



## OPINION OF THE EUROPEAN CENTRAL BANK

of 8 July 2010

on restrictions on short selling

(CON/2010/53)

### Introduction and legal basis

On 17 June 2010 the European Central Bank (ECB) received a request from the German Federal Ministry of Finance for an opinion on a draft law on the prevention of improper transactions in securities and derivatives (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the sixth indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions<sup>1</sup>, as the draft law relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

#### **1. Purpose of the draft law**

1.1 The draft law aims at counteracting recent negative market developments such as the spreading of turbulence to the markets for government bonds issued by euro area Member States. It seeks to introduce a legal ban on certain financial transactions and an improvement of transparency.

According to the explanatory memorandum to the draft law, the financial crisis revealed the need for further substantial improvements in supervisory law. Therefore, the German national legislator intends to further stabilise financial markets, alongside international efforts, by creating an explicit legal basis for the prohibition of certain transactions that could potentially exacerbate the crisis.

1.2 The draft law proposes principally three sets of amendments to the existing law. First, naked short sales<sup>2</sup> of shares and debt securities of euro area Member States authorised on a domestic stock market to trade in the regulated market are to be banned *ex lege*. Thus, risks resulting in strong downward pressure on stock market prices that could arise from such transactions, as well as from the possibility of selling more securities than available on the market, will be reduced significantly.

---

<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> Sales where the seller of the securities is not the owner of a corresponding number or amount of the same type of the securities sold or does not have an unconditionally enforceable right under the law of obligations or under a fiduciary entitlement to receive a corresponding number or amount of securities of the same type.

Second, the legislator provides for a two-level transparency system for net short positions, including covered short positions in shares and commercially corresponding positions in other financial instruments. The third amendment is aimed at inhibiting *ex lege* the conclusion of certain naked credit default protection instruments – such as ‘credit default swaps’ (CDSs) – in relation to the liabilities of Member States whose currency is the euro. As CDSs not purchased for hedging are particularly capable of intensifying negative market trends and creating excessive upward pressure on CDS premiums in the market, they are to be prohibited by law.

- 1.3 In addition, the Federal Financial Supervisory Authority’s (BaFin) generic power to take measures against material shortcomings will be further specified to include the possibility of a ban on further types of transactions on a case-by-case basis, in particular on transactions in currency derivatives based on the euro and on transactions in derivatives that reflect short sales. Moreover, on the same grounds, the Ministry will be empowered to adopt regulations imposing permanent prohibitions on certain types of transactions.

## **2. General observations**

- 2.1 In general, the ECB considers timely and welcome legislation requiring an appropriate level of transparency for certain types of transactions, such as those relating to CDSs for sovereign debt. The ECB supports in particular the enhancement of requirements for the disclosure to supervisory authorities of net short positions held by financial institutions in certain financial instruments.
- 2.2 The ECB notes that there are currently no harmonised rules banning short selling, concerning transparency in relation to short selling, or banning naked credit derivatives at Union level. However, the Commission has announced a legislative proposal to regulate short selling, to be adopted in September 2010, and launched a public consultation for this purpose. In this context, the ECB notes that given the integrated nature of the single market, regulatory initiatives aimed at safeguarding the efficiency of financial markets and promoting their orderly functioning can be fully effective only if coordinated. This is the underlying reason that inspired the adoption of the ‘Declaration on a concerted European action plan of the euro area countries’ issued by the Heads of State of the euro area on 12 October 2008 (hereinafter the ‘Declaration’)<sup>3</sup>. In this spirit, the ECB has highlighted in its opinions that close coordination at Union level of government measures intended to alleviate tensions in the financial markets is of crucial importance.
- 2.3 As regards the proposed ban on naked short selling, the ECB notes that although naked short selling practices may fulfil important economic functions, these market practices may also have potentially negative impacts from a financial stability perspective. A cautious approach underpinned by sound analysis is therefore needed in this regard. In this context, the ECB/Eurosystem supports the work started by the Commission aimed at identifying the main features of a Union legislative proposal concerning short selling and will contribute to the public

---

<sup>3</sup> The Declaration is available on the French Presidency’s website at [www.ue2008.fr](http://www.ue2008.fr).

consultation launched by the Commission. The ECB therefore draws the consulting authority's attention to the need to take into account possible developments that will emerge at European level.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 8 July 2010.

[signed]

*The President of the ECB*

Jean-Claude TRICHET