



November 2010
AK Position Paper

Proposal for a regulation of the European
Parliament and the Council on Short Selling
and certain aspects of Credit Default Swaps -
COM(2010) 482

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

Herbert Tumpel
President

More than three quarters of the 2 million member consultations carried out each year concern labour, social insurance and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 – amongst others unemployed, persons on maternity (paternity) leave, community and military service – of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Werner Muhm
Director

Executive Summary

The draft regulation does not make an attempt to tackle the basic problem, namely to create a new market order by scrutinizing products and stakeholders and standardizing new quality regulations and requirements.

The AK basically welcomes the initiatives of the European Commission, which have been pursued on the basis of the G20 decisions to correct the deregulation and liberalisation of the financial markets, both of which were introduced at the beginning of the eighties of the last century. In combination with other factors, they had significantly contributed to the vulnerability of the financial markets. Together with an increasingly unbalanced development within and between the states, this led to the most serious economic crisis in post-war history. The effort made to make the OTC market more transparent to enable the supervisory authorities to recognise systemic risks as early as possible, is a first approach. On the one hand, transparency can contribute to more market discipline and is condition for regulation on the other.

1.) New Market order - not only regulation

Apart from that, the draft regulation aims at not much more than a statistical record of market procedures; however, it does not make an attempt to tackle the basic problem, namely to create a new market order by scrutinizing products and stakeholders and standardizing new quality regulations and requirements. It is to be feared

that the actually sensible function of derivatives such as hedging against risks of real economy business transactions will continue to be sidelined and that speculation and striving for achieving short-term maximum yields will remain the top priority of financial markets.

Rather short shifted is the orientation of the draft regulation towards macroeconomic criteria. Although - and this is certainly to be welcomed - the aim is to increase transparency and financial market stability, the question, which macroeconomic benefit short sales or CDS - and also their uncovered or naked variants - provide, is far less taken into consideration. In view of the fact that the risk of falling prices or rates can also be hedged with other financial market instruments, something which has been practiced for a long time, the question arises, which additional benefit derives from short selling.

In particular in connection with liquidity, short selling can result in massive problems, especially concerning the time dimension. This leads to the question how long the market needs to recover from (large) transactions or to smooth out sharp price swings caused by (large) transactions. The reverse danger is that jumps in the share prices will trigger uncertainty. It is possible that the negative trend continues due to irrational reactions and herd behaviour.

The AK maintains that there is no liquidity problem, which has to be combated by treating short selling in a casual manner; however, there is the ongoing problem that certain stakeholders are „too big to fail“ and/or „too interconnected to fail“.

Although in a „perfect market“ one could follow the argument referring to price efficiency and counteracting bubbles, it is, however, the case that markets have a tendency to overshoot trends. In the same way as rates are constantly rising during bubble formation, it can also come to a price slump, which is additionally fuelled and further accelerated by short sales.

These instruments also carry substantial risks, ranging from panic reactions of the market as a result of (false) rumours to comments made by influential people on unusual events. However, the volatility in the market is also increased „in normal times“ when large transactions lead to distortions of prices and rates. Basically, short selling and CDS also results in a (financial) interest in a negative development and in the „insolvency“ of states as a worst case scenario. In particular the last example clearly shows that the events in the financial market go way beyond this. Hence, it is inevitable that the workforce is also affected by high volatility, uncertainty and crises. This is particularly true when rigid austerity programmes are implemented to „calm“ the markets or if a state does indeed begin to wobble.

According to the Bank for International Settlements, the nominal value of OTC derivatives at the end of December 2009 was clearly above 600 trillion USD (this is approximately **10 times the global domestic product!**). These figures show that the volume of financial transactions does by no means reflect the investments made in the

real economy. In contrast to the depiction of the European Commission, the AK maintains that there is **no liquidity problem**, which has to be combated by treating short selling in a casual manner; however, there is the ongoing problem that certain stakeholders are „too big to fail“ and/or „too interconnected to fail“, hence making it impossible to manage and control the traded volumes and the risks associated with them.

The aspect of using new investment instruments to create wider diversification opportunities will be going nowhere if the diversification across all instruments, markets and investors results in the fact that in the end once again all investment classes correlate.

