

# FINANCIAL SERVICES ACT 2010

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS AND SCHEDULES

#### *Short selling*

#### *Section 8: Power of FSA to prohibit, or require disclosure of, short selling*

114. This section inserts a new Part 8A into FSMA, consisting of ten new sections (sections 131B to 131K). These sections provide the FSA with a new power to prohibit, or require disclosure of, short selling.

#### **New section 131B: short selling rules**

115. *Subsection (1)* provides that the FSA may make rules banning short selling in relation to certain financial instruments by prohibiting persons from engaging in this practice. These rules would apply to all persons, whether authorised by the FSA or not. These powers would not enable the FSA to ban a single firm from short selling a particular financial instrument while permitting other firms to do so.
116. *Subsection (2)* provides that the FSA may make rules requiring the disclosure of information relating to short selling in relation to specified financial instruments. This disclosure regime would apply to all persons, whether authorised by the FSA or not, who have engaged in short selling.
117. *Subsection (3)* sets out some of the provisions that may be included by the FSA in rules establishing a disclosure regime for short selling, in particular, when disclosures are to be made and the way in which disclosures are to be made.
118. *Subsection (4)* ensures that the FSA is able to obtain information about short selling which has taken place before the rules are made where the person concerned still has a short position when the rules are made. This will occur, for example, when the short seller (S) has sold financial instruments which S did not own, and has not at the time the rules are made purchased the instruments concerned in order to deliver them to the buyer or return them to the lender (if the sale was settled with borrowed instruments), and so closed out the short position or otherwise reduced their short position to a level below the disclosure threshold specified by the FSA.
119. *Subsection (5)* ensures that, where there is any doubt, what is meant by “a short position being open” will be determined in accordance with the FSA’s short selling rules.
120. *Subsection (6)* makes it clear that rules under this section may apply in relation to short selling taking place wholly outside the UK by persons outside the UK, but only in relation to financial instruments admitted to trading on markets in the UK. FSA rules may also apply to short selling:
- by any person in the UK (including persons temporarily in the UK), or
  - through an intermediary present in the UK, or

*These notes refer to the Financial Services Act 2010  
(c.28) which received Royal Assent on 8 April 2010*

- in relation to shares admitted to trading in the UK (even if dual or multi-listed elsewhere in the world).
121. *Subsection (7)* allows the short selling rules described in this Part to be targeted at a particular form of financial instrument issued by a specified company.
122. *Subsection (8)* provides that rules made under section 131B are referred to as “short selling rules”.
123. *Subsection (9)* requires the FSA to take account of any international agreement on short selling measures when it makes any rules in relation to short selling.

**New section 131C: Short selling rules: definitions etc**

124. This section defines the terms used in section 131B.
125. *Subsection (2)* defines short selling for the purposes of the short selling rules. Short selling will include any case in which a person sells a financial instrument which that person does not own, and will make a profit if the price of that instrument falls before the person has to buy the instrument to deliver it to the buyer or to return to the lender (where the sale was settled with borrowed financial instruments). It will also include any case in which a person enters into a transaction in a different financial instrument to the shorted instrument (whether the first-mentioned financial instrument was in existence before the transaction, or was created as a result of the transaction), where the effect of the transaction entered into is that that person will make a profit if there is a fall in value in the shorted instrument. For example, S may buy an equity put option giving S the right to sell 1,000 shares in ABC plc for £10 a share. If the price of the shares falls to £5, S will be able to buy 1,000 shares in the market for £5,000, exercise the option and sell the same shares for £10,000, making a profit of gross £5,000. Alternatively, S may enter into a contract for difference (“CFD”) which provides that S will pay to B the difference between the current value of a financial instrument and its value at the date on which the contract for difference matures if the price increases (if the price falls, B pays the difference to S). The transaction will create a financial instrument (the CFD) and S will have engaged in short selling the financial instrument to which the CFD relates because he will make a profit if the value of the financial instrument falls before that date.
126. *Subsections (3) and (4)* define “financial instrument” and “relevant financial instrument”. *Subsections (5) and (6)* contain supplementary definitions. The definition of “relevant financial instrument” ensures that the FSA may make rules regulating short selling in relation to financial instruments admitted to trading in EEA markets, or which have any other connection to EEA markets which may be specified in the rules, as well as financial instruments admitted to trading in the UK.
127. *Subsection (7)* ensures that where a financial instrument is admitted to trading both on a UK or EEA market and markets elsewhere in the world the FSA may make short selling rules in relation to that instrument on any or all of the markets on which it is admitted to trading. Under *subsection (8)* the same applies where related financial instruments are admitted respectively to trading on an EEA market and a market elsewhere in the world. An instrument will be related for these purposes if the price or value of one instrument depends on the price or value of the other, as would be the case in relation to an equity share and a depositary receipt issued in relation to that share.
128. *Subsection (9)* defines “regulated market”. *Subsection (10)* clarifies the meaning of references to a “market” in a particular territory.

