Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (Text with EEA relevance)

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on short selling and certain aspects of credit default swaps

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank[(1)],

Having regard to the opinion of the European Economic and Social Committee[(2)],

Acting in accordance with the ordinary legislative procedure[(3)],

Whereas:

(1) At the height of the financial crisis in September 2008, competent authorities in several Member States and supervisory authorities in third countries such as the United States of America and Japan adopted emergency measures to restrict or ban short selling in some or all securities. They acted due to concerns that at a time of considerable financial instability, short selling could aggravate the downward spiral in the prices of shares, notably in financial institutions, in a way which could ultimately threaten their viability and create systemic risks. The measures adopted by Member States were divergent as the Union lacks a specific common regulatory framework for dealing with short selling issues.

(2) To ensure the proper functioning of the internal market and to improve the conditions of its functioning, in particular with regard to the financial markets, and to ensure a high level of consumer and investor protection, it is therefore appropriate to lay down a common regulatory framework with regard to the requirements and powers relating to short selling and credit default swaps and to ensure greater coordination and consistency between Member States where measures have to be taken in exceptional circumstances. It is necessary to harmonise the rules for short selling and certain aspects of credit default swaps, to prevent the creation of obstacles to the proper functioning of the internal market, as otherwise it is likely that Member States continue taking divergent measures.

(3) It is appropriate and necessary for those rules to take the legislative form of a regulation in order to ensure that provisions directly imposing obligations on private parties to notify and disclose net short positions relating to certain instruments and regarding uncovered short selling are applied in a uniform manner throughout the Union. A regulation is also necessary to confer powers on the European Supervisory Authority (European Securities and Markets Authority) (ESMA) established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council[(4)] to coordinate measures taken by competent authorities or to take measures itself.

(4) The scope of this Regulation should be as broad as possible to provide for a preventive regulatory framework to be used in exceptional circumstances. That framework should cover all financial instruments but should provide for a proportionate response to the risks that short selling of different instruments could represent. It is therefore only in the case of exceptional circumstances that competent authorities and ESMA should be entitled to take measures concerning all types of financial instruments, going beyond the permanent measures that only apply to particular types of instruments where there are clearly identified risks that need to be addressed.

(5) To end the current fragmented situation in which some Member States have taken divergent measures and to restrict the possibility that divergent measures are taken by competent authorities it is important to address the potential risks arising from short selling and credit default swaps in a harmonised manner. The requirements to be imposed should address the identified risks without unduly detracting from the benefits that short selling provides to the quality and efficiency of markets. While in certain situations it could have adverse effects, under normal market conditions, short selling plays an important role in ensuring the proper functioning of financial markets, in particular in the context of market liquidity and efficient price formation.

(6) References in this Regulation to natural and legal persons should include registered business associations without legal personality.

(7) Enhanced transparency relating to significant net short positions in specific financial instruments is likely to be of benefit to both the regulator and market participants. For shares admitted to trading on a trading venue in the Union, a two-tier model that provides for greater transparency of significant net short positions in shares at the appropriate level should be introduced. At the lower threshold, notification of a position should be made privately to the regulators concerned to enable them to monitor and, where necessary, investigate short selling that could create systemic risks, be abusive or create disorderly markets; at the higher threshold, positions should be publicly disclosed to the market in order to provide useful information to other market participants about significant individual short positions in shares.

(8) A requirement to notify regulators of significant net short positions relating to sovereign debt in the Union should be introduced as such notification would provide important information to assist regulators in monitoring whether such positions are in fact creating systemic risks or being used for abusive purposes. Such a requirement should only include private disclosure to regulators as publication of information to the market

for such instruments could have a detrimental effect on sovereign debt markets where liquidity is already impaired.

(9) The notification requirements relating to sovereign debt should apply to the debt instruments issued by a Member State and by the Union, including the European Investment Bank, a Member State's government department, agency, special purpose vehicle or international financial institution established by two or more Member States that issues debt on behalf of a Member State or on behalf of several Member States, such as the European Financial Stability Facility or the prospective European Stability Mechanism. In the case of federal Member States, the notification requirements should also apply to debt instruments issued by a member of the federation. They should not, however, apply to other regional or local bodies or quasi-public bodies in a Member State that issue debt instruments. The objective of debt instruments issued by the Union is to provide balance of payments or financial stability support to Member States or macro-financial assistance to third countries.