2.) Necessity of shrinking the traded volume

That is why regulations are urgently required at European level, which aim at shrinking the still macroeconomic bloated derivative volume. This can be achieved on the one hand by limiting tradable products, hence by **banning uncovered short sales and short sales in particular in connection with commodities** and by standardising products on the other. Apart from that risks have to be optimally calculated and adequately hedged - that is in case bilateral trade shall still be allowed. Although this might result in higher costs for individual enterprises, they much better reflect the actual costs of a derivative, which may also contribute

to reducing the trade volume to an economically sensible quantity.

Only then it is possible to start considering settlements via central counterparties, which otherwise will carry an unacceptable high systemic risk in future. This product regulation must be supplemented by restricting trade in form of the so-called „uptick rule“ (see Reason, Amendment Application to Article 12).

The AK arrives at this conclusion on the basis of the following considerations:

Basically, a short sale is similar to a bet because the value of the product price is only variable on the seller side. The short seller makes a profit if he succeeds in buying securities in the market, which he had previously sold (short) at a high price. The maximum profit of the short sale is limited to the market value of the shares sold. In contrast, if, against the expectations of the short seller the value increases, he might be faced with an unlimited loss. However, in the event that the short seller becomes insolvent, this loss has to be borne - according to the currently planned regulatory system - by the central counterparty and eventually by the taxpayer, when the loss exceeds the „liquidity“ of the central counterparties.

This is added by the fact that both contracting parties do not check whether the subject matter of the sales contract is actually available on the market. That means that more securi-

ties or derivatives are sold than actually exist, which might subsequently result in compensation claims of the buyer against the seller (because of non-performance), thus seriously endangering the financial market stability.

That further temporizing in respect of establishing a new market order concerning short sales of commodities has unforeseeable consequences is among others shown in a UNCTAD study:

According to UNCTAD, trading with commodity securities (index funds, futures and warrants) rose by 32 percent in 2007. At the same time, the value of commodity futures, which were traded off the floor, rose by 160 percent between June 2005 and June 2007. Between 2002 - 2008, the number of outstanding futures and warrants rose threefold, the fictive price of OTC commodity derivatives 14-fold. Between October 2007 and the end of March 2008, the number of contracts on the Commodity Market in Chicago increased by 65 percent, without an increase of real agricultural production. In September 2008, the U.S. Commodity Futures Trading Commission (CFTC) commented „that the commodity market had created price distortions or even a speculative bubble.“ The speculation with commodity values beyond an economically sensible extent, which reflects the actual hedging requirement, must be stopped. With this in mind, the instruments to trade with commodity values must also be restricted. Therefore, short sales of commodity titles have to be banned.

The speculation with commodity values beyond an economically sensible extent, which reflects the actual hedging requirement, must be stopped.

3.) Special problem Credit Default Swaps, CDS

It is a positive sign that the European Commission not only regards short sales but also Credit Default Swaps as very problematic. This assessment is not only justified as a result of the ongoing speculations concerning certain country ratings (initially Greece, but now also Ireland, Portugal, Italy and Spain), but also because of the exploding volume of these derivatives.

Between 2002 and 2007, the outstanding gross nominal value rose from 2 trillion USD to 60 trillion USD. This is immense compared to the global outstanding bond volume of ca. 80 trillion U.S. Dollars. However, the volume of outstanding CDS contracts has fallen again since 2007; but since then rose to 30 trillion U.S. Dollars in 2009. In contrast to the general trend, in respect of sovereign CDS, the gross volume continued to grow. This is certainly also a consequence of the risks assumed by the states during the financial crisis.

The financial crisis has also shown that the economic sense of CDS has been reduced to removing risks from the bank books in order to release as much capital as possible for further transactions resp. to bloat the respective volume more and more. This was added by the fact that there was no longer any proximity to the underlying transaction. The speculation on debtor default via uncovered CDS increases the risk of default - without hedging the underlying transaction.

Unfortunately, in its submitted draft regulation on this set of issues, the European Commission provides no considerations, as to how the currently ongoing speculations, among others in respect of EU states, - partly by the banks settled in the affected Member States - could be halted. From the point of view of European citizens, the macroeconomic consequences of speculating on national bankruptcy are unacceptable. Therefore, the AK demands a **general ban on short sales of CDS**.

4.) Competencies of the European Securities and Markets Authority (ESMA) and possibilities for intervention of national supervision

A new and positive aspect is the effort to harmonise possibilities for intervention of the supervisory authorities for the financial market, in particular the mutual information requirements and the authorization of ESMA. But here too, one seems to be afraid to have the courage of one's own conviction by preventing rapid interventions by imposing a large variety of formal conditions and because the periods of the intervention are far too short to allow the market to be calmed.

