Linklaters

Updated December 2012

# Regulation on Short Selling and Certain Aspects of Credit Default Swaps Fact Sheet

## Background to the Regulation and its purpose

The Council of the European Union and the European Parliament adopted a regulation on short selling and certain aspects of credit default swaps ("Regulation") on 14 March 2012, implementing the Commission's plans for an EU wide regulatory regime for short selling.

This follows the European Commission's legislative proposal in September 2010 and political agreement on the Regulation in October 2011, as well as a considerable body of work carried out by the Committee of European Securities Regulators (ESMA's predecessor) and the Commission concerning an EU wide regulatory regime for short selling.

The main drive of the Regulation is to introduce a pan-European regulatory framework for dealing with short selling issues. During the financial crisis in Autumn 2008, regulators worldwide adopted emergency measures to restrict or ban short selling in some or all securities. There was a prevailing concern that at a time of considerable financial instability, short selling could aggregate the downward spiral in share price, particularly of financial institutions. Throughout the EU, divergent measures were taken by different regulators, reflecting the lack of an EU-wide common regime for dealing with short selling issues. This had made compliance with short-selling restrictions on a global basis extremely difficult.

The Regulation came into force on 25 March 2012 and came into effect 1 November 2012.

## Timetable

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| **15 September 2010** | European Commission published its proposal for the Regulation |
| **18 October 2011** | European Parliament and the Council reached political agreement on a compromise text of the Regulation in the trilogue |
| **10 November 2011** | Compromise text endorsed by COREPER |
| **15 November 2011** | European Parliament adopted the Regulation at first reading |
| **21 February 2012** | European Council adopted the Regulation |
| **14 March 2012** | Final Act signed and published (18 March) in the Official Journal |
| **31 March 2012** | ESMA submitted technical standards and provided advice to the Commission on the delegated acts |
| **20 April 2012** | ESMA published its final report to the European Commission on its technical advice on possible delegated acts |
| **29 June 2012** | European Commission adopted Delegated Regulation supplementing the Regulation with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to ESMA in relation to net short positions and the method for calculating turnover to determine exempted shares ("Delegated Regulation") and Implementing Regulation laying down implementing technical standards on short selling ("Implementing Regulation") |

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| **5 July 2012** | European Commission adopted Delegated Regulation supplementing the Regulation with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments ("Regulatory Technical Standard") and the Delegated Regulation dealing with the delegated acts ("Delegated Act") |
| **13 September 2012** | ESMA published a Questions and Answers document ("Q&A") |
| **17 September 2012** | ESMA published a consultation paper on the Regulation |
| **18 September 2012** | The Delegated Regulation and Implementing Regulation was published in the Official Journal |
| **September 2012** | FSA published guidance on the market maker and primary dealer exemptions, entitled "The UK notification process for market-making activities and primary market operations" (the "FSA Guidance") |
| **9 October 2012** | The Regulatory Technical Standard and the Delegated Act was published in the Official Journal |
| **10 October 2012** | ESMA published an update of its Q&A |
| **November 2012** | FSA published its factsheet for Short Selling |
| **22 October 2010** | European Commission published formal mandate requesting ESMA to provide technical advice on the observable impacts of the Regulation |
| **November 2012** | FSA published Policy Statement 12/19 on the Short Selling Regulation |
| **1 November 2012** | The Regulation and Level 2 came into effect |

## Current status of the Regulation

- Transitional measures applied until 1 November 2012, in particular entry into new sovereign CDS transactions was permitted as long as any uncovered positions had been unwound or covered by 1 November 2012.
- The Regulation was adopted by the European Council on 21 February 2012 following trilogue discussions in October 2011 and adoption by Parliament in November 2011. The Regulation entered into force on 25 March 2012, the day after it was published in the Official Journal and applied from 1 November 2012.
- A considerable amount of detail in the Regulation was left for ESMA to provide in technical standards in order for firms to be able to comply with the Regulation. For example, ESMA was tasked with setting out what constitutes an uncovered position in a sovereign CDS, and at what thresholds net short positions in sovereign debt become notifiable to regulators. The Commission published a roadmap on 21 February 2012 regarding the preparation of these secondary measures. ESMA submitted secondary measures to the Commission on 30 March 2012, and published its final report and technical advice on 20 April 2012. With the publication, on 29 June and 5 July 2012, of the final technical standards and delegated acts, the Commission completed all Level 2 measures.
- The Delegated Regulation, the Implementing Regulation and the Regulatory Technical Standard entered into force on the day following their publication in the Official Journal (which was the 18 September 2012 for the Delegated Regulation and Implementing Regulation, and 9 October 2012 for the Regulatory Technical Standard) and applied from 1 November 2012.