(10) In order to ensure comprehensive and effective transparency, it is important that the notification requirements cover not only short positions created by trading shares or sovereign debt on trading venues but also short positions created by trading outside trading venues and 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.

(11) To be useful to regulators and markets, any transparency regime should provide complete and accurate information about a natural or legal person's positions. In particular, information provided to the regulator or to the market should take into account both short and long positions so as to provide valuable information about the natural or legal person's net short position in shares, sovereign debt and credit default swaps.

(12) The calculation of short or long positions should take into account any form of economic interest which a natural or legal person has in relation to the issued share capital of a company or to the issued sovereign debt of a Member State or of the Union. In particular, it should take into account such an economic interest obtained directly or indirectly through the use of derivatives such as options, futures, contracts for differences and spread bets relating to shares or sovereign debt, and indices, baskets of securities and exchange traded funds. In the case of positions relating to sovereign debt it should also take into account credit default swaps relating to sovereign debt issuers.

(13) In addition to the transparency regime provided for in this Regulation, the Commission should consider, in the context of its revision of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments[(5)], whether inclusion by investment firms of information about short sales in transaction reports to competent authorities would provide useful supplementary information to enable competent authorities to monitor levels of short selling.

(14) Buying credit default swaps without having a long position in underlying sovereign debt or any assets, portfolio of assets, financial obligations or financial contracts the value of which is correlated to the value of the sovereign debt, can be, economically

speaking, equivalent to taking a short position on the underlying debt instrument. The calculation of a net short position in relation to sovereign debt should therefore include credit default swaps relating to an obligation of a sovereign debt issuer. The credit default swap position should be taken into account both for the purposes of determining whether a natural or legal person has a significant net short position relating to sovereign debt that needs to be notified to a competent authority and where a competent authority suspends restrictions on uncovered credit default swap transactions for the purposes of determining the significant uncovered position in a credit default swap relating to a sovereign debt issuer that needs to be notified to the competent authority.

(15) To enable ongoing monitoring of positions, the transparency regime should also include notification or disclosure where a change in a net short position results in an increase or decrease above or below certain thresholds.

(16) In order to be effective, it is important that the transparency regime apply regardless of where the natural or legal person is located, including in a third country, where that person has a significant net short position in a company that has shares admitted to trading on a trading venue in the Union or a net short position in sovereign debt issued by a Member State or by the Union.

(17) The definition of a short sale should not include a repurchase agreement between two parties where one party sells the other a security at a specified price with a commitment to buy the security back at a later date at another specified price or a derivative contract where it is agreed to sell securities at a specified price at a future date. The definition should not include a transfer of securities under a securities lending agreement.

(18) Uncovered short selling of shares and sovereign debt is sometimes viewed as increasing the potential risk of settlement failure and volatility. To reduce such risks it is appropriate to place proportionate restrictions on uncovered short selling of such instruments. The detailed restrictions should take into account the different arrangements currently used for covered short selling. These include a separate repurchase agreement on the basis of which the person selling a security short buys back an equivalent security in due time to allow settlement of the short sale transaction and includes collateral arrangements if the collateral taker can use the security for settling the short sale transaction. Further examples include rights issues (offerings) of companies to existing shareholders, lending pools and repurchase agreement facilities provided, for instance, by trading venues, clearing systems or central banks.

(19) In relation to uncovered short selling of shares it is necessary for a natural or legal person to have an arrangement with a third party under which the third party has confirmed that the share has been located, which means that the third party confirms that it considers that it can make the share available for settlement when it is due. In order to give this confirmation it is necessary for measures to be taken vis-à-vis third parties for the natural or legal person to have a reasonable expectation that settlement can be effected when it is due. This includes measures such as a third party having allocated the shares for borrowing or purchase so that settlement can be effected when it is due. With regard to short sales to be covered by purchase of the share during the same day this includes confirmation by the third party that it considers the share to be easy to borrow or to

purchase. The liquidity of the shares, in particular the level of turnover and the ease with which buying, selling and borrowing can take place with minimum market impact, should be taken into account by ESMA in determining what measures are necessary in order to have a reasonable expectation that settlement can be effected when it is due.

(20) In relation to uncovered short selling of sovereign debt, the fact that a short sale will be covered by the purchase of the sovereign debt during the same day can be considered as an example of offering a reasonable expectation that settlement can be effected when it is due.