Apart from that, the focus should in particular be on preventing crisis situations, which is the reason for the AK to come out in favour of a general ban on certain instruments. Although the created opportunities for authorities to intervene in the market are to be welcomed, they identify the symptoms but

A new and positive aspect is the effort to harmonise possibilities for intervention of the supervisory authorities for the financial market.

do not solve the problem. The dilemmas associated with this: it is not only necessary to provide relevant resources for the regulation, one must also assume that some market participants will only begin to be alarmed because of these emergency measures and that the herd behaviour, which is typical for this market, might entail unforeseeable consequences.

Having said that, the AK would ask you, dear Madam, dear Sir to ensure that

- uncovered short sales in the EU will be banned and that covered short sales will only be possible within the framework of an „uptick rule“,
- general short sales of commodities and CDS in the EU will be prohibited,
- the regulation will also be extended to those CDS, whose reference entities are companies (including banks), in particular if these are systemically relevant,
- the exceptions for market makers and primary market activities as well as for shares, which are also traded on market places outside the EU, are deleted,
- the period of the intervention into the market conditions will remain at the discretion of the national supervisory authorities.

However, the AK welcomes among others the

- inclusion of OTC trading in the reporting duties as this amounts to 90 percent of derivative trading - the Bank for International Settlements estimates the volume at about 600 trillion USD, which is 10 times the global BIP,
- the new role of ESMA as subsidiary intervention authority if the European financial market stability is at risk.

The AK welcomes the new role of ESMA as subsidiary intervention authority if the European financial market stability is at risk.

The AK position in detail

The AK therefore suggests the following concrete amendment proposals:

Recitals

Recital 4:

European Commission:

To set an end to the current fragmented situation in which some Member States have taken divergent measures and to restrict the possibility of divergent measures being taken by competent authorities it is important to address the potential risks arising from short selling and credit default swaps in a harmonised manner.

The requirements to be imposed should address the identified risks without unduly detracting from the benefits that short selling provides to the quality and efficiency of markets.

Reason:

It would be counterproductive if particularly ambitious Member States had to lower their comprehensive regulations to a poorer level again.

Amendment Application

... arising from short selling and credit default swaps **require a certain approach. It must still be an option for the Member States to impose stricter provisions.**

The requirements to be imposed should **address** the identified risks **under special consideration of the problems short selling inflicts on market quality and efficiency. In particular uncovered short sales and short sales associated with commodities have to be rejected.**

The to-date identified advantage of short sales is strictly based on the increase of liquidity. The bloated trade in the financial market - even without

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However, the macroeconomic disadvantages prevail in respect of uncovered short sales and short selling in connection with commodities; therefore, they have to be rejected at European level.

short sales - suggest extremely high liquidity. Nevertheless, the high volume overall is not related to the real economy and its investments, which entails a high macroeconomic risk. In particular short sales carry the additional risk of collapsing when a link in the chain can no longer obtain the promised securities. This risk significantly outweighs

the benefit of any possible higher liquidity. That is why the top priority of the Directive should be to shrink the market volume of derivatives. However, the macroeconomic disadvantages prevail in respect of uncovered short sales and short selling in connection with commodities; therefore, they have to be rejected at European level.

Recital 16:

European Commission:

Uncovered short selling of shares and sovereign debt is sometimes viewed as increasing the potential risk of settlement failure and volatility. To reduce such risks it is appropriate to place proportionate restrictions on uncovered short selling. The detailed restrictions should take into account the different arrangements currently used for covered short selling.

It is also appropriate to include requirements on trading venues relating to buy-in procedures and fines for failed

Amendment Application:

... should take into account ...

... Uncovered short sales and general short sales in connection with commodities will be prohibited as they do not provide any macroeconomic benefits and entail previously non-assessable or recognisable systemic risks, for which, if the short seller defaults, a central counterparty, but in the end once again the taxpayers will foot the bill. As far as risk hedging in connection with commodities is required, this can be achieved with other instruments such as futures and options.

It is also appropriate to include requirements...

It is no longer acceptable for European citizens that further speculation bubbles might trigger a new financial crisis.

settlement of transactions in those instruments. The buy-in procedures and late settlement requirements should set basic standards relating to settlement discipline.