  The Delegated Act entered into force on the third day following its publication on the 9 October 2012 in the Official Journal and applied from 1 November 2012.
- The Regulation and the Level 2 measures have direct effect in the UK and other Member States.

## Broad overview of the Regulation

**Two-tier transparency for shares** – for significant net short positions in shares of EU listed companies, the Regulation creates a two-tier reporting model:

(i) **private disclosure**, at a lower threshold – when a net short position has reached 0.20% of the issuer's share capital (and at every 0.1% thereafter) - positions must be reported to regulators so they can detect and investigate short sales that might create systemic risks or constitute abuse;

(ii) **public disclosure**, at a higher threshold – on reaching 0.50% (and at every 0.1% thereafter) – positions must be disclosed to the market in order to provide useful information to other market participants;

This requirement does not apply to shares admitted to trading on an EU trading venue (i.e. an EU regulated market or MTF) where the principal venue for such shares is located in a third country (which the relevant competent authority is to so determine with reference to the trading volume for a particular trading venue, and is required to produce a list of such shares at least every 2 years).

**Private disclosure for sovereign debt and CDSs** – significant net short positions relating to issuers in the EU require private disclosure to regulators once prescribed thresholds have been reached or exceeded (see the Delegated Act below for threshold amounts). Where regulators suspend the restrictions on uncovered sovereign CDSs, short positions in uncovered sovereign

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CDSs would also have to be notified to the regulators once the positions reaches or falls below the relevant notification thresholds applicable for the sovereign issuer. There are, however, exemptions from the disclosure requirements for market-making activities, for authorised primary dealers in sovereign debt and for stabilisation activities conducted within the safe harbour under the Market Abuse Directive (see the additional FSA guidance below).

**Restrictions for uncovered short selling** – according to the Regulation, anyone entering into a short sale must at the time of the sale have borrowed the instruments, entered into an agreement to borrow them or have entered into an arrangement in which the relevant security has been located to ensure that the sale can be settled in time. This does not apply to the short selling of sovereign debt if the transaction serves to hedge a long position in debt instruments of an issuer. In cases where the liquidity of sovereign debt falls below a specified threshold, the restrictions on uncovered short selling may be temporarily suspended by the regulator. The prohibition does not apply in respect of shares admitted to trading on an EU trading venue (i.e. an EU regulated market or MTF) where the principal venue for such shares is located in a third country.

**Restrictions on uncovered sovereign CDSs** – sovereign CDSs are only permitted provided they are not "uncovered" i.e. they are only permitted where the instrument serves to hedge against:

(i) a long position in the sovereign debt of that issuer to which the sovereign CDS relates; or

(ii) the risk of decline in the price/value of assets or liabilities which are correlated to the value of (i) above.

The sovereign CDS position must also be proportionate to the hedged position and their durations must be appropriately aligned. In the event that the sovereign debt market is not functioning properly and this restriction might have a negative impact on the sovereign CDS market, the restrictions on uncovered sovereign CDSs may be temporarily suspended by the regulator.

**Regulators' powers in exceptional situations** - in cases where there is a serious threat to financial stability or market confidence regulators may:

(i) require disclosure of net short positions in respect of financial instruments other than shares and EU sovereign bonds, and/or

(ii) prohibit or impose conditions on short sales of any financial instruments, and/or

(iii) prohibit or restrict credit default transactions relating to obligations of an EU Member State or the EU, and/or

(iv) restrict the value of such transactions that may be entered into; and/or

(v) temporarily restrict short selling of financial instruments if there has been a significant fall in the price since the previous day's closing price (10% or more in the case of a share).

Such measures must be temporary in duration and will need to be notified to ESMA who will act as a coordinator to ensure that measures are necessary and proportionate.

ESMA also has powers to take measures in cases with cross-border implications.