(21) Sovereign credit default swaps should be based on the insurable interest principle whilst recognising that there can be interests in a sovereign issuer other than bond ownership. Such interests include hedging against the risk of default of the sovereign issuer where a natural or legal person has a long position in the sovereign debt of that issuer or hedging against the risk of a decline in the value of the sovereign debt where the natural or legal person holds assets or is subject to liabilities which refer to public or private sector entities in the Member State concerned, the value of which is correlated to the value of the sovereign debt. Such assets should include financial contracts, a portfolio of assets or financial obligations, as well as interest rate or currency swap transactions with respect to which the sovereign credit default swap is used as a counterparty risk management tool for hedging exposure on financial and foreign trade contracts. No position or portfolio of positions used in the context of hedging exposures to a sovereign should be considered an uncovered position in a sovereign credit default swap. This includes any exposures to the central, regional and local administration, public sector entities or any exposure guaranteed by any referred entity. Furthermore, exposure to private sector entities established in the Member State concerned should also be included. All exposures should be considered in this context including loans, counterparty credit risk (including potential exposure when regulatory capital is required to such exposure), receivables and guarantees. This also includes indirect exposures to any of the referred entities obtained, inter alia, through exposure to indices, funds or special purpose vehicles.

(22) Since entering into a sovereign credit default swap without underlying exposure to the risk of a decline in the value of the sovereign debt could have an adverse impact on the stability of sovereign debt markets, natural or legal persons should be prohibited from entering into such uncovered credit default swap positions. However, at the very first signal that the sovereign debt market is not functioning properly, the competent authority should be able to suspend such a restriction temporarily. Such a suspension should be based on the belief of the competent authority based on objective grounds following an analysis of the indicators set out in this Regulation. Competent authorities should also be able to use additional indicators.

(23) It is also appropriate to include requirements on central counterparties relating to buy-in procedures and fines for failed settlement of transactions in shares. The buy-in procedures and late settlement requirements should set basic standards relating to settlement discipline. The buy-in and fining requirements should be sufficiently flexible to permit the central counterparty that is responsible for ensuring such procedures are

in place to be able to rely on another market participant to perform operationally the buy-in or impose the fine. However, for the proper functioning of financial markets it is essential to address wider aspects of settlement discipline in a horizontal legislative proposal.

(24) Measures relating to sovereign debt and sovereign credit default swaps including increased transparency and restrictions on uncovered short selling should impose requirements which are proportionate and at the same time avoid an adverse impact on the liquidity of sovereign bond markets and sovereign bond repurchase markets.

(25) Shares are increasingly admitted to trading on different trading venues within the Union and in third countries. Many large companies based in a third country also have shares admitted to trading on a trading venue within the Union. For reasons of efficiency, it is appropriate to exempt securities from certain notification and disclosure requirements, where the principal venue for trading of that instrument is in a third country.

(26) Market making activities play a crucial role in providing liquidity to markets within the Union and market makers need to take short positions to perform that role. Imposing requirements on such activities could severely inhibit their ability to provide liquidity and have a significant adverse impact on the efficiency of the Union markets. Furthermore market makers would not be expected to take significant short positions except for very brief periods. It is therefore appropriate to exempt natural or legal persons involved in such activities from requirements which could impair their ability to perform such a function and therefore adversely affect the Union markets. In order for such requirements to capture equivalent third-country entities a procedure is necessary to assess the equivalence of third-country markets. The exemption should apply to the different types of market-making activity but not to proprietary trading. It is also appropriate to exempt certain primary market operations such as those relating to sovereign debt and stabilisation schemes as they are important activities that assist the efficient functioning of markets. Competent authorities should be notified of the use of exemptions and should have the power to prohibit a natural or legal person from using an exemption if they do not fulfil the relevant criteria in the exemption. Competent authorities should also be able to request information from the natural or legal person to monitor their use of the exemption.

(27) In the case of adverse developments which constitute a serious threat to financial stability or to market confidence in a Member State or the Union, competent authorities should have powers of intervention to require further transparency or to impose temporary restrictions on short selling, credit default swap transactions or other transactions in order to prevent a disorderly decline in the price of a financial instrument. Such measures could be necessary due to a variety of adverse events or developments including not just financial or economic events but also for example natural disasters or terrorist acts. Furthermore, some adverse events or developments requiring measures could arise in a single Member State and have no cross-border implications. Such powers need to be flexible enough to enable competent authorities to deal with a range of different exceptional circumstances. In taking such measures, competent authorities should pay due regard to the principle of proportionality.