Reason:

It is no longer acceptable for European citizens that further speculation bubbles might trigger a new financial crisis. After all, they are the ones who carry the main burden of the 2008

crisis, as most of the European states, as a result of bailing out the banks, became heavily indebted and have to impose austerity programmes, which put the automatic stabilisers at risk.

Recital 19:

European Commission:

Market making activities play a crucial role in providing liquidity to markets within the Union and market makers need to take short positions to perform that role. Imposing requirements on such activities could severely inhibit their ability to provide liquidity and have a significant adverse impact on the efficiency of the Union markets. Further market makers would not be expected to take significant short positions except for very brief periods.

Amendment Application:

Market making activities play a certain role in providing liquidity to the markets within the Union; **market makers will have to secure the tradability (market liquidity) of securities by continuously providing bid and offering prices. In case of a functioning market, a sale is only possible on the basis of the conditions determined by the market maker. In general, the stock exchange rules and regulations only request the market maker to specify a minimum volume of the shares or bonds to be purchased by him. Apart from that, previously determined spreads may not be exceeded; however, it is not required to provide a fair, value based on financial mathematics. Instead the market maker himself can determine the pricing criteria. If the market maker seizes his activities without repurchasing the shares, the second market will also become non-liquid resp. the central counterparty has to step in if trade takes place via this institution.**

It is therefore appropriate to exempt natural or legal persons involved in such activities from requirements which may impair their ability to perform such a function and therefore adversely affect the Union markets. In order to capture equivalent third country entities a procedure is necessary to assess the equivalence of the third country markets. The exemption should apply to the different types of market making activity but not to exempt proprietary trading. It is also appropriate to exempt certain primary market operations such as those relating to sovereign debt and stabilisation schemes as they are important activities that assist the efficient functioning of markets. Competent authorities should be notified of the use of exemptions and should have the power to prohibit a natural or legal person from using an exemption if they do not fulfil the relevant criteria in the exemption. Competent authorities should also be able to request information from the natural or legal person to monitor their use of the exemption.

It is therefore appropriate **that the provisions (delete) apply to natural or legal persons involved in such market making activities (delete).**

In order to capture equivalent third country entities ...

In case of default or if they do not fulfil their bid and offering prices, market making activities as well as other exchange participants can cause serious systemic turbulences.

Reason:

In case of default or if they do not fulfil their bid and offering prices, market making activities as well as other exchange participants can cause serious systemic turbulences. Lehman Brothers were also active as market makers, offering bid prices in the market for bonds on behalf of issuers.

Recital 22:

European Commission:

In the case of a significant fall in the price of a financial instrument on a trading venue a competent authority should also have the ability to temporarily restrict short selling of the financial instrument on that venue in order to be able to intervene rapidly where appropriate and for a 24 hour period to prevent a disorderly price fall of the instrument concerned.

Amendment Application:

... in order to be able to rapidly intervene **(delete)** to prevent a disorderly price fall of the instrument concerned **for a period, which takes the seriousness of the disruption of the financial market into account**

Reason:

It does not appear to be sensible to restrict the power to act for the national authorities from the outset. Instead,

the period for suspending trade should remain at the reasonable discretion of the national supervisory authorities.

Recital 37:

European Commission:

Since some Member States have already put in place restrictions on short selling and since delegated acts and binding technical standards are provided for which should be adopted before the framework to be introduced can be usefully applied, it is necessary to provide for a sufficient period of time.

Amendment Application:

Since only some Member States have already put in place restrictions on short selling, **the EU-wide regulation must come into effect as soon as possible. This is also required by the still high instability of the market and the problems surrounding sovereign CDS, so that the stabilisation the regulation is aiming at is overall a matter of great urgency for the EU as whole.**

Everything should be done to prevent the crisis mechanism from taking effect.

Reason:

apart from the stabilisation of the markets, the issue also concerns the prevention of risks in connection with sovereign CDS. Speculations on the loss in government bonds could continue to push up their bond interests, which might significantly aggravate the situation of the affected states, but also of the EU as a whole. Everything should

be done to prevent the crisis mechanism from taking effect. This includes above all also the actual implementation of the regulation measures. Apart from that, uncertainty and time-limits increase the uncertainty on the markets themselves, which additionally fuels speculations.