## Broad overview of Level 2 measures

The level 2 measures cover a range of different areas in relation to the Regulation (which at times appear overlapping) though, broadly, the level 2 measures comprise:

- **The Implementing Regulation**

  Which deals with:

  - the means of public disclosure;

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- format of the information which competent authorities are required to report to ESMA;
- details of the arrangements in which short sales will not be considered as "uncovered";
- the "principal trading venue" determination period;

- **The Delegated Regulation**

  Which deals with:
  - details and format of the information which net short position holders are required to report to the relevant competent authority and the information which has to be made public;
  - details of the information which competent authorities are required to report to ESMA;
  - method for calculating turnover to determine exempted shares;
- **The Delegated Act**

  Which deals with:
  - further details on the calculation of net short positions;
  - details of specific situations in which positions in sovereign CDSs will not be considered as "uncovered";
  - further details in relation to correlation calculations and proportionality;
  - notification thresholds for net shorting positions in sovereign debt;
  - method for calculating a fall in the liquidity of sovereign debt and adverse events;
- **The Regulatory Technical Standard**

  Which deals with:
  - method for calculating a fall in value of liquid shares and other financial instruments;

Each of which is explained in more detail below.

**The Implementing Regulation** aims to set out the means by which public disclosures should be made, the format of the information which competent authorities should send to ESMA, further details of the types of arrangements in which short sales in shares and sovereign debt would be considered as "covered" and the "principal trading venue" determination period.

Some of the key points to note are as follows:

- Information on significant net short positions which is required to be made public must be disclosed on a central web site operated or supervised by the competent authorities in a specified format, to allow the public to search the information by share issuer and to see historical data;
- Information that local regulators must provide to ESMA on a quarterly basis on net short positions must be provided in the format specified by the Implementing Regulation and sent to ESMA electronically through a system established by ESMA to ensure completeness, integrity and confidentiality;
- In relation to the obligation for short sales to be "covered", agreements to borrow (such as futures and swaps, options, repurchase agreements, or standing agreements) must:
  - cover at least the number of shares or debt instruments being sold short;

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- be entered into prior to or at the same time as the short sale; and
- specify the delivery or expiration date to ensure settlement of the short sale can be effected when due;

- As an alternative to borrowing the securities, short sales in sovereign debt or in shares can be regarded as "covered" where the short seller has entered into a locate arrangement with a third party whereby that third party (e.g. a broker), prior to the short sale, confirms that the relevant sovereign debt or shares have been located and can be made available in time for settlement, taking into account market conditions and the size of the short sale. For locate arrangements relating to a short sale in *shares*, it would also be necessary for the third party to separately confirm that the relevant numbers of shares have been put on hold. Further requirements to the locate arrangements apply in respect of same day locate arrangements relating to a short sale in shares.
- Locate arrangements can only be made with certain third parties, including investment firms, central counterparties, central banks, EU authorised firms and third country firms. However, investment firms, EU authorised firms and third country firms must meet certain requirements to be eligible to enter into arrangements with short sellers to ensure settlement, including participating in the management of borrowing or purchasing of the shares/ sovereign debt, providing evidence of such participation and being able to provide on request evidence of their ability to deliver, including statistical evidence;
- Competent authorities must notify ESMA of shares for which the principal trading venue is outside the EU so ESMA can implement the exemption in the Regulation for those shares. ESMA is also required to regularly publish a list of exempted dual-traded shares.

**The Delegated Regulation** seeks to establish a uniform regime for the notification to competent authorities of net short positions in shares and in sovereign debt, and the disclosure to the public of net short positions in shares. It also specifies what information competent authorities must report on a quarterly basis to ESMA and a common method for the calculation of turnover for ESMA to determine the principal trading venue of shares.

- When a net short position reaches or subsequently falls below a specified threshold, notification to the relevant competent authority and public disclosure must be made. The Delegated Regulation specifies the information that such notifications should contain (e.g. the position holder, the name of the issuer, the ISIN, the net short position size as a percentage and the position date);
- Competent authorities must provide ESMA, on quarterly basis, with information in relation to notification of net short positions, in the form of some daily aggregated data. They should also provide ESMA with additional information on net short positions upon request;
- For the purposes of calculating turnover to determine the principal trading venue of a share, competent authorities must use "the best available information" such as for example publicly available information, information provided by another competent authority or the issuer of the traded share, or the information from trading venues where the relevant share is traded. Further, transactions included in the calculations should only be counted once and those reported through a trading venue but executed outside should not be counted.