(28) As this Regulation addresses only restrictions on short selling and credit default swaps to prevent a disorderly decline in the price of a financial instrument, the need for other types of restrictions such as position limits or restrictions on products, which may give rise to serious investor protection concerns, are more appropriately considered in the context of the Commission's revision of Directive 2004/39/EC.

(29) While competent authorities are usually best placed to monitor market conditions and to react initially to an adverse event or development by deciding if a serious threat to financial stability or to market confidence has arisen and whether it is necessary to take measures to address such a situation, powers in this regard and the conditions and procedures for their use should be harmonised as far as possible.

(30) 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 restrict temporarily short selling of the financial instrument on that venue within its own jurisdiction or to request that ESMA restrict such short selling in other jurisdictions in order to be able to intervene rapidly where appropriate and for a short period to prevent a disorderly decline in price of the instrument concerned. The competent authority should also be required to notify ESMA of such a decision so that ESMA can immediately inform the competent authorities of other Member States with venues which trade the same instrument, coordinate the taking of measures by those other Member States and, if necessary, assist them in reaching an agreement or take a decision itself, in accordance with Article 19 of Regulation (EU) No 1095/2010.

(31) Where an adverse event or development extends beyond a single Member State or has other cross-border implications, for example if a financial instrument is admitted to trading on different trading venues in a number of different Member States, close consultation and cooperation between competent authorities is essential. ESMA should perform a key coordination role in such a situation and should try to ensure consistency between competent authorities. The composition of ESMA, which includes representatives of competent authorities, will assist it in the performance of such a role. In addition, competent authorities should have power to take measures where they have an interest in intervening.

(32) In addition to coordinating measures by competent authorities, ESMA should ensure that measures are taken by competent authorities only where necessary and proportionate. ESMA should be able to give opinions to competent authorities on the use of powers of intervention.

(33) While competent authorities will often be best placed to monitor and to react quickly to an adverse event or development, ESMA should also have the power to take measures where short selling and other related activities threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union, where there are cross-border implications and competent authorities have not taken sufficient measures to address the threat. ESMA should consult the European Systemic Risk Board (ESRB) established by Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European

Systemic Risk Board[6] where possible, and other relevant authorities where such a measure could have effects beyond the financial markets, as could be the case for commodity derivatives which are used to hedge physical positions.

(34) ESMA's powers under this Regulation to restrict short selling and other related activities in exceptional circumstances are in accordance with Article 9(5) of Regulation (EU) No 1095/2010. Those powers should be without prejudice to the powers of ESMA in an emergency situation under Article 18 of Regulation (EU) No 1095/2010. In particular, ESMA should be able to adopt individual decisions requiring competent authorities to take measures or individual decisions addressed to financial market participants under Article 18 of Regulation (EU) No 1095/2010.

(35) References in this Regulation to Articles 18 and 38 of Regulation (EU) No 1095/2010 are of a declaratory nature. Those articles apply even in the absence of such references.

(36) Powers of intervention of competent authorities and ESMA to restrict short selling, credit default swaps and other transactions should be only of a temporary nature and should be exercised only for such a period and to the extent necessary to deal with the specific threat.

(37) Because of the specific risks which can arise from the use of credit default swaps, such transactions require close monitoring by competent authorities. In particular, competent authorities should, in exceptional cases, have the power to require information from natural or legal persons entering into such transactions about the purpose for which the transaction is entered into.

(38) ESMA should be given power to conduct an inquiry into an issue or practice relating to short selling or the use of credit default swaps to assess whether that issue or practice poses any potential threat to financial stability or to market confidence. ESMA should publish a report setting out its findings where it conducts such an inquiry.

(39) As some of the provisions of this Regulation apply to natural or legal persons and actions in third countries, it is necessary that competent authorities and supervisory authorities in third countries cooperate in certain situations. Competent authorities should therefore enter into arrangements with supervisory authorities in third countries. ESMA should coordinate the development of such cooperation arrangements and the exchange between competent authorities of information received from third countries.