**New section 131D: Short selling rules: procedure in urgent cases**

129. New section 131D provides for the procedure to be followed by the FSA where the FSA is making urgent restrictions on engaging in short selling.

130. *Subsection (1)* gives the FSA the power to make short selling rules, and subsequently to amend those rules, without going through the normal consultation process, where it is necessary to do so to protect the stability of the financial system, or to maintain confidence in the financial system.
131. *Subsection (2)* provides that initially these emergency short selling rules may last for no more than three months. However, under *subsections (3) and (4)* the FSA is given power to extend these rules for a further three months provided that it still considers them to be necessary to protect the stability of the financial system or to maintain confidence in the financial system at the time when the direction is given. Under *subsection (5)*, this direction must be published.
132. *Subsection (6)* provides that nothing prevents the FSA from revoking emergency rules before the end of the periods referred to in subsections (2) or (3).

#### **New section 131E: Power to require information**

133. This section gives the FSA a power to require the production of information or documents in order to ascertain whether there has been a breach of any short selling rules.
134. *Subsection (1)* gives the FSA the power to require information or documents to be produced. This applies whether or not the person concerned is an “authorised person” under FSMA. *Subsection (2)* sets out the scope of this power – the FSA may only impose such a requirement on a person if the information or documents are required in order to enable the FSA to determine whether that person or any person connected to that person, has breached any provision of the short selling rules.
135. *Subsections (3) to (5)* allow the FSA to specify the time and form in which the information must be provided. They may also require the person providing the information to take reasonable steps specified by the FSA to verify the information provided. *Subsection (7)* defines what is meant by a “connected person” for the purpose of this section.

#### **New section 131F: Power to require information: supplementary**

136. This section contains provisions corresponding to the provisions of section 175 of FSMA.
137. *Subsection (1)* enables the FSA to compel the production of a document by a person who is holding a document on behalf of another person if they would have the power to compel the latter to produce the document under new section 131E. Under *subsection (2)* a document, once obtained under new section 131E, may be copied or have extracts taken from it, and the person producing the document, or any other relevant person, may be required to explain it. *Subsection (3)* defines “relevant person” for these purposes.
138. Under *subsection (4)*, if any person required to produce a document fails to do so, they may be compelled to state where, to the best of their knowledge, the document is. Under *subsection (5)* lawyers may be compelled to provide the name and address of their clients.
139. Under *subsection (6)* documents subject to banking confidentiality may be withheld unless the person holding the information, or the person to whom the duty of confidence is owed, is the person under investigation or a related company, or the person to whom the duty is owed consents to its disclosure. *Subsection (7)* provides that the production of a document does not affect any lien a third party may have over it.

**New section 131G: Power to impose penalty or issue censure**

140. *Subsections (1) to (3)* set out the penalty for contravention of the short selling rules, or failure to comply with an information requirement imposed under new section 131E, or new section 131F. The FSA may impose an unlimited fine on any person, whether or not that person is an authorised person, if it is satisfied that the person has contravened any part of the short selling rules or an information requirement. The FSA may alternatively decide not to impose a fine, but to publish a statement of censure instead.
141. *Subsections (4) to (6)* impose a three-year time limit on the FSA's ability to take such enforcement action against a person, unless, before the end of the three-year period, the FSA has given a warning notice to the person concerned under section 131H. The three-year period within which the FSA can act begins with the first day that the FSA knew that a person contravened any provision of the short selling rules or the information requirement.

**New section 131H: Procedure and right to refer to Tribunal**

142. *Subsections (1) to (3)* provide that a person must be given a warning notice detailing the amount of the fine or the terms of the public censure (as applicable) if the FSA proposes to take action against them.
143. *Subsections (4) to (6)* provide that a person must be given a decision notice detailing the amount of the fine or the terms of the public censure (as applicable) if the FSA decides to take action against them.
144. *Subsection (7)* provides that a person may refer the matter to the Tribunal if the FSA decides to take action against them.

**New section 131I: Duty on publication of statement**

145. This section requires the FSA to send a copy of any public censure to the person concerned and to any other person who was given a copy of the decision notice.

**New section 131J: Imposition of penalties under section 131G: statement of policy**

146. This section requires the FSA to issue a statement of its policy in relation to the imposition and amount of penalties. The policy set out in the statement must take account of the factors set out in *subsection (2)*.
147. Under *subsection (3)* the FSA is given power to alter or replace the statement of policy. If it does so, it must, under *subsection (4)*, issue the revised statement.
148. *Subsections (5) and (6)* require the FSA to give the Treasury a copy of any statement of policy it publishes, and to publish the statement so as to ensure that it is brought to public attention.
149. *Subsection (7)* enables the FSA to charge a fee for providing a copy of the statement of policy.
150. *Subsection (8)* requires the FSA to have regard to the statement in force at the time of the misconduct when imposing penalties under new section 131G.

**New section 131K: Statement of policy: procedure**

151. This section sets out the procedure for issuing a statement under new section 131J. Before deciding on its policies, or changing those policies, the FSA will be required to consult the public on its proposals.