European Commission´s proposal on short selling and CDSs. November 2010.

The European Commission (COM), on september 2009, submitted its legislative proposal on short selling and CDS. This proposal is aimed at ensuring the implementation of coordinated actions under a regulation harmonised at European level, increasing transparency and reducing risks. It will grant national and European authorities the power to restrict or ban transactions in exceptional situations.

Instruments

Requirements for transparency and for uncovered short selling apply to EU shares and sovereign debt and to CDS regarding EU sovereign issuers.

Transparency

Information on short selling is currently scanty and not fully trustworthy. The proposal on transparency conforms to the model proposed by CESR. It includes a requirement for the marking (flagging) of all short orders on shares executed on trading venues as short orders. Trading venues will be required to publish daily information about volumes of orders marked as short.

In addition, investors shall notify national authorities of net short positions in shares above a certain threshold (0.2% of issued share capital), and shall disclose them to the market above 0.5%.

In the case of short positions relating to sovereign debt or uncovered positions relating to CDS, this information will be privately disclosed to authorities when they exceed certain thresholds, to be determined by delegated acts of the COM based on their relative importance for the debt issued by each Member State.

National authorities shall provide information, in summarised form, to ESMA on a quarterly basis on the notifications they receive. ESMA may request additional information at any time, which shall be provided at the latest within seven calendar days.

Restrictions on uncovered short selling

Investors with short positions (in shares or sovereign debt) must have borrowed the instruments or made arrangements which ensure that they can be borrowed, so that settlement of the transaction can be effected when it is due.

Trading venues must ensure that there are arrangements in place that allow the buy-in of the instruments when there is a failure to settle a transaction. In that case, they will impose fines on those investors failing to settle and ban them from short selling.

Exemptions

The previous requirements shall not apply to shares whose principal trading market is located in a country outside the European Union. An exemption is also provided for market makers and dealers who assist issuers of sovereign debt or for the purposes of stabilisation schemes under the Market Abuse Directive. National authorities shall be notified of persons willing to use exceptions and shall have the power to prohibit those persons from using an exemption if they do not fulfil the relevant criteria laid down for its use.

Powers of the authorities.

The proposal of the COM confers new powers on national authorities and ESMA:

– National authorities are given the power to request notification and/or disclosure of short positions when they exceed certain thresholds established by the authority in exceptional situations (that they constitute a serious threat to market stability or to market confidence in the Member State or one or more other Member States, and whenever the measure is necessary to control such threat.)

– In exceptional situations, national authorities may prohibit or impose conditions on persons entering into a short sale, or a transaction other than a short sale, when the effect of that transaction is to confer a financial advantage on the investor about an instrument when there is a decrease in the price of another one. Similarly, they may prohibit or impose conditions on CDS transactions relating to the sovereign debt of a Member State.

– National authorities may prohibit or limit the value of transactions.

The aforementioned measures may apply to any type of instrument and authorities may define exceptions regarding market makers or primary markets. These measures shall not exceed three months and may be renewed once.

Before imposing or renewing a measure, ESMA and other authorities shall be notified of that intention, giving at least 24 hours notice.

– When the price falls more than 10% in the case of a share (of the threshold fixed by the COM for other financial instruments), competent authorities may prohibit or limit short selling (or other types of transactions). This measure shall not exceed the trading day on which the fall in price occurs.

Powers of ESMA

– ESMA shall act as coordinator in relation to measures taken by the competent authorities.

– After receiving notification, ESMA shall issue an opinion within 24 hours on whether the measure fulfils the requirements and is appropriate and on whether the intervention of other authorities is necessary. This opinion will be published on its website. If the authority is going to take measures contrary to an ESMA opinion, it shall publish the reasons why.

When the threat affects financial markets or the stability of the European financial system and has transboundary implications, or when one or several authorities have not taken the necessary measures, after consulting with the relevant authorities, including the ESRB, ESMA may adopt the same intervention measures described above for the national authorities.

Inspection and penalties. Co-operation.

National authorities shall have all the necessary powers of supervision, investigation and sanction in their legislation for the enforcement of the new Regulation. European authorities shall co-operate with third countries under ESMA co-ordination.

Next steps.

The proposal must be adopted by the European Parliament and the Council. The negotiation period has just begun. This proposal is expected to enter into force on 1st July, 2012.

Link to the proposal on short selling and CDS: Enlace con la propuesta sobre short selling y CDS: http://ec.europa.eu/internal_market/securities/short_selling_en.htm.