



Three years Short Sell Regulation

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The Netherlands Authority for the Financial Markets

The AFM is committed to promoting fair and transparent financial markets.

As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.

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1. Introduction

The European Union's Regulation on *Short Selling and certain aspects of credit default swaps*¹ (also called 'Short Sell Regulation') came into force on 1 November 2012. With this publication the AFM reflects on three years of transparency in net short positions, processing notifications of net short positions and keeping the register up to date.

1.1 Background and main objectives of the Short Sell Regulation

At the height of the financial crisis in 2008, national competent authorities in several European Union (EU) Member States, including the Netherlands, adopted emergency measures to restrict and/or impose conditions on short selling. They acted due to concerns that at a time of considerable financial instability, short selling may aggravate the downward spiral in the prices of shares. Especially in financial institutions this instability could ultimately threaten their viability and create systematic risks.

Due to the absence of a legislative framework at the European level, a variety of measures have been adopted by the EU Member States. However, a fragmented approach would limit the effectiveness of such measures, lead to regulatory arbitrage and create additional costs and difficulties for investors. Therefore, the European Commission considered it desirable to have a harmonised regime relating to short selling across the European Union.²

The main objectives of the Short Sell Regulation are:

- to increase transparency on short positions held by investors in certain EU securities;
- to ensure EU Member States have clear powers to intervene in exceptional situations to reduce systemic risks and risks to financial stability and market confidence arising from short selling and credit default swaps;
- to facilitate coordination between EU Member States and the European Securities Markets Authority (ESMA) in emergency situations;
- to reduce settlement risks and other risks linked with uncovered or naked short selling; and
- to reduce risks to the stability of sovereign debt markets posed by uncovered (naked) CDS positions, while providing for the temporary suspension of restrictions where sovereign debt markets are not functioning properly.

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:086:0001:0024:en:PDF>

² Proposal for a regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Default Swaps, COM (2010) 482.

2. Key provisions of the Short Sell Regulation

Scope

The Short Sell Regulation applies to natural and legal persons undertaking short selling of shares, sovereign debt, sovereign credit default swaps (CDS) and related instruments that are admitted to trading or traded on an EU trading venue (unless they are primarily traded on a third country venue).

Calculation of a net short position

To calculate whether a natural person or legal person has a net short position, the short positions and long positions of such person must first be examined. This examination must take into account all forms of economic interests that this person has in the issued share capital of an enterprise or the sovereign debt of a Member State or of the EU. This can include the economic interest obtained by the use of derivatives, such as options, futures, contracts for differences and spread bets, but also by the use of indices, baskets of securities, or index funds. The position that remains after any long position has been deducted from any short position is classified as a net short position under the Short Sell Regulation.

Apart from the disclosure of significant net short positions pursuant to the Short Sell Regulation, significant gross short positions (equal to or exceeding 3% of the issued share capital of a listed company) shall have to be notified to the AFM pursuant to articles 5:38 and 5:39 of the Dutch Financial Supervision Act. The gross short position is the short position which is available when the long positions have not been deducted from the short positions.

Disclosure of net short positions

According to the Short Sell Regulation, significant net short positions in shares must be (i) reported to the relevant competent authority when they are at least equal to 0.2% of the company issued share capital and every 0.1% above that and (ii) disclosed to the public when they are at least equal to 0.5% of the company issued share capital and every 0.1% above that. Significant net short positions in sovereign debt should be reported to the relevant competent authority when reaching or crossing one of the thresholds published by ESMA. In the Netherlands, the AFM is the relevant competent authority in terms of the Short Sell Regulation.

Notifications should be made no later than 15.30 local time (in the jurisdiction of the relevant trading venue of the instrument) on the day after the trading day on which the position was reached. All calculations should be made at midnight on the trading day the position was reached.

Restrictions on uncovered short sales

To reduce the risks of settlement failures and increased price volatility that can be associated with naked short selling of shares an investor must meet certain requirements in order to enter into a short sale. Namely, the investor must have borrowed the instruments concerned, entered into an

agreement to borrow them, or have an arrangement with a third party under which that third party has confirmed that the share has been located and has taken measures vis-à-vis third parties necessary for the investor to have reasonable expectation that settlement can be effected when it is due. This is known as the 'locate rule'. A short transaction in a share can thus only be contracted if a reasonable case can be made that the shares sold can actually be delivered.

