Financial markets: short selling and certain aspects of credit default swaps

2010/0251(COD) - 05/07/2011 - Text adopted by Parliament, partial vote at 1st reading/single reading

The European Parliament amended, at first reading of the ordinary procedure, the proposal for a regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Default Swaps.

The vote on the legislative resolution was postponed to a later date.

Reduction of risk: Members consider that the requirements to be imposed should address the identified risks taking into account differences in the Member States and the potential economic impact of the requirements and without unduly detracting from the benefits that short selling provides to the quality and efficiency of markets by increasing market liquidity (as the short seller sells securities and then later repurchases those securities to cover the short sale) and by allowing investors to act when they believe a security is overvalued short selling leading therefore to the more efficient pricing of securities.

Scope: commodity markets and, in particular, agricultural markets do not fall within the scope of the Regulation. The report states that the Commission should, by 1 January 2012, report to the European Parliament and the Council on the risks existing on those markets, taking into account their specificities, and put forward any appropriate proposals. Commodities relevant to the energy sector should be addressed in the Commission's proposal for a Regulation on energy market integrity and transparency.

Furthermore, the technical details of the settlement discipline regimes should not be included in the scope of this Regulation and should be defined in the appropriate post-trading legislative proposal of the Commission. The latter should therefore make concrete proposals by the end of 2011, in parallel with a proposal to create a harmonised legal framework for central securities depositories.

Uncovered position in a credit default swap: the amended proposal specifies that a natural or legal person shall be considered to have an uncovered position in a credit default swap relating to an obligation of a Member State or the Union, to the extent that the credit default swap is not serving to hedge against:

either the risk of default of the issuer where the natural or legal person has a long position in the sovereign debt of that issuer

or the risk of decline in the value of any asset or portfolio of assets to the natural or legal person holding such asset or portfolio of assets where the decline of the price of those asset or portfolio of assets has a high correlation with the decline of the price of the obligation of a Member state or the Union in the case of a decline in the creditworthiness of a Member State or the Union.

Effective transparency regime and marking of sell orders: Members state that transparency requirements should include short positions created by trading outside trading venues and economic net short positions created by the use of derivatives, such as options, futures, index-related instruments, contracts for differences and spread bets relating to shares or sovereign debt. The calculation of short position or long position should include indices, baskets and exchange traded funds.

In addition to the transparency regime for the reporting of net short positions in shares, Parliament includes a requirement for the **marking of sell orders that are executed as short sales as observed at the end of the day** should be introduced to provide supplementary information about the volume of short

sales of shares executed. Information about short sell transactions should be collated by the firm and communicated to the competent authority at least daily in order to help competent authorities to monitor levels of short selling.

A failure to cover a short position at the end of the trading day should result in sufficiently high penalties so as not to allow the seller to make a profit.

In order to improve transparency on short sales, the European Supervisory Authority (European Securities and Markets Authority) (ESMA) may issue and send to the European Parliament, the Council and the Commission an opinion on adjusting the thresholds, taking into account the developments in financial markets.

Notification to competent authorities of significant net short positions in sovereign debt and credit default swaps: a natural or legal person who has a net short position relating to the issued sovereign debt of a Member State or of the Union shall notify the relevant competent authority whenever such position reaches or falls below a relevant notification threshold for the Member State concerned or the Union.

Method of notification and disclosure: any disclosure shall include details, in anonymous form, of the size of the relevant position, the issuer in relation to which the relevant position is held and the date on which the relevant position was created, was changed or ceased to be held. Natural and legal persons that hold significant net short positions shall keep, for a period of five years, records of the gross positions which make a significant net short position.

Information to be provided to ESMA: the proposal stated that the competent authority shall provide the requested information to ESMA at the latest within seven calendar days. Members add that where there are adverse events or developments which constitute a serious threat to financial stability or to market confidence in the Member State or in another Member State, the competent authority shall provide the requested information to ESMA within 24 hours.

In order to ensure consistent harmonisation, ESMA shall develop draft regulatory technical standards specifying the details of the information to be provide. ESMA shall submit drafts for those regulatory technical standards to the Commission by 31 December 2011.

Sovereign credit default swap: these should be based on the insurable interest principle whilst recognising that there can be interests in a sovereign state other than bond ownership.

Temporary restrictions on short selling: in the case of a significant fall in the price of a financial instrument on a trading venue a competent authority should also have the ability to temporarily restrict short selling of the financial instrument on that venue within its own jurisdiction or request to ESMA such restriction in other jurisdictions in order to be able to intervene rapidly where appropriate to prevent a disorderly price fall of the instrument concerned.

Disclosure in exceptional situations: Parliament inserted a provision stating that the competent authority of a Member State may require natural or legal persons who have net short positions in relation to a specific financial instrument or class of financial instruments to notify it details of the position whenever the position reaches or falls below a notification threshold fixed by the competent authority, where both of the following conditions are fulfilled: (i) there are adverse events or developments which constitute a serious threat to financial stability or to market confidence in the Member State or one or more other Member States; (ii) the measure will not have a detrimental effect on the efficiency of financial markets which is disproportionate to its benefits.

Penalties: based on guidelines adopted by ESMA and taking into consideration the Commission's Communication on reinforcing sanctioning regimes in the financial services sector, Member States

shall establish rules on administrative measures, sanctions and pecuniary penalties applicable to infringements of the provisions of this Regulation. The measures, sanctions and penalties provided for shall be effective, proportionate and dissuasive.

Delegated acts: power to adopt acts in accordance with Article 290 TFEU is delegated to the Commission in respect of details concerning calculating short positions, when a natural or legal person has an uncovered position in a credit default swap, and notification or disclosure thresholds. SMA should play a central role in the drafting of delegated acts by delivering advice to the Commission.