

**EXPLANATORY MEMORANDUM TO**  
**THE FINANCIAL SERVICES AND MARKETS ACT 2000 (SHORT SELLING)**  
**REGULATIONS 2012**

**2012 No. 2554**

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. **Purpose of the instrument**

2.1 These Regulations implement in part 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 (“the short selling regulation”) principally by making amendments to the Financial Services and Markets Act 2000 (c.8) (“the 2000 Act”). These Regulations repeal provisions in domestic law which are inconsistent with the short selling regulation or no longer required, and ensure that the short selling regulation is fully effective and enforceable in the United Kingdom.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None

4. **Legislative Context**

4.1 These Regulations implement in part the short selling regulation, which requires notification of certain short positions and positions in sovereign credit default swaps, contains measures in relation to short selling and gives enforcement powers to national competent authorities and the European Securities and Markets Authority.

4.2 The Regulations amend the 2000 Act to repeal provisions which are inconsistent with the short selling regulation or no longer required. Rules made by the Financial Services Authority (“FSA”) under repealed sections are also to be revoked. To ensure that the short selling regulation is effective in the UK, other amendments to the 2000 Act provide for the enforcement of the regulation and for sanctions. The Regulations make minor amendments to the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (S.I. 2001/2188) to give effect to restrictions in the short selling regulation on disclosure of information to competent authorities of non-EEA states. The Regulations also designate the FSA as the competent authority and include provision about making applications to and notifying the FSA.

4.3 Explanatory Memorandum 13840/10 relating to the short selling regulation was sent to both scrutiny committees on 22 September 2010. Following a debate on 5 April 2011 in the European Scrutiny Committee, the Committee cleared scrutiny for the Commons on 6 April 2011. The Lords EU Economic and Financial Affairs and International Trade Sub-Committee decided to hold the Explanatory Memorandum under scrutiny in conjunction with its Call for Evidence on the Commission's proposal, which was launched on 21 November 2010, and to request updates on negotiations. It was cleared by the House of Lords on 8 November 2011.

## **5. Territorial Extent and Application**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

The Financial Secretary to the Treasury, Greg Clark MP, has made the following statement regarding Human Rights:

*In my view the provisions of the Financial Services and Markets Act 2000 (Short Selling) Regulations 2012 are compatible with the Convention rights.*

## **7. Policy background**

### ***What is being done and why***

7.1 In September 2010 the European Commission adopted a proposal for a "Regulation on short selling and certain aspects of credit default swaps". The objectives of the short selling regulation were to lay down a common regulatory framework for the requirements and powers relating to short selling<sup>1</sup> and credit default swaps (CDS<sup>2</sup>), and to ensure a more coordinated and consistent approach by Member States when measures need to be taken in exceptional situations.

7.2 The UK already has in place a short selling regime. The 2000 Act gives the FSA power to make short selling rules. The Regulations repeal sections of the 2000 Act which gave the FSA the power to make short selling rules; this is because this power is superseded by the short selling regulation and is inconsistent with it. The FSA is designated to be the UK's competent authority for purposes of the short selling regulation.

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<sup>1</sup> Short selling is the practice where an investor sells an asset that they do not own, with the intention of buying identical assets back at a later date.

<sup>2</sup> Credit default swaps are derivative contracts which act as insurance or a hedge against an issuer's debt in case of a credit event (e.g. a default or debt restructuring).

7.3 The short selling regulation requires competent authorities to have all the supervisory and investigatory powers necessary for the exercise of their functions, one of which is the power to carry out on-site inspections with or without prior announcement. The Regulations amend the 2000 Act to give the FSA power to require information and documents for its functions as a competent authority. Provisions are also made for on-site inspections by means of compulsory power of entry under warrant if an FSA authorised person has failed to comply with an information requirement. The Regulations also allow the FSA to appoint an investigator to carry out investigations in relation to suspected or actual contraventions of the short selling regulation, and to apply for a court injunction in the event of an actual or likely break of the short selling regulation. These are all to ensure the effectiveness of the short selling regulation, and healthy functioning of the financial system at large.

