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**COUNCIL OF
THE EUROPEAN UNION**

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PRESSE 54

Regulation adopted on short selling and credit default swaps

The Council today[1] adopted a regulation on short selling and certain aspects of credit default swaps which introduces common EU transparency requirements and harmonises the powers that regulators may use in exceptional situations where there is a serious threat to financial stability (*docs 6216/12* + *6216/12 ADD 1 REV 1* + *PE-CONS 68/11*).

Adoption of the regulation follows agreement reached with the European Parliament in first reading on 18 October 2011, and subsequent approval by the Permanent Representatives Committee on 10 November 2011.

At the height of the financial crisis in 2008, several member states adopted emergency measures to restrict or ban short selling in some or all securities in order to counter a downward spiral in the prices of shares that could create systemic risks.

As the EU lacks a common regulatory framework for dealing with short selling, member states adopted divergent measures. The current fragmented approach limits the effectiveness of the adopted measures and results in regulatory arbitrage[2]. It may also create confusion in the markets and impose additional costs on market participants.

The regulation is intended to address these issues, whilst acknowleging the role of short selling in ensuring the proper functioning of financial markets, in particular in providing liquidity and contributing to efficient pricing.

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[1] The decision was taken without discussion at a meeting of the Economic and Financial Affairs Council. The United Kingdom abstained.

[2] i.e. where investors exploit differences between regulatory systems.

P R E S S

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The regulation covers all types of financial instruments but provides for a response proportionate to the potential risks posed by the short selling of different instruments. In particular, for shares of companies listed in the EU, it creates a two-tier model for the disclosure of significant net short positions: While at a lower threshold, notification of a position must be made privately to the regulator, at a higher threshold, positions must be disclosed to the market.

For sovereign debt, on the other hand, significant net short positions relating to issuers in the EU would always require private disclosure to regulators. The proposed regime also provides for notification of significant positions in credit default swaps that relate to EU sovereign debt issuers.

To tackle the increased risks posed by uncovered short sales[1], the proposal requires that 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 made other arrangements to ensure they can be borrowed in time to settle the deal.

However, these restrictions don't apply to the short selling of sovereign debt if the transaction serves to hedge a long position in debt instruments of an issuer. Moreover, if the liquidity of sovereign debt falls below a specified threshold, the restrictions on uncovered short selling may be temporarily suspended by the competent authority.

In exceptional situations that threaten financial stability or market confidence in a member state or the EU, the regulation provides that competent authorities should have temporary powers to require greater transparency or to impose restrictions on short selling and credit default swap transactions or to limit individuals from entering into derivative transactions.

In such a situation, the European Securities Market Authority (ESMA) is given a key co-ordination role, to ensure consistency between competent authorities and to guarantee that such measures are only taken where they are necessary and proportionate. ESMA is also given the power to take measures where the situation has cross-border implications.

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[1] "Uncovered" or "naked" short selling is a practice where the seller has not made arrangements to borrow the security.