires à la CBFA ne distingue pas les ventes à découvert	Publication de toute position courte nette supérieure à 0,25% du capital des valeurs financières (même durée)
Portugal	Interdiction des ventes à découvert sans emprunt préalable des titres pour les valeurs financières jusqu'à nouvel avis	Livraison à J+3 puis rachat par LCH Clearnet en cas de suspens à J+10 Egalement une pénalité financière forfaitaire imposée par Euroclear en cas de suspens	La déclaration des transactions par les intermédiaires à la CMVM ne distingue pas les ventes à découvert L'obligation pour les membres d'Euronext Portugal de déclarer les ventes à découvert à la CMVM quotidiennement a été levée le 9 janvier 2009	Publication de toute position courte nette supérieure à 0,25% du capital de toute société cotée jusqu'à nouvel avis
Allemagne	Interdiction des ventes à découvert sans emprunt préalable des titres pour les valeurs financières jusqu'au 31 mars 2009 sauf prorogation	Livraison à J+2 puis en cas de suspens rachat possible par Eurex CCP à partir de J+8	La déclaration des transactions par les intemédiaires à la BaFin ne distingue pas les ventes à découvert	Néant
Italie	Interdiction des ventes à découvert, jusqu'au 28 février sauf prorogation : - pour les valeurs financières et pour les sociétés en période d'augmentation du capital, avec ou sans emprunt préalable des titres, - pour les autres valeurs, sans emprunt préalable des titres.	Livraison à J+3 puis en cas de suspens pénalité financière forfaitaire par jour enfin rachat à J+ 11 assorti d'une pénalité financière proportionnelle à la valeur du suspens (rachat et pénalités imposés par la chambre de compensation)	La déclaration des transactions par les intermédiaires à la CONSOB ne distingue pas les ventes à découvert	Néant

Espagne	Interdiction des ventes à découvert sans emprunt préalable des titres pour toutes les valeurs (décret de 1967) ; en pratique pas de sanction si les titres sont empruntés ou achetés à J	Livraison à J+3 puis rachat par Iberclear dès J+4 assorti d'une pénalité (pénalité forfaitaire de 2,00% et pénalité proportionnelle de 0,10% par jour) et la confiscation de tout profit (différence entre le prix de la vente et le prix du rachat s'il est inférieur)	La déclaration des transactions par les intermédiaires à la CNMV ne distingue pas les ventes à découvert	Publication de toute position courte nette supérieure à 0,25% du capital des valeurs financières
Suisse	Interdiction des ventes à découvert sans emprunt préalable des titres pour toutes les valeurs cotées sur SWX (cette prohibition ne s'applique pas aux valeurs cotées sur SWX Europe)		Déclaration à J+5 au plus tard des positions courtes (dérivés seulement) par les détenteurs de 3% du capital de toute société cotée (déclaration faite par l'investisseur à la bourse à la société émettrice concernée)	Publication à J+7 au plus tard (par la bourse et/ou la société émettrice concernée)
Canada	Encadrement du prix (uptick rule) sauf pour les valeurs canadiennes également cotées aux Etats-Unis (exception en vigueur depuis juillet 2007, date à laquelle cette disposition a été supprimée aux Etats-Unis)		Déclaration bimensuelle à la Bourse par les intermédiaires de la position courte (titres seulement) par titre pour chaque client et le compte propre de l'intermédiaire	Publication bimensuelle des données agrégées sur la position courte (titres seulement) par titre par TSX (pour le compte de toutes les Bourses canadiennes)
Japon	Interdiction des ventes à découvert sans emprunt préalable pour toutes les valeurs jusqu'au 31 mars 2009 sauf prorogation Encadrement du prix (uptick rule)		Déclaration à J+2 par les intermédiaires à la Bourse de toute position courte (titres seulement) par titre et pour chaque client jusqu'au 31 mars 2009 sauf prorogation	Publication par la Bourse de toute position courte (titres seulement) supérieure à 0,25% du capital de toute société cotée (cette information est publiée par la Bourse sur la base des déclarations faites par les intermédiaires)