**The Delegated Act** substantially reflects the ESMA's technical advice and includes the technical rules relating to the reporting of short positions in shares and the calculation of net short positions.

- The Delegated Act specifies that the delta adjusted method should be used for the

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calculation of net short positions in shares and in sovereign debt. In respect of both shares and sovereign debt, the calculation is to take into account:

- transactions in all financial instruments conferring an advantage in the event of a change in price or value of the shares (or sovereign debt), whether traded on or outside a trading venue; and
- shares (or sovereign debt) represented in a basket of securities, indices and ETFs (only to the extent it is reasonably discoverable using publically available information).

In respect of the net short position in sovereign debt calculation, debt instruments of another sovereign issuer (excluding issuers located outside the EU) can be included in the calculation of the long position provided its pricing is highly correlated to the pricing of the given sovereign debt;

- Where the debt of two sovereign issuers have been calculated as highly correlated with each other, their positions must be aggregated for the purposes of determining the long position component of the net short position calculation. However, as there is no obligation to perform the correlation analysis in the first place, an investor can avoid any undesirable netting of sovereign debt positions (which may arise due to the unintended correlation between two potentially correlated sovereign debt instruments) by abstaining from conducting this correlation analysis from the outset.
- The net short position calculations should be conducted on a legal entity level. However, where that person is part of a group, the net short positions within that group in respect of a particular issuer would also have to be aggregated and, where a notification threshold has been reached or exceeded, be reported by a group entity to the relevant competent authority on behalf of the whole group. This calculation, however, excludes any positions arising from the performance of any discretionary management activities.
- Persons performing discretionary management activities will be required to calculate, separately from any non-managed holdings, net short positions (and, if necessary to notify and/or disclose such position) for:
  - each individual fund (regardless of legal form) which it discretionarily manages; and
  - each portfolio which it discretionary manages.

  In addition, each legal will be required to aggregate the net short positions of the funds and portfolios under its management for which the same investment strategy (e.g. to go long or short) is pursued in relation to a particular issuer.
- The Delegated Act also sets out a limited number of situations with a multijurisdictional aspect where a short position in a sovereign CDS would not be regarded as uncovered, provided at all times the correlation test has been satisfied, such as:
  - where the asset or liability (the exposure to which the sovereign CDS is intended to hedge against) is in relation to a company located in one member state, however that company is being provided with credit support by (e.g. a loan) from its parent, it would be permissible to purchase a sovereign CDS in the member state of the parent (rather than the subsidiary);
  - where a parent holding company which owns or controls a subsidiary operating company in a different Member State issues a bond but the assets and revenues being hedged are owned by the subsidiary, it would be possible to purchase a

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sovereign CDS referenced to the Member State of the subsidiary;

- where the asset or liability (the exposure to which the sovereign CDS is intended to hedge against) is in relation to a company located in one member state but that company has invested in the sovereign debt of a second Member State, it would be possible to purchase a sovereign CDS referenced to the latter Member State provided that the company would be significantly impacted should there be a significant fall in the value of the sovereign debt of that latter Member State. The company must, however, be established in both relevant Member States;
- where the counterparty to an asset of liability being hedged is a company which has operations across the EU, or where the exposure being hedged relates to the EU or to a member of the EU, it would be possible to hedge this through an appropriate European or Euro area index of sovereign bond CDS;
- where the counterparty to an asset or liability being hedged is a supra-national issuer, it would be possible to hedge the counterparty risk with an appropriately chosen basket of sovereign CDS referencing that entity's guarantors or shareholders.

- The Delegated Act specifies notification thresholds for net short positions in sovereign debt as well as thresholds for significant price falls for illiquid shares, bonds and derivatives during a single trading day which can trigger a short term suspension of short selling by regulators.

  The net short position notification thresholds for sovereign debt are:

  - 0.1% of the total monetary amount of outstanding issued sovereign debt for a particular EU sovereign issuer where this amount is not greater than EUR 500 billion; or
  - 0.5% where this amount exceeds EUR 500 billion or the relevant competent authority has determined that there is a liquid futures market for the particular sovereign debt.