The same applies for a short transaction in sovereign debt. A transaction related to a credit default swap on sovereign debt can only be contracted if this transaction does not lead to an unhedged position.

Exemptions

The Short Sell Regulation includes an exemption for market makers and primary dealers from the restrictions applying to naked short selling and the transparency requirements regarding net short positions.

Powers of intervention of competent authorities and of ESMA

In case of adverse events or developments which constitute a serious threat to financial stability or to market confidence in a Member State or in case of a significant fall in price of a financial instrument, individual competent authorities have various emergency powers of intervention available to them. These powers *inter alia* include to impose notification or disclosure requirements concerning short positions in financial instruments other than shares, sovereign debt and sovereign credit default swaps and to prohibit or impose conditions on entering into a short sale or equivalent transaction. In exceptional circumstances, ESMA can also decide to intervene directly.

3. Statistics of three years Short Sell Regulation

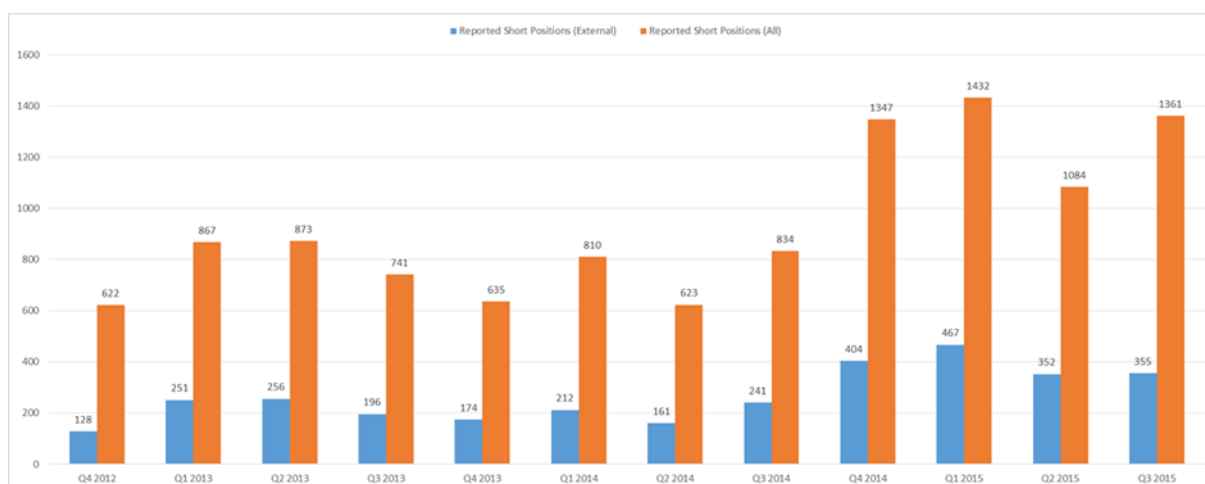
3.1 Trends and developments

The Short Sell Regulation entered into effect on 1 November 2012. In November 2012, the AFM received approximately 130 initial notifications of (existing) net short positions in shares. After such initial notifications, expectations were that the AFM would receive 5 to 10 notifications a day. This turned out not to be the case. On average, the AFM receives 25 notifications a day. Roughly 80% of these notifications are 'private' notifications and 20% are 'public' notifications.

Figures show that the number of notifications of net short positions in shares has increased in the second half of 2014 and in 2015. If a comparison is made between the first half of 2013 and the first half of 2015, the figures show an increase of 1088 notifications. This trend in increasing numbers of notifications has led to the 10,000th notification to occur already in the summer of 2015.

Figure 1, shows the quarterly number of reported net short positions in shares from November 2012 to September 2015.

