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New European Rules on short selling and credit default swaps

The European Parliament and Council have finally approved the common rules on short selling and credit default swaps: Regulation (EU) No 236/2012 of the European Parliament and of the Council of March 14th, 2012.

The Regulation, now approved, harmonises information and public disclosure duties on short positions throughout the EU, sets forth restrictions to uncovered short selling and creates broad powers for the European Securities and Markets Authority (ESMA) to impose additional restrictions on short selling in case of emergency situations.

The new framework further includes specific provisions applicable to the short selling of sovereign debt. Worthy of note is the ban on uncovered credit default swaps relating to EU sovereign debt, although Member States are able to suspend such a ban in their respective jurisdictions in given circumstances.

With regard to shares, the Regulation introduces a requirement to make a notification to the competent authorities in the relevant Member State of net short positions above 0.2 percent of the issued share capital of an issuer, and subsequent notifications at each 0.1 percent increment, as well as public disclosure when such a position reaches 0.5 percent, and subsequent disclosure at each further 0.1 percent increment. Notification relating to short positions in sovereign debt need only be made to the regulators and not to the public.

It should be noted that the Regulation excludes from the definition of 'short sales' the transfer of securities under a repo agreement, loan agreement or futures contract or other derivative contract where it is agreed to sell securities at a specified price at a future date.

Probably as a result of the influence exercised by Member States concerned with assuring liquidity in their respective sovereign debt markets, the restrictions for short sales of sovereign debt are more relaxed than the ones applicable to shares. Within the scope of short sales of sovereign debt, it is enough that the seller has a reasonable expectation that settlement can be effected when it is due.

Certain exemptions are provided for in the Regulation for market makers and in relation to issuers where the principal market for the shares is located outside the EU.



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The Regulation's legal form, giving direct effect to this new framework, gives the Member States' competent authorities and the European Securities and Markets Authority (ESMA) the powers required to intervene in the markets in crisis situations.

In particular, ESMA has the power to coordinate the measures taken by the competent authorities, or to take measures itself in exceptional emergency situations, by demanding notification or public disclosure or by imposing additional restrictions on certain transactions whenever such measures are required to ensure financial stability in the EU, where the case has cross border implications and where no competent authority has taken sufficient measures to overcome the emergency situation.

The Regulation comes into force on November 1st, 2012. Uncovered sovereign credit default swap transactions concluded before March 25th, 2012 may be held until the maturity date of the contract.

Short selling restrictions and/or notification requirements brought in by the Member States as a response to the financial crisis and that were in force prior to September 15th, 2010, and which are still in place, may remain applicable until July 1st, 2013, provided that they were notified to the EU Commission by April 24th, 2012.

Member State measures put in place after September, 15th, 2010 will lapse on November 1st, 2012. Portuguese rules on information and disclosure duties of short positions predate September 15th, 2010. However, considering that no information was made public in respect of any notification made to the EU Commission, the provisions of the Regulation on this matter shall be effective in Portugal as of November 1st, 2012.

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