  Subsequent notification thresholds will be set at incremental levels at half of the initial threshold level (e.g. at every subsequent 0.05% after an initial threshold of 0.1%, or at every subsequent 0.25% after an initial threshold of 0.5%). ESMA will calculate and publish on a quarterly basis the actual monetary amounts which reflect these percentage thresholds.
- A temporary suspension of restrictions on uncovered short sales of sovereign debt may be triggered when the turnover in the sovereign debt in a given month falls below the fifth percentile of the monthly volume traded in the previous twelve months. Regulators are expected to check that the significant drop in liquidity is not due to seasonal effects on liquidity that are usually observed in August and December;
- When determining whether there is a threat to financial stability which could trigger temporary short selling bans, the national regulators should take into account the criteria specified by the Commission including, for example, serious financial, monetary or budgetary problems which may lead to financial instability of a Member State, a bank or other financial institution deemed important to the global financial system.

**The Regulatory Technical Standard** specifies the method of calculation of the 10% fall in value for shares and other specified financial instruments such as sovereign and corporate debt, EFTs and money market instruments, for the purposes of determining when the power granted to competent authorities under the Regulation to temporarily restrict short selling in the case of a significant fall in

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price becomes available. For shares, the fall in value is to be calculated from the official closing price of the previous trading day excluding downward price movements resulting solely from a split or any corporate action adopted by the issuer which can lead to a price adjustment by the trading venue.

**List of Exempted Shares**

ESMA has already published the list of exempted shares. The list will be updated on a case by case basis by the national competent authorities when required. Any revised list shall be effective the next day after its publication.

**Notification Threshold Figures for Net Short Positions in Sovereign Debt**

ESMA has published an indicative list of the actual figures which represent the relevant notification percentage thresholds set out in The Delegated Act.

ESMA had said that it will publish definitive thresholds by 1 November 2012, however, ESMA has yet to do so. Those issuers for which there is no figure in the table will be updated as soon as ESMA receives the corresponding information from each relevant competent authority.

**Additional Guidance**

**ESMA Questions and Answers ("Q&A")** serves to promote a common supervisory approach and practice in the application of the Regulation by responding to questions posed by the general public, market participants and competent authorities. Of the more useful clarificatory points raised:

- The Q&A reiterated the extraterritorial effect of the Regulation. Where a person has a significant net short position in a company that has shares admitted to trading on a trading venue in the EU or a net short position in sovereign debt issued by a Member State or by the EU, these positions need to be reported regardless of wherever the trades are executed or booked. Equally, the restrictions on uncovered short sales apply regardless of where the short sales are being conducted.
- Shares in funds which are managed on a discretionary basis by a management entity are not required to be taken into account since the calculation takes place at fund or fund manager level. However, shares in ETFs are within the scope and should be taken into account when calculating net short positions to the extent to which the underlying shares are represented in the ETF.
- A person has met its obligation under the Regulation by making the disclosure by no later than 15.30 local time even if the notification is published by the competent authority or the operator of the central website supervised by the competent authority at a later point.
- The time specified for the notification of a net short position (i.e. 15.30) should be calculated according to the time in the Member State of the relevant competent authority to whom a net short position would have to be notified.
- The position to report should be rounded to the first two decimal places by truncating the other decimal places. For instance, if the net short position is 0.3199 %, a notification is required and should indicate the 0.31% position.
- In respect to the obligation for firms to "look through" indices, baskets and ETFs to the extent that it is reasonable to do so having regard to publicly available information, ESMA only requires firms to have regard to information available free of charge which need not be provided on a real-time basis (such as composition information provided on a market operator's or issuer's website). Furthermore, ESMA clarified that "acting reasonably" relates only to obtaining information about the composition and not to how investors process that information for conducting the calculation of the net short position.
- Net short positions in sovereign debt should be calculated on a duration adjusted basis, whereby it is necessary to multiply the duration of each individual issued debt instrument in which the investor has, at the end of the day, a long or short position by the nominal value of each of those positions, with a positive sign for long positions and a negative one for short positions, and add up all the products.

