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Christine Scheel
Chairperson of the Finance Committee
of the German Bundestag
Platz der Republik 1
11011 Berlin
Germany

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Proposal of the Fourth Financial Market Enhancement Act - temporary ban of short-selling

Dear Mrs Scheel,

The International Swaps and Derivatives Association (ISDA) is the global trade association representing leading participants in the privately negotiated derivatives industry. ISDA's members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Since its inception, the Association has pioneered efforts to identify and reduce the sources of unintended risk in the derivatives and risk management business. The ISDA Master Agreement, issued and continuously advanced by the ISDA, establishes the worldwide standard for international over-the-counter (OTC) transactions in derivatives.

We write to you to express our concerns about the introduction of Section 4a of the Securities Trading Act (**WpHG**) in your Ministry's proposal for the Fourth Financial Markets Enhancement Act.

This provision enables the Federal Supervisory Authority, in coordination with the Federal Ministry of Finance and the Deutsche Bundesbank, to ban temporarily the short-selling of shares. The prohibition would be addressed to market participants pursuant to Section 9 of the WpHG and would be related to shares of such companies that have their registered seat in Germany and are listed on a German stock exchange. The prohibition shall apply in the event of a threat of severe market disruption which is expected to cause grave danger for the economy as a whole or for the financial system.

We consider this to be an isolated move on the part of Germany that would certainly be to the detriment of the German financial market without being suitable for achieving the legislator's intention.

Short-selling is an essential tool in maintaining liquid markets. Market participants often rely on this technique to manage the risk of a decrease in share prices efficiently. Therefore, short-selling can be an appropriate technique that is more likely to provide advantages than pose risks. Although short-selling

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can also be used for speculative purposes, it primarily enables the market participants to increase their liquidity in the short term. The shadow of the possible imposition of a ban on short-selling in times of market disruption would hang over the German markets and make them less attractive to investors who, if the ban were imposed, would find themselves in a position from which they could not easily escape. This could encourage investors to move to financial market places abroad.

The rapid growth in sales of investment funds to retail customers in recent years shows that there is great interest in funds that can react much faster to market conditions and still make money in a downturn through short-selling. If the legislator were to subject the instrument of short-selling to a potential ban, he would limit the framework in which such investment funds could operate. There is already a gap between the number of funds that have their seat in Germany and the demand of German clients for such investments. The proposed regulation would most likely prevent the establishment of further such funds in Germany and therefore cause German investors to move their money to foreign markets.

Due to several uncertain legal terms contained in the provision, the interpretation of this provision by the competent authority will not be predictable. This creates legal uncertainty which may lead to further market uncertainty and in the end to a movement of investors to financial markets abroad.

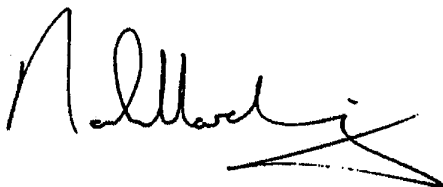
Even if the ban could protect the markets in times of a crisis, this would require an immediate reaction by the authorities. In view of the requirement of prior co-ordination between the Federal Supervisory Authority, the Federal Ministry of Finance and the Deutsche Bundesbank, such an immediate reaction is not very likely to take place. However, a belated reaction could cause more harm than good.

Since the area of application of the proposed legislation, as with most of the provisions of the WpHG, is limited to Germany, the enforceability of the ban does not extend to the short-selling of German shares performed OTC in other countries or on foreign markets. Thus, while most likely missing the legislator's intention, the proposed provision creates a high risk that funds will flow to off-shore markets.

Finally, in the light of the correlation of the international financial markets, it is questionable whether in times of a threat of severe market disruptions, a ban on short-selling only in Germany could protect the German markets from negative influence from other financial markets.

Therefore, we think that the proposed law in its current form will create market uncertainty which will lead to economic risks that by far exceed the benefits. We do not expect that the proposed provision is likely to achieve the legislator's intention, i.e. enhancement of the financial markets. Therefore, we kindly ask you to reconsider the proposal. If the proposed Section 4a of the WpHG is to be enacted, we ask that the conditions under which the ban can be invoked be narrowly and precisely defined.

Yours sincerely,



Mark Harding
Chair of the ISDA European Regulatory Committee

cc. Mr Karl-Burkhard Caspari, Federal Ministry of Finance