Articles

Article 1:

European Commission:

Debt instruments issued by a Member State or the Union and derivatives set out in Annex I Section C points (4) to (10) of Directive 2004/39/EC that relate to such debt instruments issued by a Member State or the Union or to an obligation of a Member State or the Union.

Amendment Application:

Debt instruments issued by a Member State or the Union ...

... or **relate to** an obligation of a Member State **or the Union or systemic relevant institution established or resident in the Union.**

It is difficult to see why CDS with States as reference entity have been included in the regulation, however not those, which show systemic relevant institutions - in particular of financial institutes - as reference entity.

Reason:

It is difficult to see why CDS with States as reference entity have been included in the regulation, however not those, which show systemic relevant institutions - in particular of financial institutes - as reference entity. The scope of the regulation must be expanded as particular CDS related to financial institutes also represent one of the triggers for the financial crisis. Refer-

ring to companies, the draft regulation does mention shares and short sales of shares, but not debt instruments. This is also difficult to understand in view of the fact that private institutions and above all financial institutes, issue higher levels of debt instruments (corporate bonds), in particular when private institutions are regarded as being systemic relevant.

Article 2 – Definitions:

European Commission:

Art 2 (p) „Debt instruments issued by a Member State or the Union and derivatives set out in Annex I Section C points (4) to (10) of Directive 2004/39/EC that relate to such debt instruments issued by a Member State or the Union or to

Amendment Application:

Uncovered short sales are particular problematic because more derivatives can be sold than overall exist or are available on the market.

an obligation of a Member State or the Union „short sale“ in relation to a share or debt means any sale of the share or debt which the seller does not own at the time of entering into the agreement to sell including such a sale where at the time of entering into the agreement to sell the seller has borrowed or agreed to borrow the share or debt for delivery at settlement;

... has borrowed the share or debt.
Uncovered short selling is prohibited.

Reason:

Uncovered short sales are particular problematic because more derivatives can be sold than overall exist or are available on the market. Apart from that, uncovered short sales appear in large numbers where backing by securities lending, mainly because of bottlenecks - is difficult, i.e. when the fulfilment of the short sale cannot be realized or only at high cost. In order to prevent that by non-fulfilment of

the short seller - for example due to a shortage of securities relating to the sale - or due to insolvency of the short seller - for example through unexpected price increase of the securities - the systemic risk is transferred to the central counterparty and where the taxpayer in case of lack of liquidity of the central counterparty has to make an advance contribution again, it is necessary to ban uncovered short sales.

Article 3:

European Commission:

1. For the purposes of this Regulation, a position resulting from either of the following shall be considered a short position relating to the issued share capital of a company or issued sovereign debt of a Member State or the Union:

(a) a short sale of a share issued by the company or a debt instrument issued by the Member State or Union,

Amendment Application:

1. For the purpose of this Regulation, position resulting from either of the following shall be considered a short position relating to the issued share capital of a company or the issued **debt instruments** of a Member State or the Union:

a) a short sale of a share issued by the company or a debt instrument issued by the Member State or Union **or a systemic relevant institution,**

2. For the purposes of this Regulation, a position resulting from either of the following shall be considered a long position relating to the issued share capital of a company or issued sovereign debt of a Member State or the Union:

(a) holding a share issued by the company or a debt instrument issued by the Member State or Union, ...

5. For the purposes of this Regulation, the position remaining after deducting any long position that a natural or legal person holds in relation to the issued sovereign debt of a Member State or the Union from any short position that that natural or legal person holds in relation to the same debt shall be considered a net short position in relation to the issued sovereign debt of a Member State or the Union.

6. The calculation under paragraphs 1 to 5 for sovereign debt shall be for each single Member State or for the Union ...

Reason:
see Article 1

2. For the purposes of this Regulation, a position resulting from either of the following shall be considered a long position relating to the issued share capital of a company or issued **debt instruments** of a Member State or the Union:

a) holding a share issued by the company or a debt instrument issued by the Member State or Union **or a systemic relevant institution**, ...

5. For the purposes of this Regulation, the position remaining after deducting any long position that a natural or legal person holds in relation to the issued sovereign debt of a Member State or the Union from any short position that that natural or legal person holds in relation to the same debt shall be considered a net short position in relation **to the debt instruments (deleted)**.

6. The calculation under paragraphs 1 to 5 for **debt instruments** shall be for each single Member State or for the **Union or for a systemic relevant institution established or resident in the Union**, ...