7.4 The UK is obliged under the short selling regulation to ensure there are effective, proportionate and dissuasive penalties in place. The Regulations establish power for the FSA to impose penalties for infringement of the short selling regulation, which are effective, proportionate and dissuasive. The FSA also has the power to publish a statement censuring a person in relation to breaches of the short selling regulation. There are criminal penalties for failure to comply with information requirements. This ensures the FSA's powers it currently has for breaches of information requirements connected with suspected contraventions of the existing domestic short selling rules apply to the short selling regulation.

7.5 These changes largely maintain the same enforcements available to the FSA from the 2000 Act. Minimal changes are being made in replacing the existing regime and implementing the short selling regulation.

7.6 The short selling regulation sets out a number of actions that can be taken where a competent authority receives a request from a competent authority of another Member State to carry out an on-site inspection or an investigation. The Regulations make provision for the FSA to cooperate with the competent authority of another Member State, or the European Securities and Markets Authority (ESMA), where they require assistance for inspections or investigations. This will result in a more harmonised regime across the EU and greater predictability for market participants; it will also reduce potential regulatory arbitrage between Member States.

7.7 The Regulations are implementing an EU measure. There is no significant public interest in the policy, nor media interest. The change is not deemed to be politically or legally important.

### ***Consolidation***

7.8 These Regulations make amendments to domestic legislation to implement in part the short selling regulation. Since the amendments are limited in scope, consolidation of the secondary legislation is not merited. The 2000 Act is due to be amended extensively by forthcoming primary legislation.

## **8. Consultation outcome**

8.1 The Treasury did not formally consult on the implementation of the short selling regulation, as the enforcement powers of the FSA (as a competent authority) are largely similar to its powers in relation to the existing regime, which are familiar to market participants. However, due to the nature of the short selling regulation, the existing regime will be repealed by the Regulations.

## **9. Guidance**

9.1 The Treasury does not propose to produce any guidance in relation to the Regulations. ESMA are due to consult on Guidelines for Market Maker Exemptions in mid-September in order to publish these Guidelines in November. It is not anticipated that these Guidelines will be in place prior to Regulations coming into force; therefore the FSA will be providing information on how firms can notify that they are intending to use exemptions in the short selling regulation in mid-September.

## **10. Impact**

10.1 There will be some impact on businesses; however the UK already has in place a short selling regime, which is familiar to market participants. This will help to ease the transition to the new changes which are being made, with some of the changes being incremental over an existing regime, so the marginal costs should be smaller.

10.2 The impact on charities and voluntary bodies is negligible.

10.3 The impact on the public sector is negligible.

10.4 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the OPSI website.

## **11. Regulating small business**

11.1 The legislation applies to small business.

11.2 There is no provision to minimise the impact of the requirements on small firms employing up to 20 people. The short selling regulation does not provide any basis for excluding small or micro businesses from regulation. It is also undesirable to exempt smaller firms from the short selling regulation as this would hinder its effectiveness, and run the risk of regulatory arbitrage based on firm size.

11.3 There was no formal consultation of market participants, other than informal consultation throughout negotiations with market participants on the European Commission's proposals, including a number of round table meetings, as well as the European Commission's public consultation which informed the short selling regulation proposal. Therefore, the Treasury did not formally consult with small firms on possible exemptions for small businesses, as these were not considered as part of the implementation. Such an exemption would not be possible due to the direct applicability of the Short Selling Regulations.

## **12. Monitoring & review**

12.1 The Treasury is required to review the operation and effect of the Regulations within a five year period after the Regulations come into force and within every five years after that.

12.2 Under Article 45 of the short selling regulation the Commission is required to review certain provisions of the regulation and report to the European Parliament and Council by 30 June 2013.

## **13. Contact**

Neeraj Patel at the HM Treasury, telephone: 020 7270 2718 or email: [neeraj.patel@hmtreasury.gsi.gov.uk](mailto:neeraj.patel@hmtreasury.gsi.gov.uk) can answer any queries regarding the instrument.