  For example, an investor with a short position of 10 million € in a bond with Modified Duration 5 and a 1 million € short position in a bond with Modified Duration 3,5 will have a net short position equivalent to -53,5 million € (-10 x 5) +( - 1 x 3,5).
- Net short positions in sovereign debt should also be calculated on a sovereign issuer basis. The correlation calculation should be undertaken on the basis of the issued sovereign debt, involving a comparison of the yield curves of the two sovereign issuers.
- No aggregation and netting of the short and long positions of different management entities within the same group is required (in respect of positions resulting from management activities only).

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"**The UK notification process for market-making activities and primary market operations**" (the "**FSA Guidance**") was published by the FSA in September 2012 which sets out the notification process with which firms would have to comply in order to benefit from the market maker and primary dealer exemptions, each of which would exempt firms from the obligation to comply with the net short position transparency requirements, the prohibition on uncovered short sales and uncovered sovereign CDSs.

Primary Dealer Exemption ("**PDE**")

- Persons requiring the use of the primary dealer exemption in relation to UK sovereign debt are required to notify the FSA.
- The notification must be made to the FSA 30 days before the person intends to rely on the PDE (though the FSA may notify such persons that they can use the PDE sooner).
- In order to benefit from the PDE, a primary dealer (which can be either natural or legal) must be an authorised primary dealer in that they have signed an agreement with a sovereign issuer or have been formally recognised as a primary dealer by or on behalf of a sovereign issuer and who, in accordance with that agreement or recognition, has committed to dealing as principal in connection with primary and secondary market operations relating to debt issued by that issuer.

Market Maker Exemption ("**MME**")

- A person wishing to make use of the MME is required to make its notification to the FSA where the UK is the person's home Member State.
- The notification must be made to the FSA 30 days before the person intends to rely on the MME (though the FSA may notify such persons that they can use the MME sooner).
- A person that wishes to rely on the MME must deal as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:
  - posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
  - as part of its usual business, fulfilling orders initiated by clients or in response to clients' requests to trade;
  - hedging positions arising from the fulfilment of the two tasks above.
- Only the following entities can qualify for the MME:
  - an investment firm that deals as principal in a financial instrument in any of the two capacities and related hedging activities specified;
  - a credit institution that deals as principal in a financial instrument in any of the two capacities and related hedging activities specified;
  - a third-country entity that deals as principal in a financial instrument in any of the

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two capacities and related hedging activities specified; or

- a firm as referred to in point (l) of Article 2(1)10 of MiFID,[1] that deals as principal in a financial instrument in any of the two capacities and related hedging activities specified.

- The MME will apply only to the performance of market making activities and only in relation to the particular financial instruments notified to the relevant competent authority, i.e. the MME will apply on an instrument by instrument basis, and should not be considered as a blanket exemption for market making activities in all financial instruments.
- In addition to shares, sovereign debt and sovereign CDSs which are subject to the Regulation, the MME is also available to market making activities carried out on *other financial instruments related to these instruments* ("Related Instruments"). When notifying the intention to use the exemption for market making activities in these Related Instruments, the notifying entity should provide information regarding the underlying basic instrument and the category of the related financial instrument as set out in MiFID.
- It is also necessary for a person intending to rely on the MME to be a member of a trading venue where the basic instrument for which the MME is sought is admitted to trading or, in respect of Related Instruments, a trading venue where the Related Instrument or its underlying basic instrument is admitted to trading.
- It should be noted that the notifying person is not required to conduct the market making activities on that venue or market where the membership exists, nor is it required to be recognised as a market maker or liquidity provider under the rules of that trading venue or market. There is also no requirement to have a separate contractual obligation to carry out market making activities.

The FSA market maker and primary dealer notification forms.

The particular content requirements are set out in an ESMA consultation paper published on 17 September 2012 in relation to the Regulation.

The FSA noted that where particular evidence required for the market maker/primary dealer forms has already been provided to the FSA, it is sufficient to refer to the previous submission in the forms rather than re-submit such evidence to the FSA.

Notifications can be made by email to SSRMarketMaker@fsa.gov.uk or by post to:

Short Selling Market Maker Exemptions
Markets Division, Financial Services Authority
25 The North Colonnade
Canary Wharf
E14 5HS

The FSA will contact firms within the 30 day period to confirm whether the FSA are minded to prohibit the use of the market maker or primary dealer exemptions in their circumstance.