Article 4:

European Commission:

For the purposes of this Regulation, a natural or legal person shall be considered to have an uncovered position in a credit default swap relating to an obligation of a Member State or the Union, to the extent that the credit default swap is not serving to hedge against the risk of default of the issuer where ...

... the natural or legal person has a long position in the sovereign debt of that issuer or any long position in the debt of an issuer for which the price of its debt has a high correlation with the price of the obligation of a Member State or the Union.

Amendment Application:

For the purposes of this Regulation, a natural or legal person shall be considered to have an uncovered position in a credit default swap relating to an obligation of a Member State **or the Union or a systemic relevant institution established or resident in the Union**, to the extent that the credit default swap is not serving to hedge against the risk of default of the issuer where the natural or legal person has a long position in the **(deleted) debt instrument** of that issuer or any long position in the debt of an issuer for which the price of its debt has a high correlation with the price of the obligation of a Member State or the Union.

Reason:

siehe Artikel 1

Article 8:

European Commission:

1a) a net short position relating to the issued sovereign debt of a Member State or of the Union,

1b) an uncovered position in a credit default swap relating to an obligation of a Member State or the Union.

Amendment Application:

1a) a net short position relating to the issued sovereign debt of a Member State **or of the Union or a systemic relevant institution established or resident in the Union**,

1b) an uncovered position in a credit default swap relating to an obligation of a Member State or the Union **or a**

systemic relevant institution established or resident in the Union.

Begründung:
siehe Artikel 1

Article 12 – Restrictions on uncovered short sales:

European Commission:

1. A natural or legal person may only enter into a short sale of a share admitted to trading on a trading venue or a short sale of a sovereign debt instrument where one of the following conditions is fulfilled:

(a) the natural or legal person has borrowed the share or sovereign debt instrument;

(b) the natural or legal person has entered into an agreement to borrow the share or sovereign debt instrument;

(c) the natural or legal person has an arrangement with a third party under which that third party has confirmed that the share or sovereign debt instrument has been located and reserved for lending for the natural or legal person so that settlement can be effected when it is due. ...

Amendment Application:

1. A natural or legal person may only enter into a short sale of a share admitted to trading on a trading venue or a short sale of a **(deleted)** debt instrument where one of the following conditions is fulfilled:

a) the natural or legal person has borrowed the share or sovereign debt instrument,

b) the natural or legal person has entered into an agreement to borrow the share or **(deleted)** debt instrument,

c) (new) uncovered short selling is prohibited....

3. (new) Short sales of shares or bonds relating to commodities and credit default swaps, are prohibited.

Due to the events since 2008 and the current debt crisis of the EU Member States, this trade restriction is a necessary level to prevent a second stock market crash.

Reason:

The ban on uncovered short sales is necessary to prevent that due to the non-fulfilment of the short sellers - for example due to a shortage of securities relating to the sale - or due to insolvency of the short seller - for example through unexpected price increase of the securities - the systemic risk is transferred to the central counterparty and in case of lack of its liquidity to the taxpayer.

The general ban (Paragraph 3 new) on short sales (covered and uncovered) of commodities shall prevent that in future in addition to price fluctuations, which are caused by low stocks, crop failure, decline of production etc, these are even more intensified by commodity speculations.

The absolute ban on short sales of credit default swaps is necessary to prevent the consolidation of the

4. (new) A share or a debt may only be sold short when the short sale is taking place immediately after a risen or unchanged share price at the bid rate.

budgets of the EU Member States from being endangered by speculations on their insolvency. Moreover, additional liquidity is not required for this market; the default risk can be covered by traditional instruments such as futures and options or through „covered“ CDS. The new provision (paragraph 4) corresponds to the so-called „uptick“ rule. The general purpose of an „uptick“ rule is to prevent inappropriate, excessive price reductions in the market and to put a stop to initial, potential overreactions of the trading participants due to „bad“ news, as uncovered short sales at falling rates reinforce existing trends, whilst they can curb exaggerations in a bull market. Due to the events since 2008 and the current debt crisis of the EU Member States, this trade restriction is a necessary level to prevent a second stock market crash.