The Financial Services and Markets Act 2000 (Short Selling) Regulations 2012 : provisions implementing 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

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Abbreviations

"DCI" is the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001 (SI 2001/2188)

"FSMA" is the Financial Services and Markets Act 2000

"SSR" is the Financial Services and Markets Act 2000 (Short Selling) Regulations 2012

Article	Full text of the provision	Relevant domestic provision
17.5	The exemption referred to in paragraph 1 shall apply only where the natural or legal person concerned has notified the competent authority of its home Member State in writing that it intends to make use of the exemption. The notification shall be made not less than 30 calendar days before the natural or legal person first intends to use the exemption.	Regulation 6 of the SSR
17.6	The exemption referred to in paragraph 3 shall apply only where the authorised primary dealer has notified the relevant competent authority in relation to the sovereign debt concerned in writing that it intends to make use of the exemption. The notification shall be made not less than 30 calendar days before the natural or legal person acting as authorised primary dealer first intends to use the exemption.	Regulation 6 of the SSR
17.9	A natural or legal person who has given a notification under paragraph 5 shall as soon as possible notify in writing the competent authority of its home Member State where there are any changes affecting that person's eligibility to use the exemption, or if it no longer wishes to use the exemption.	Regulation 6 of the SSR
17.10	A natural or legal person who has given a notification under paragraph 6 shall as soon as possible notify in writing the relevant competent authority in relation to sovereign debt concerned where there are any changes affecting that person's eligibility to use the exemption, or if it no longer wishes to use the exemption.	Regulation 6 of the SSR
18.1	Subject to Article 22, a competent authority 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 or to disclose to the public details of the position where the position reaches or falls below a notification threshold fixed by the competent authority and where: (a) there are adverse events or developments which constitute a serious threat to financial stability or to market	Regulation 6 of the SSR

	confidence in the Member State concerned or in one or more other Member States; and (b) the measure is necessary to address the threat and will not have a detrimental effect on the efficiency of financial markets which is disproportionate to its benefits.	
19.2	A competent authority may require natural or legal persons engaged in the lending of a specific financial instrument or class of financial instruments to notify any significant change in the fees requested for such lending.	Regulation 6 of the SSR
32	Each Member State shall designate one or more of the competent authorities for the purpose of this Regulation. Where a Member State designates more than one competent authority, it shall clearly determine their respective roles and it shall designate the authority to be responsible for coordinating the cooperation and the exchange of information with the Commission, ESMA and the competent authorities of the other Member States. Member States shall inform the Commission, ESMA and the competent authorities of the other Member States of those designations.	Regulation 4 of the SSR
33.1	In order to fulfil their duties under this Regulation, the competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions. They shall exercise their powers in any of the following ways: (a) directly; (b) in collaboration with other authorities; (c) by application to the competent judicial authorities.	See under article 33.2
33.2	In order to fulfil their duties under this Regulation, the competent authorities shall, in accordance with national law, have the power:	
(a)	to gain access to any document in any form and to receive or take a copy thereof;	Sections 131E and 131F of FSMA as amended by regulation 2(3) and (4) of the SSR; Section 168 of FSMA as amended by regulation 2(11) of the SSR; Sections 170 to 172 and 174 to 175 of FSMA.
(b)	to require information from any natural or legal person and if necessary to summon and question a natural or legal person with a view to obtaining information;	Sections 131E and 131F of FSMA as amended by regulation 2(3) and (4) of the SSR; Section 168 of FSMA as amended by regulation 2(11) of the SSR; Sections 170 to 172 and 174 to 175 of FSMA.

