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EUROCLEAR S.A./N.V.
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ESMA consultation on draft Technical Standards on Short Selling

Euroclear response

We are pleased to be given the opportunity to offer Euroclear's¹ views on ESMA's consultation on the draft Technical Standards on Short Selling.

Euroclear is registered on the European Commission's register of interest representatives - ID number 88290282308-75.

As part of its securities settlement services to financial markets, Euroclear Bank offers its clients a Securities Lending and Borrowing Programme which is designed to enhance settlement efficiency by avoiding settlement fails (however those fails might be caused). This Programme is fully integrated with the settlement process and allows a client to agree that securities are borrowed whenever there is a short-fall on its account. Our main concern with the Consultation is that under the draft Implementing Regulation, the market might not be able to benefit from such a Programme which generally serves as a mechanism for securities lending of last resort. Brief details of the Programme itself are given in an Annex.

Summary

We believe that automated Securities Lending and Borrowing Programmes provided by some Securities Settlement Systems provide significant market efficiency benefits, but that the current draft Technical Standards proposed by ESMA are ambiguous in their treatment of such Programmes. The intention behind the Regulation is to include such a Programme as an eligible mechanism that can ensure that an investor has a reasonable expectation of timely settlement. It should therefore, also be the

¹ The Euroclear group is the world's leading provider of domestic and cross-border settlement and related services for bond, equity, fund and derivative transactions. User owned and user governed, the group comprises the international central securities depository Euroclear Bank, based in Brussels, as well as the national central securities depositories (CSDs) Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland and Euroclear Finland and Euroclear Sweden. Euroclear also owns Xtrakter, which operates the trade and transaction reporting services.



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objective of the Technical Standards. The Regulation itself, in Article 12(1)c and Article 13(1)c, refers explicitly to "*a reasonable expectation that settlement can be effected when it is due*". However, the detailed locate and confirmation arrangements in section II.V of the ESMA Consultation are far-reaching and appear inconsistent with the text of the Regulation, and have not been structured to support the inclusion of such automated Securities Lending & Borrowing Programmes that are operated by Securities Settlement Systems. We believe that the market should continue to be able to take advantage of such automated Programmes in order to avoid settlement fails, regardless of the origin of those fails.

Indeed, we encourage ESMA to ensure that such Programmes can be regarded as an eligible mechanism for managing settlement fails that might potentially result from short selling activity.

Impact of the Technical Standards

In order to ensure that such Programmes can continue to be included under the Implementing Regulation, ESMA needs to consider the following options

(i) Automated securities borrowing and lending Programmes through a Securities Settlement System would tend to fall under Article 12(1)(b) or 13(1)(b) of the regulation, since it would be reasonable for an auto-borrower in a Programme to expect to be able to borrow from the lendable pool, even if the Operator of the Programme does not disclose the pool, nor guarantees that a borrow would always be granted. In such Programmes the lending pool is not committed and the lender (for liquidity reasons, for example) might wish to withdraw some securities from the lending pool or have a need to meet its own delivery commitments.

In view of this, we would suggest that the list of Agreements specified in Article 5 of the Implementing Regulation could be extended to include automated securities borrowing and lending Programmes in a Securities Settlement System. In such cases, it should be made clear that the "enforceability" requirement relates to an enforceable agreement to/participation in the Programme as borrower. Also, it should be made clear that the requirement to ensure that the amount of securities will be made available, in the case of automated securities lending and borrowing through a Securities Settlement System, is satisfied if the relevant security is eligible in the automated programme.



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(ii) Alternatively, automated securities borrowing and lending Programmes through a Securities Settlement System could be regarded as an arrangement with a third party and therefore fall under Article 12(1)(c) or 13(1)(c) of the Regulation. However, the detailed 'locate' provisions described by ESMA in paragraphs 20-27 of the Consultation paper would actually preclude the use of such an automated securities borrowing and lending Programme. This is because Securities Settlement Systems do not provide locate confirmations at the point of trade, nor do they reserve securities specifically for a third party (e.g., because the lending pool is not guaranteed and the borrowing demand changes in real-time in line with settlement activity).

Therefore, we believe that ESMA needs to review fundamentally its approach to Securities Settlement Systems. We would suggest that the Implementing Regulation should

- be consistent with the precise text of Article 12(1)c and Article 13(1)c which refers explicitly to "*a reasonable expectation that settlement can be effected when it is due*",
- explicitly recognise the use of automated securities borrowing and lending Programmes through Securities Settlement Systems, as being consistent with the Regulation, and should,
- clarify the application of the enforceability requirement in relation to automated securities lending programmes through Securities Settlement Systems and exempt such programmes from the proposed locate/reserve conditions proposed in the Consultation document.

Contacts

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ANNEX – EUROCLEAR BANK SECURITIES LENDING AND BORROWING PROGRAMME

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The scope of the Euroclear Bank Securities Lending and Borrowing programme is to enhance settlement efficiency by avoiding settlement fails. Within the context of its settlement system, Euroclear Bank offers a centralised Securities Lending and Borrowing Programme in both the batch and real-time processes for the benefit of Euroclear Participants. Loans are generated and may be reimbursed as a result of each securities lending and borrowing process. The integration of securities lending and borrowing into the securities settlement process allows for borrowing to correspond exactly to Borrowers' needs (subject to the availability of the corresponding pool of lendable securities) so as to avoid either over- or under borrowing. All securities made available by Lenders are aggregated into an anonymous "lending pool". There is no direct link between lenders and the borrowers. Each have a contractual relationship with Euroclear Bank to cover their activity. Upon signing the legal documentation with Euroclear they can opt to become either automatic lenders and/or borrowers in the programme.

From a Borrower's point of view, the Programme allows them to acquire securities needed to settle transactions that would have otherwise failed for lack of securities. For Lenders, the Programme increases the yield of their portfolios, allowing them to retain the economic benefits of ownership on lent securities by keeping the collateral value for lent securities free of safekeeping fees to secure their credit arrangements.

Euroclear Bank guarantees Lenders the return of lent securities, the compensation after cash or non-cash distributions (such as interest, dividends and subscription rights paid by issuers on lent securities), or their cash equivalent, as well as the payment of the lending fees.