[1] Firms which provide investment services and/or perform investment activities consisting exclusively in dealing on own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets or which deal for the accounts of other members of those markets or make prices for them and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such firms is assumed by clearing members of the same markets.

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In November 2012, the FSA published its "**FSA factsheet for Short Selling**", most of which reiterated points already covered in other publications. However, of particular help, the FSA provided further guidance to the notification and disclosure procedures.

- Persons required to submit private notifications or make public disclosures may do so by completing the relevant forms and emailing them to the FSA at the following address:
  - Private notifications and cancellations to privatedisclosureSSR@fsa.gov.uk
  - Public share disclosures and cancellations to publicdisclosureSSR@fsa.gov.uk

  The forms are available on the FSA website, a link to which can be found here.
- When making an initial notification or disclosure, such person would need to provide the FSA with a signed letter on headed paper giving the contact details of the particular individual(s) who will be making notifications/disclosures on that person's behalf.
- Notifications of positions should be submitted by 3.30pm of the trading day following the day the position was reached.
- All public positions will be made public on the FSA website.
- When making a public disclosure of a net short position of more than 0.5%, it is not necessary to also make a private notification. However, if the position drops from over 0.5% to below, there will be a need to make a public disclosure as well as a private notification if the position is between 0.2% and 0.49%. In order to comply with this obligation to make both a public and private notification it is sufficient to post the Public Disclosure form to both email addresses.
- All contact details must be given in the forms.
- Should a mistake be made on a submitted form, on realising the mistake a new, the relevant cancellation form should be submitted along with the original set of information provided, and then a new notification or disclosure form should submitted with the correct information.
- The forms, which are in Excel format, must be emailed to the FSA in the same format.

In addition, also in November 2012, the FSA published **Policy Statement 12/19 on the Short Selling Regulation** in which summarised the responses to their previous consultation paper on the topic, as well as set out the final changes to Financial Stability and Market Confidence Sourcebook ("FINMAR") of the FSA handbook.

Whilst the Regulation has direct applicability as law in the UK (and so does not require specific implementation in domestic legislation and/or the FSA rules), the Regulation does provide Member States with discretion in respect of how to exercise certain powers. Such discretion is required to be dealt with in the national legation of the Member States, which this Policy Statement seeks to do for the UK.

Amongst other amendments to the FSA's investigatory and enforcement powers to reflect the FSA's responsibility to ensure compliance with the Regulation within the UK, of particular note:

- When considering whether to impose measures to prohibit or restrict short selling or otherwise limit transactions in financial instruments traded on a trading venue but the price of which has fallen significantly during a single trading day, the FSA will (at minimum) have regard to the following:

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- Whether there has been a violent or sudden movement in the price of a particular financial instrument on a particular trading venue (note, the FSA had decided not to set a quantitative threshold as the wide range of financial instruments made it difficult to set any that would be meaningful);
- Whether there is evidence of unusual or improper trading in a financial instrument on a particular trading venue which could indicate the existence of pressure to move the price of that instrument to at abnormal level (the FSA noted that "abnormal" is be read taking into account the factors set out in the existing Market Conduct (MAR) rule 1.6.10); and
- Whether there are unsubstantiated rumours or dissemination of false or misleading information regarding that instrument (the FSA will verify the veracity of any such rumours with the issuer or their advisers).

- Should the FSA make a determination that a firm, which had notified the FSA in respect of intending to use the market maker or primary dealer exemption, should be prohibited from doing so (where the FSA considers that such a firm has not satisfied the conditions for the exemption) the firm may seek a review of that decision. The review is to be conducted by a different group of people other than those connected or involved in the first determination and consisting of at least of three senior FSA staff.

  The FSA has set a time limit for the review to be conducted of 3 months. However, whilst this is the maximum time period, the FSA intends to carry out any review requests as soon as possible.

**Additional developments**

On 10 December 2012, pursuant to the obligation under the Regulation for the Commission to report to the European Parliament and the Council by 30 June 2013 on, broadly, the impact and effectiveness of the Regulation with respect to the market, the Commission issued a formal request to ESMA for technical advice on the evaluation of the Regulation. As part of this, ESMA has been invited to widely consult market participants in an open and transparent manner for the purposes of this evaluation. The Commission has asked for ESMA to deliver its technical advice by 31 May 2013.

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