Article 14 – Exemption where the principal trading venue is outside the Union:

European Commission:

1. Articles 5, 7, 12 and 13 shall not apply to shares of a company admitted to trading on a trading venue in the Union where the principal venue for

Amendment Application:

delete

The rating system provided in paragraph 2 removes the need for an exemption from reporting duties and disclosure obligations, as turnover can hardly be compared if no trading data is available.

the trading of the shares is located in a country outside the Union. ...

2. The relevant competent authority for shares of a company that are traded on a trading venue in the Union and a venue located outside the Union shall determine, at least every two years, whether the principal venue for the trading of those shares is located outside the Union. ...

delete

The relevant competent authority shall notify ESMA of any such shares identified as having their principal venue located outside the Union. ESMA shall publish the list of shares for which the principal venue is located outside the Union every two years. The list shall be effective for a two year period.

delete

3. Powers are delegated to the Commission to adopt regulatory technical standards specifying the method for calculation of the turnover to determine the principal venue for the trading of a share. ...

delete

Reason:

The rating system provided in paragraph 2 removes the need for an exemption from reporting duties and disclosure obligations, as turnover can hardly be compared if no trading data is available. An exemption from the restrictions in respect of short selling and covering obligations enable the

accumulation of non-foreseeable risks (in particular, where it will be only examined every 2 years, whether the requirements of Art 14 are still being fulfilled). However, in the end this is (also) the liability of the CCP, which in turn increases its systemic risk.

**Exemption for market making and primary market operations
Article 15 paragraph 1:**

European Commission:

1. Articles 5, 6, 7, 8 and 12 shall not apply to the activities of an investment firm or a third country entity or a local firm that is a member of a trading venue or of a market in a third country, whose legal and supervisory framework has been declared equivalent pursuant to paragraph 2, when it deals as principal in a financial instrument, whether traded on or outside a trading venue, in either or both of the following capacities: ...

Amendment Application:

1. Articles 5,6,7,8 and 12 **also** apply to the activities of an investment firm ...

Any non-conforming to the reporting and disclosure obligation reduces the transparency of the derivative market.

Reason:

Any non-conforming to the reporting and disclosure obligation reduces the transparency of the derivative market. The financial crisis was also aggravated by the excessive accumulation of counterparty risks. Market makers should continuously provide bid and offering prices to ensure the tradability (market liquidity) of securities. The issuer of securities and certificates may also act as market maker. The regulations of the trading places only require the market maker to specify a

minimum volume of the certificates to be purchased by him. Apart from that, previously determined spreads may not be exceeded; however, it is not required to provide a fair, value based on financial mathematics. The case of Lehman Brothers, a financial institute that also acted as market maker, demonstrated that the cease of activities as market maker and the subsequent failure to repurchase the shares had a serious impact on the market.

Article 15 Abs 3:

European Commission:

3. Articles 8 and 12 shall not apply to the activities of a natural or legal person when, acting as an authorised

Amendment Application:

3. Articles 8 and 12 **also** apply to the activities ...

primary dealer pursuant to an agreement with an issuer of sovereign debt, it is dealing as principal in a financial instrument in relation to primary or secondary market operations relating to the sovereign debt.

Reason:

In particular the proprietary trading with certificates led, in connection with the collapse of Lehman Brothers, to total losses for investors. Therefore, an

exemption from Art 12 and in particular from the reporting duty has to be rejected if one wants to recognize any systemic risks at an early stage.

Article 15 Abs 4:

European Commission:

4. Articles 5, 6, 7 and 12 shall not apply to a natural or legal person when it enters into a short sale of a security or has a net short position in relation to the carrying out of a stabilisation under Chapter III of Commission Regulation (EC) No 2273/200322. ...

Amendment Application:

4. Articles **6 and 7** shall not apply to ...

A minimum degree of transparency is also required when carrying out repurchase programmes of issuers.

Reason:

A minimum degree of transparency is also required when carrying out repurchase programmes of issuers. This requires at least the reporting duty to supervisory authorities. Complying

with the regulations on short sales is a minimum condition, which must also cover transactions like these in order not to undermine the objective of the regulation.

Article 15 paragraph 5:

European Commission:

5. The exemptions referred to in paragraphs 1 and 3 shall only apply where the natural or legal person concerned has first notified the competent authority of its home Member State, in writing that they intend to make use of the exemption. The notification shall be made not less than thirty calendar days before the natural or legal person intends to use the exemption.

Reason:

this adjustment is necessary because of the restriction of the exemptions in paragraph 4.