Australie	Interdiction des ventes à découvert : - pour les valeurs financières, avec ou sans emprunt préalable des titres, jusqu'au 6 mars 2009 sauf prorogation, - pour les autres valeurs, sans emprunt préalable des titres (mesure permanente, assortie d'une dérogation pour les ventes à découvert résultant de l'exercice d'options négociables en bourse) Encadrement du prix (uptick rule)		Déclaration quotidienne (J+1 9h00) à la bourse (ASX) par les intermédiaires des ventes longues, des ventes courtes et des ventes courtes exemptées (ventes à découvert de valeurs financières aux fins d'arbitrage oui couverture) par titre	Publication quotidienne à J+1 par ASX des ventes à découvert agrégées par titre
Hong Kong	Interdiction des ventes à découvert sans emprunt préalable des titres pour toutes les valeurs Encadrement du prix (uptick rule)		Déclaration à la Bourse : - des ventes à découvert (« marquage des ordres ») - des positions courtes (titres seulement) supérieures à 1,00% du capital par les détenteurs de 5% du capital de toute société cotée	Publication quotidienne par la Bourse des ventes à découvert agrégées par titre Publication par la Bourse à J+3 des positions courtes déclarées

ANNEX V:
SHORT-SELLING - MEASURES IN FORCE IN SELECTED EUROPEAN COUNTRIES –
Questions put to professionals

BELGIUM / FRANCE / THE NETHERLANDS (ESES)

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
No (except for specific restrictions, in force since October 2008, related to a list of Banks and Insurance Companies securities, one list per CSD. For the latest, the seller must own or at least acquire the securities before selling them). There is however a commitment from the seller to deliver the sold securities on settlement date

Q2: Should it be the case, can he obtain the stocks by borrowing them?
Yes (except for restricted securities see above)

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
Yes

Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
Yes there is a commitment to deliver at pre agreed Settlement Date. For OTC transactions, the commitment is between the trading parties (the seller and the buyer) according to market practice. For On exchange, the commitment is with the CCP (see rule book).

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
Depending of the CSD a fee based penalty mechanism may be in place to reinforce the market discipline within members (e.g. in France, fixed fee applicable to the failing member for every failed trade after settlement date. This is not applicable in NL or BE for CIK.). For On Exchange transactions, the CCP will use its own rules. See below.

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?
The CCP (LCH Clearnet) has set up buy-in rules to protect the buyer. In principle, every seller that fail to deliver on due date is exposed to a "buy-in" from the CCP. The buy-in is triggered as soon as a buyer can not be delivered after SD+7.

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
No

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
N/A

GERMANY

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
No. It is sufficient to have an unconditional entitlement of transfer of ownership in the shares.

Q2: Should it be the case, can he obtain the stocks by borrowing them?
Yes, he can. But stock lending agreement has to be done before or at least at the same time when the sale transaction is concluded (unconditional entitlement of transfer of ownership as mentioned under point 1)

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
Yes, see comment under question 1.

Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
There is no commitment for OTC trades in the German market.

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
There is no penalty mechanism. Counterparts have to claim bilaterally. There are special conditions for CCP (see point 5)

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?
There are buy-in procedures in place (Eurex CCP e.g. fist buy-in after 5 fail days)

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
N/A

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
The restriction for short selling announced by the German BAFIN only concerns a limited list of securities:

GREECE

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
Seller needs to have the position on his account on D - this applies especially for retail clients-, For FI clients though seller needs to have the position on his account available at least on Settlement Date.

Q2: Should it be the case, can he obtain the stocks by borrowing them?
Yes, he can borrow shares either through the derivatives market or through OTC trade.

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
Yes. Stocks obtained before [or even at D] are eligible.

Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
In the Greek market this obligation goes to the local broker [currently the only one able to book trades in the local market].Therefore if for any reason client does not deliver on SD then full responsibility of the trade goes to the local broker who has various mechanisms to cover the shortage. For this reason [obligation to the local broker] fail trades do not exist in the market. Any fees or penalty imposed by the market to the local broker can be requested back from the client.

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
The local broker who booked the trade in the market is responsible to fulfil the delivery obligation. There are three different options that broker can choose from. SPOT1 mechanism will be applied on D+3, SPOT2 on D+4 until 9.40 CET or STRA (Standard Type Repurchase Agreement) on D+3 or D+4 until 9.40 CET. The SPOT1 and SPOT2 procedures are initiated by the local broker who had booked the trade for the seller and he is obliged to buy the shares at any price from the market to cover the short position. The price difference between the initial delivery on D and the purchase of the stock on D+3 is the cost allocated to the seller. Regarding STRA, the local broker borrows the stock from the derivatives pool in order to settle the delivery and the interest charged by the pool is passed to the client. This procedure is usually followed when the seller is able to deliver right after D+4. If for any reason the broker fails to follow any of the above mechanisms and close the short position there are pure penalty fees for trades' value up to EUR 449,999 and from EUR 450,000 the clearing member is excluded from the trading sessions until the time he covers the delivery obligations.