(40) This Regulation respects the fundamental rights and observes the principles recognised in particular in the Treaty on the Functioning of the European Union (TFEU) and in the Charter of Fundamental Rights of the European Union (Charter), in particular the right to the protection of personal data provided for in Article 16 TFEU and in Article 8 of the Charter. Transparency regarding significant net short positions, including public disclosure above a certain threshold, where provided for under this Regulation, is necessary for reasons of financial market stability and investor protection. Such transparency will enable regulators to monitor the use of short selling in connection with abusive strategies and the implications of short selling on the proper functioning of the markets. In addition, such transparency could help reduce information asymmetries, ensuring that all market participants are adequately informed about the extent to which

short selling is affecting prices. Any exchange or transmission of information by competent authorities should take place in accordance with the rules on the transfer of personal data as laid down in Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data[(7)]. Any exchange or transmission of information by ESMA should take place in accordance with the rules on the transfer of personal data as laid down in Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data[(8)], which should be fully applicable to the processing of personal data for the purposes of this Regulation.

(41) Taking into consideration the principles set out in the Commission's Communication on reinforcing sanctioning regimes in the financial services sector and legal acts of the Union adopted as a follow-up to that Communication, Member States should lay down rules on penalties and administrative measures applicable to infringements of the provisions of this Regulation and should ensure that they are implemented. Those penalties and administrative measures should be effective, proportionate and dissuasive. They should be based on guidelines adopted by ESMA to promote convergence and cross-sector consistency of penalty regimes in the financial sector.

(42) In order to ensure uniform conditions for the implementation of this Regulation, implementing powers should be conferred on the Commission. Those powers should be exercised in accordance with Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers[(9)]. The Commission should keep the European Parliament informed of progress relating to decisions determining the equivalence of third-country legal and supervisory frameworks with requirements of this Regulation.

(43) The power to adopt acts in accordance with Article 290 TFEU should be delegated to the Commission in respect of details concerning calculating short positions, where a natural or legal person has an uncovered position in a credit default swap, notification or disclosure thresholds and further specification of criteria and factors for determining in which cases an adverse event or development creates a serious threat to financial stability or to market confidence in a Member State or the Union. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at the level of experts of the relevant institutions, authorities and agencies, where appropriate. The Commission, when preparing and drawing up delegated acts, should ensure a simultaneous, timely and appropriate transmission of relevant documents to the European Parliament and to the Council.

(44) The Commission should submit a report to the European Parliament and the Council assessing the appropriateness of the notification and public disclosure thresholds provided for, the operation of the restrictions and requirements relating to the transparency of net short positions, and whether any other restrictions or conditions on short selling or credit default swaps are appropriate.

(45) Since the objectives of this Regulation cannot be sufficiently achieved by the Member States, although competent authorities are better placed to monitor, and have better knowledge of, market developments, the overall impact of the problems relating to short selling and credit default swaps can be fully perceived only in a Union context, and can therefore be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives.

(46) Since some Member States have already put in place restrictions on short selling and since this Regulation provides for delegated acts and binding technical standards which should be adopted before it can be usefully applied, it is necessary to provide for a sufficient period of time for transitional purposes. Since it is essential to specify, before 1 November 2012, key non-essential elements which will facilitate compliance by market participants with this Regulation and enforcement by competent authorities, it is also necessary to provide the Commission with the means to adopt the technical standards and delegated acts before that date,

HAVE ADOPTED THIS REGULATION:

(**1**) OJ C 91, 23.3.2011, p. 1.

(**2**) OJ C 84, 17.3.2011, p. 34.

(**3**) Position of the European Parliament of 15 November 2011 (not yet published in the Official Journal) and decision of the Council of 21 February 2012.

(**4**) OJ L 331, 15.12.2010, p. 84.

(**5**) OJ L 145, 30.4.2004, p. 1.

(**6**) OJ L 331, 15.12.2010, p. 1.

(**7**) OJ L 281, 23.11.1995, p. 31.

(**8**) OJ L 8, 12.1.2001, p. 1.

(**9**) OJ L 55, 28.2.2011, p. 13.

Status:
Point in time view as at 14/03/2012.

Changes to legislation:
There are outstanding changes not yet made to Regulation (EU) No 236/2012 of the European Parliament and of the Council. Any changes that have already been made to the legislation appear in the content and are referenced with annotations.