(c)	to carry out on-site inspections with or without prior announcement;	Sections 131FB and 131FC of FSMA inserted by regulation 2(5) of the SSR; section 176 of FSMA.
(d)	to require existing telephone and existing data traffic records;	Section 172 of FSMA; Regulation of Investigatory Powers Act 2000.
(e)	to require the cessation of any practice that is contrary to the provisions in this Regulation;	Section 380 of FSMA as amended by regulation 2(12) of the SSR.
(f)	to require the freezing and/or the sequestration of assets.	Sections 380 and 382 of FSMA as amended by regulation 2(12) and (13) of the SSR; Orders 45 and 46 of the Rules of the Supreme Court.
33.3	The competent authorities shall, without prejudice to points (a) and (b) of paragraph 2, have the power in individual cases to require a natural or legal person entering into a credit default swap transaction to provide: (a) an explanation about the purpose of the transaction and whether it is for the purposes of hedging against a risk or otherwise; and (b) information verifying the underlying risk where the transaction is for hedging purposes.	Sections 131E and 131F of FSMA as amended by regulation 2(3) and (4) of the SSR.
37.1	The competent authority of one Member State may request assistance from the competent authority of another Member State with regard to on-site inspections or investigations.  The requesting competent authority shall inform ESMA of any request referred to in the first subparagraph. In case of an investigation or an inspection with cross-border effects, ESMA may and if requested shall coordinate the investigation or inspection.	Section 131E(5A) and (5B) of FSMA inserted by regulation 2(3) of the SSR; Section 131FA of FSMA inserted by regulation 2(5) of the SSR; Section 131FB(10) and (11) of FSMA inserted by regulation 2(5) of the SSR; Section 354 of FSMA.
37.2	Where a competent authority receives a request from a competent authority of another Member State to carry out an on-site inspection or an investigation, it may: (a) carry out the on-site inspection or investigation itself; (b) allow the competent authority which submitted the request to participate in an on-site inspection or investigation; (c) allow the competent authority which submitted the request to carry out the on-site inspection or investigation itself;	Section 131E(5A) and (5B) of FSMA inserted by regulation 2(3) of the SSR; Section 131FA of FSMA inserted by regulation 2(5) of the SSR; Sections 131FB and 131FC of FSMA inserted by regulation 2(5) of the



	<p>(d) appoint auditors or experts to carry out the on-site inspection or investigation;</p> <p>(e) share specific tasks relating to supervisory activities with the other competent authorities.</p>	<p>SSR;</p> <p>Section 168 of FSMA as amended by regulation 2(11) of the SSR;</p> <p>Sections 170 to 172 and 174 to 175 of FSMA;</p> <p>Section 176 of FSMA;</p> <p>Section 354 of FSMA.</p>
37.3	ESMA may request the competent authorities to carry out specific investigatory tasks and on-site inspections where information is reasonably required by ESMA to enable it to exercise a power expressly conferred on it by this Regulation.	Section 131E(5A) and (5B) of FSMA inserted by regulation 2(3) of the SSR.
38.1	<p>The competent authorities shall, where possible, conclude cooperation arrangements with supervisory authorities of third countries concerning the exchange of information with supervisory authorities of third countries, the enforcement of obligations arising under this Regulation in third countries and the taking of similar measures in third countries by their supervisory authorities to complement measures taken under Chapter V. These cooperation arrangements shall ensure at least an efficient exchange of information that allows the competent authorities to carry out their duties under this Regulation.</p> <p>A competent authority shall inform ESMA and the competent authorities of the other Member States where it proposes to enter into such an arrangement.</p>	Regulation 12 of the DCI as amended by regulation 5 of the SSR.
40	<p>A competent authority may transfer to a supervisory authority of a third country data and the analysis of data where the conditions laid down in Article 25 or 26 of Directive 95/46/EC are fulfilled but such transfer shall be made only on a case-by-case basis. The competent authority shall be satisfied that the transfer is necessary for the purposes of this Regulation. Any such transfer shall be made under agreement that the third country shall not transfer the data to the supervisory authority of another third country without the express written authorisation of the competent authority.</p> <p>A competent authority shall disclose information which is confidential pursuant to Article 34 and which is received from a competent authority of another Member State to a supervisory authority of a third country only where the competent authority has obtained the express agreement of the competent authority which transmitted the information and, where applicable, the information is disclosed solely for the purposes for which that competent authority gave its agreement.</p>	Regulation 12 of the DCI as amended by regulation 5 of the SSR.
41	Member States shall establish rules on penalties and administrative measures, applicable to infringements of this Regulation and shall take all measures necessary to ensure that they are implemented. Those penalties and administrative measures shall be effective, proportionate	<p>Sections 131G to 131K of FSMA as amended by regulation 2(7) of the SSR;</p> <p>section 131L of FSMA</p>

	and dissuasive.	inserted by regulation 2(8) of the SSR; section 177 of FSMA; section 398 of FSMA as amended by regulation 2(14) of the SSR.
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