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?

Same as above. In case of delivery failures local brokers are considered to be the clearing member.

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
Currently, sellers are not obliged to notify broker that they are selling short.

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
Besides the fail mechanisms that have been briefly described in Q4, market has also available two funds [Guarantee Fund and Supplementary Fund] that can contribute - cash wise- in case of market disturbances or broker defaulting.

ITALY

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
In case of sale of shares issued by banks or insurance companies, the ordering party must have the availability and the ownership of the securities position from trade date (D) and up to settlement date of the transaction.
In case of sale of other shares listed and traded on any Italian regulated market, the ordering party must have the availability of the securities position.

Q2: Should it be the case, can he obtain the stocks by borrowing them?
In case of sale of shares issued by banks or insurance companies, Securities held through securities lending transactions shall consequently not be taken into account for the purposes of the availability and ownership requirements.
In case of sale of other shares listed and traded on any Italian regulated market, securities held through securities lending transactions can in this case be taken into account. The commitment from the lender to deliver shares at TD+3 must be taken at TD.

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
See point 1/2

Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
Should the seller fail to deliver on settlement date, the normal procedure applied to fails on exchange will be applied (see point 5).

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
There are no specific rules about it.

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?
As there are no specific rules about it, the common market rules must be followed. Transactions are considered "failed" when a member's contractual position is not settled by the end of settlement day. The commission will be levied on each failed contractual position present in the clearing system and in the gross settlement cycle at the beginning of every day on the basis of the following scale: fail counter value category: 0.01-100.000,00 Euro (50 Euro commission) / 100.000,01-1.000.000,00 Euro (150 Euro commission) / 1.000.000,01-2.000.000,00 Euro (200 Euro commission). On SD+4 the buy-in notification will be automatically sent to the failing party by the CCG. On the evening of SD+8 the buy-in will be executed. Members who have not delivered the financial instrument for a given "end of validity date" will

be charged with a commission consisting of a fixed fee of 1.000,00 Euro plus a variable fee of 0.1% of the counter value of the financial instruments purchased through the buy-in agent on each buy-in executed.

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
There are no a specific rules about it.

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
More restrictions: short selling is not allowed from the day after approval of the capital increase by the Board of directors up to the day new shares have been delivered to those who have exercised their rights.

PORTUGAL

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
There is no obligation to hold the securities in its account when placing the order (except for specific restrictions, in force since October 2008, related to a list of Banks), however, the legitimacy of the orderer may also take place by demonstrating that the availability of said securities has been ensured for settlement through loans or other legal means which assigns temporary ownership.

Q2: Should it be the case, can he obtain the stocks by borrowing them?
Yes (except for restricted securities see above)

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
Yes
Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
Yes there is a commitment to deliver at pre agreed Settlement Date.
For OTC transactions, the commitment is between the trading parties (the seller and the buyer) according to market practice.
For On exchange, the commitment is with the CCP (see rule book)

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
Depending of the CSD a fee based penalty mechanism may be in place to reinforce the market discipline within members (e.g. in France, fixed fee applicable to the failing member for every failed trade after settlement date. This is not applicable in NL or BE for CIK.).
For On Exchange transactions, the CCP will use its own rules. See below.
In Portugal there is also a fixed fee applied by the Portuguese CSD for the resubmission of a trade after the first settlement attempt.

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?
The CCP (Clearnet) has set up buy-in rules to protect the buyer. In principle, every seller that fail to deliver on due date is exposed to a "buy-in" from the CCP. The buy-in is triggered as soon as a buyer can not be delivered after SD+7.

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
No, however the financial intermediary may refuse to accept an order when the entity placing the order does not prove the availability of the financial instruments to be disposed.

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
N/A

SPAIN

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
The seller must have the stock before or acquire it during D. Other option will be to become the owner of the stock by borrowing it, or by executing an irrevocable conversion right, option or any kind of derivative instrument with physical delivery.

Q2: Should it be the case, can he obtain the stocks by borrowing them?
Yes. In the case that the seller has not the position, as mentioned before, there is the option to become the owner of the stock by borrowing them. This borrow must be traded before D+3, in order to settle the sale within the proper deadlines (D+3 before 15:00h CET).

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
Yes.

Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
Yes. Once the trade has been traded on D, during D or D+1 the broker allocates the shape to a settlement agent, following the instructions of the seller. The settlement agent (normally the custodian bank of the seller) is an entity within Iberclear, the Spanish CSD. The settlement agent has a time frame to accept or reject the allocation of the shape. If the shape is accepted in front of Iberclear, the settlement agent has the commitment to deliver the stocks on D+3 before 15:00h CET. There is a "second" opportunity to deliver the stock that takes until D+4 at 15:00h CET. If the seller fails to deliver after that time, the stock will be bought-in by Iberclear.

