E.U. proposal aims for stability

BRUSSELS

Limits on short-selling and more information on derivatives are sought

BY JAMES KANTER

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The European Commission proposed on Wednesday clamping down on certain kinds of trading on financial markets that governments have blamed for destabilizing the global economy and endangering the euro.

Michel Barnier, the commissioner for the European Union's internal market, said clear rules were needed in the areas of short-selling and trading in derivatives to defend vulnerable economies and to reassure markets that Europe was operating under a single rule book.

Under his proposals, regulators would "gain clear powers to restrict or ban short-selling in exceptional situations," Mr. Barnier said. He also outlined separate rules designed to give regulators and investors more information about the often opaque markets for derivatives.

Short-selling is essentially a bet by an investor that the price of an asset will fall. Derivatives are financial contracts linked to the future value or status of the underlying asset.

He said the rules were broadly in line with actions already taken in the United States, which were designed to stop the collapse of banks like Lehman Brothers from destabilizing entire economies.

"No financial market can afford to remain a Wild West territory," he said. So-called over-the-counter derivatives, which are not traded on an exchange, "have a big impact on the real economy, from mortgages to food prices."

Germany and France have also said so-called naked short-selling — where traders bet against securities they do not actually hold — exacerbated the sovereign debt crisis in countries like Greece, Spain and Portugal.

Mr. Barnier called the package "a further step toward greater financial stability in Europe."

But representatives of the hedge fund industry immediately said they would seek to amend the proposals, which need the backing of E.U. governments and the European Parliament to become law.

Folake Shasanya, a director at the Association for Financial Markets in Europe, an industry group, warned that the proposals on derivatives "may introduce disproportionate costs or reduce their effectiveness as risk-management tools."

The proposals on speculative trading follow the decision by Germany in May to halt naked short-selling. That angered financial regulators in other countries and at the E.U. headquarters in Brussels.

But Germany kept up the pressure on Mr. Barnier, saying in June that he had been moving too slowly to regulate risky financial practices that made it unnecessarily expensive for governments to pay their debts.

"Every product, every actor, every financial market participant must be regulated so that we have an overview of what is happening on the financial markets," Chancellor Angela Merkel of Germany said Wednesday in a speech to lawmakers in Berlin.

Mr. Barnier insisted on Wednesday that short-selling had economic benefits and contributed to the efficiency of markets. But he also acknowledged the risks.

"In normal times, short-selling enhances market liquidity and contributes to efficient pricing," he said. "But in dis-

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Under the proposals, national regulators would, in exceptional circumstances, be allowed to temporarily restrict or ban short-selling in any financial instrument, after having consulted with the new European Securities and Markets Authority.

Exceptional circumstances could be if the price of a financial instrument fell by a significant amount in one day.

Additionally, the European authority could impose bans on short-selling for up to three months in parts of or throughout the 27-nation Union.

To curtail naked short-selling, the new rules would require an investor to have borrowed the instruments concerned, entered into an agreement to borrow them or have an arrangement with a third party to locate and reserve them for lending and delivery within a maximum of four days after the transaction.

In the United States, naked short-sellers, before they execute the sale, also have to ensure that they can actually cover a short sale, but E.U. officials said the proposed rules for Europe would be even more precise.

Mr. Barnier said trades involving short sales should be "flagged" so regulators and investors could detect them more easily.

Traders would need to notify the authorities of any short position exceeding 0.2 percent of a company's shares and tell the market of positions exceeding 0.5 percent.

Mr. Barnier also said that regulators should be able to access similar information about short positions on bond markets, including on credit default swaps, which are used by investors to insure against the risk of government default.

Speaking in Brussels on Wednesday, Lorenzo Bini Smaghi, a member of the executive board of the European Central Bank, reiterated his view that short-sellers and other speculators helped foment the market turmoil that required policy makers this year to pledge nearly $1 trillion to support Greece and other heavily indebted countries.

"The fact that money can be gained from the bankruptcy of a company, or even a country, without ever investing in it, raises issues related to the functioning of financial markets," he said.

But Andrew Baker, the chief executive of the Alternative Investment Management Association, which represents hedge funds, said he hoped the new powers to ban short-selling were never used.

"Such bans have never worked," he said, "and indeed all the evidence is that the shorting bans during the crisis made the situation even worse."

Mr. Baker also protested that traders should only have to report short positions to the regulator, rather than publicly to the market. "The market should receive aggregate position reporting only," he said.

He also warned against rules for derivatives trading that could exclude some parts of the industry based outside the Union.

The measure "is potentially protectionist, and we would urge European lawmakers to rethink it," Mr. Baker said.

Sharon Bowles, the chair of the European Parliament's Economic and Monetary Affairs Committee, said her group would scrutinize the proposals and consider amendments before entering negotiations on the final form.

Mr. Barnier said he hoped the new rules could be in force by the end of 2012.

Judy Dempsey contributed reporting from Berlin and Jack Ewing from Frankfurt.

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