Article 15 paragraph 9:

European Commission:

9. The competent authority of the home Member State may request information, in writing, from a natural or legal person operating under the exemptions set out in paragraph 1, 3 or 4 about short positions held or activities conducted under the exemption. The natural or legal person shall provide the information not later than four calendar days after the request is made at the latest...

Reason:

This adjustment is necessary because of the restriction of the exemptions.

Amendment Application:

5. The **exemption referred to in paragraph 3** shall only apply ...

Amendment Application:

9. ...
... from a natural or legal person operating under the exemptions set out in **paragraph 4** about short positions held or activities conducted under the exemption ...

Article 18 paragraph 1:

European Commission:

The competent authority of a Member State may limit natural or legal persons from entering into credit default swap transactions relating to an obligation of a Member State or the Union or limit the value of uncovered credit default swap positions that may be entered into by natural or legal persons that relate to an obligation of a Member State or the Union ...

Reason:

As a general ban on short sales of CDS should apply (see Reason to Art

Amendment Application:

deleted

12), respective special measures are irrelevant.

Article 19 - Power to temporarily restrict short selling of financial instruments in case of a significant fall in price:

European Commission:

1. Where the price of a financial instrument on a trading venue has during a single trading day fallen by the value referred to in paragraph 4 from the closing price on that venue on the previous trading day, the competent authority of the home Member State for that venue shall consider whether it is appropriate to prohibit or restrict natural or legal persons from engaging in short selling of the financial instrument on the trading venue or otherwise limit transactions in that financial instrument on that trading venue in order to prevent a disorderly decline in the price of the financial instrument.

Where the competent authority is satis-

Amendment Application:

fied under the first subparagraph that it is appropriate to do so, it shall in the case of a share or debt prohibit or restrict persons from entering into a short sale on the trading venue or in the case of another type of financial instrument, limit transactions in that financial instrument on that trading venue.

2. The measure shall apply for a period not exceeding the end of the trading day following the trading day on which the fall in price occurs....

2. The measure has to be **limited to a period, which is appropriate to the extent of the price collapse.**

It does not appear to be sensible to restrict the power to act for the national authorities from the outset.

Reason:

It does not appear to be sensible to restrict the power to act for the national authorities from the outset. Instead,

the period for suspending trade should remain at the reasonable discretion of the national supervisory authorities.

Article 20 - Period of restrictions:

European Commission:

Any measure imposed under Article 16 to 18 shall be valid for an initial period not exceeding three months from the date of publication of the notice referred to in Article 21.

Any such measure may be renewed for further periods not exceeding three months at a time.

Amendment Application:

Any such measure may be renewed **for a further period appropriate for the seriousness of the market disturbance.**

Reason:

Experiences in Austria and Germany show that it might also be necessary to impose trading restrictions during financial market disturbances for a pe-

riod exceeding one year. The national supervisory authorities should therefore act at their discretion.

Article 24:

European Commission:

1 c) limit natural or legal persons from entering into credit default swap transactions relating to an obligation of a Member State or the Union or limit the value of uncovered credit default swap positions that a natural or legal person may enter into relating to an obligation of a Member State or the Union;

Amendment Application:

1 c) limit natural or legal persons from entering into credit default swap transactions relating to an obligation of a Member State or the Union **or a systemic relevant institution established or resident in the Union** or limit the value of uncovered credit default swap positions that a natural or legal person may enter into relating to an obligation of a Member State or the Union **or a systemic relevant institution established or resident in the Union**;

Reason:

see Article 1

Should you have any further questions
please do not hesitate to contact

Mrs Judith Vorbach

Tel: + 43 (0) 732 6906 2434
vorbach.j@akooe.at

Mrs Susanne Wixforth

Tel: + 43 (0) 1 501 65 2122
susanne.wixforth@akwien.at

as well as

Mr Amir Ghoreishi

(in our Brussels office)
T +32 (0) 2 230 62 54
amir.ghoreishi@akeuropa.eu

Bundesarbeitskammer Österreich

Prinz-Eugen-Straße 8-10
A-1040 Wien, Österreich
T +43 (0) 1 501 65-0
F +43 (0) 1 501 65-0

AK EUROPA

Ständige Vertretung Österreichs bei
der EU
Avenue de Cortenbergh, 30
B-1040 Brüssel, Belgien
T +32 (0) 2 230 62 54
F +32 (0) 2 230 29 73