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
Yes. Short-selling is not permitted and is penalised by Iberclear. In the case the seller settles the delivery by using shares purchased after D, Iberclear applies a short sale fine of 10bp per day of the gross sale amount for each day elapsed between the trade date of the sale and the date the securities are purchased. Additionally, confiscation of price-generated profit, based upon the difference between the sale price and the post dated purchase price, will also be charged by Iberclear. Buy-in procedure takes place if the sale is not settled before D+4 at 15:00h CET. At that moment Iberclear executes a buy-in in the market in order to cover the outstanding sale which the seller has failed to settle. The seller is made to bear the cost of the buy-in, which is composed of the cost of the shares themselves and a fine of 2% over the effective amount of the purchase. In addition, should the price of the shares at the time of the buy-in be lower than that of the sale, Iberclear will confiscate the profit

made on the transaction. If the purchase price is higher than that of the sale, the investor is made to bear that loss.

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?
There is no clearing house for securities as such in the Spanish market. Every participant in the market has the same responsibility for delivery in D+3.

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
No. The broker, as intermediary, just processes the selling instruction, it is the seller who takes the responsibility of the position control. Therefore, no indication of short selling is given.

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
All Spanish Equities contain a registration component. Each time Spanish Equities are purchased in the market, the investor must provide the Spanish broker with a registration name, which is then communicated to the "Sociedad Rectora" (Stock Exchange). The investor must quote this same registration name when the position is sold in the market.
This registration is included as part of the trade execution when shares are purchased. There are no physical certificates to send out; the "Sociedad Rectora" maintains registration in electronic form. Brokers have until D+1 in the afternoon to convey this information to the market authorities. Original registration provided to the local brokers can be amended until D+2 at 19.00h CET when it is forwarded to Iberclear by the Stock Exchange.
The recorded registration details remain with the shares throughout the settlement cycle and are held within Iberclear's book entry system. The registration name determines ownership.
One of the features that characterises the Spanish Equities market is the existence of "Referencias de Registro" (Record References) numbers, also known as RRs. The RR is a fifteen digit number which contains the following information: Type of Trade (Purchase, Loan) / Trade date (YYMMDD) / Transaction Number Control Digit. The RR is linked in Iberclear to a beneficiary and price for the stock. Every time there is a transaction in the market (that is, a purchase, loan or put-through), a new RR is created, linked to a different beneficiary. The trade date and price information is used by Iberclear to calculate short sale fines where necessary. As one RR is created for each trade communicated to Iberclear, it represents the bundle of stock that is the subject of that trade.

UNITED-KINGDOM

Q1: When the seller sells stocks on Day D, does he need to have the stocks on his account on D, or before D?
No, on settlement date is sufficient.

Q2: Should it be the case, can he obtain the stocks by borrowing them?
N/A

Q3: If there's no obligation for the seller to have the stocks on his account on D, can stocks obtained via purchases (or other operations) made before D but only settled on D+1, D+2 or D+3, be eligible?
Yes, any purchase or borrow will be eligible to settle the delivery.

Q3 Bis: If there's no obligation for the seller to have the stocks on his account on D, does he however have to commit to deliver the stocks on the settlement date (i.e. in general D+3)? Should it be the case, how does he provide such commitment and to whom?
The only commitment is provided to the buyer through trade confirmation.

Q4: Should the seller not be required to have the stocks on his account on D or before, what happens if he fails to deliver on D+3? Is there a penalty mechanism and how does it work?
The mechanism in place is the implementation of "settlement fines" by Crest based on the overall settlement efficiency for a given participant on a monthly basis.

Q5: When the settlement involves a clearing member, what do the clearing house's rules provide for, if the stocks are not available for delivery on D+3?
There is no auto borrow provided by the clearing house. A buy-in mechanism is in place through LCH or can be invoked by the buyer for other securities like physicals or unit trusts.

Q6: Does the seller have to indicate to the broker that he's selling short? Should it be the case, how does he provide such indication and to whom?
No, there is no obligation to inform the buyer.

Q7: Are there any other questions on this issue that should be also covered for a better understanding of your settlement system?
Please note that short selling was banned in the UK in September 18th 2008 and the ban was removed in January 16th 2009.
Short selling is strictly followed up by FSA through the Transaction Reporting mechanism.