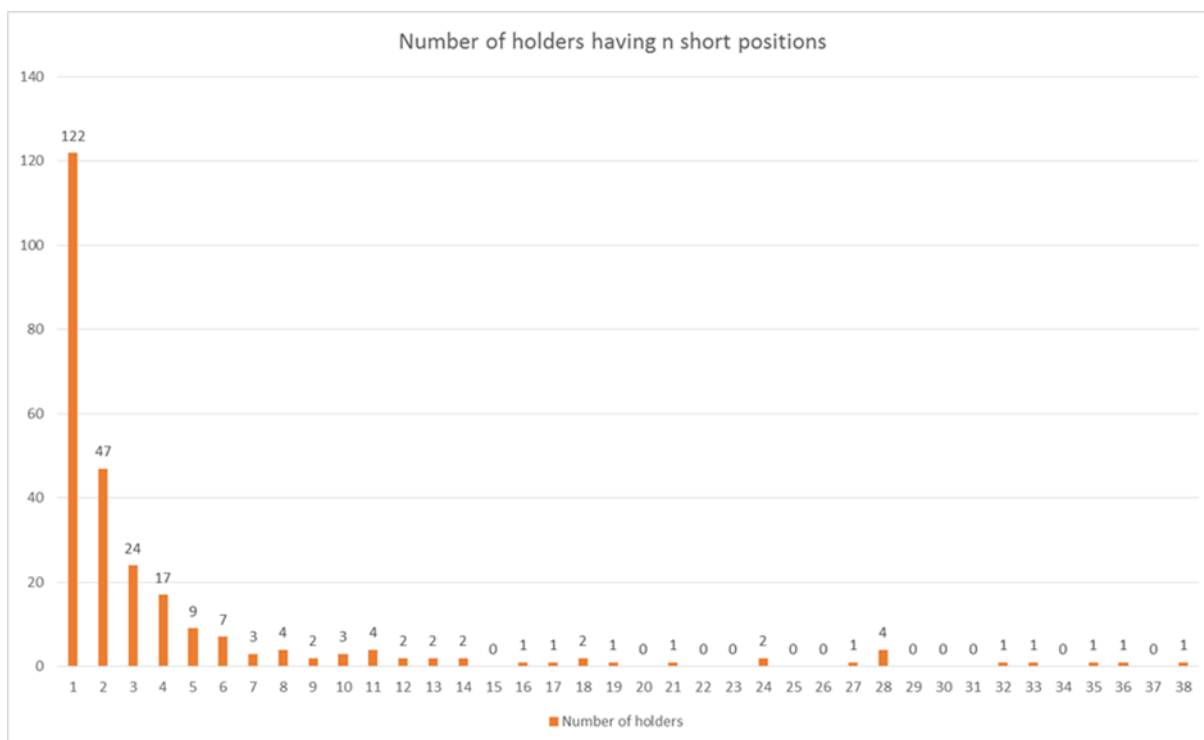
Figure 1.



Since the Short Sell Regulation entered into effect, the highest net short position in shares during a day was equal to 6.27%.

Figure 2, shows the number of short positions held by the reporters of net short positions in shares. Almost half of the 266 reporters (122) have a short position in relation to the issued share capital of only one company. There is one investor that has reported net short positions in relation to the issued share capital of 38 different companies over time. On average, reporters have disclosed net short positions in shares in relation to the issued share capital of 4.27 issuers. Slightly more than 50% of the reporting investors is of US origin.

Figure 2



3.2 The AFM register in relation to net short positions in shares

The AFM’s register in relation to net short positions in shares is being used and consulted by multiple websites, blogs, tweets and newspapers on a daily basis. Since November 2012, the register website has had 192.494 page views. On average, the register (in excel format) is downloaded 80 times per day, with a record of 814 downloads on a single day. This shows the public is interested in the net short positions and it can be concluded that keeping a register contributes to the transparency the Short Sell Regulation aims to achieve.

3.3 Emergency measures

With respect to emergency measures that can be imposed pursuant to the Short Sell Regulation, a distinction should be made between long-term measures (valid for an initial period of not more than three months) and short-term measures (valid for an initial period of one trading day). Since the application of the Short Sell Regulation, several competent authorities have used the powers of intervention, pursuant to which short-term measures and three long-term measures have been imposed. One of these long-term measures, which has initially been imposed on 29 June 2015 and has been renewed several times since, is currently still in place. This long-term measure is valid until 9 November 2015³.

³ Reference is made to ESMA opinions on emergency measures as published on the ESMA website.

4. Notification process and supervision by the AFM

4.1 Notification process

Significant net short positions in financial instruments for which the AFM is the relevant competent authority should be reported by using the applicable notification form that can be found on the AFM website under 'Notification of net short positions'. The completed notification form must be sent to the AFM by email (melden@afm.nl) and by postal mail. The notification form must be received by the AFM not later than at 15.30 (CET) on the day after the trading day on which the position was reached.

The AFM processes the incoming notifications. Net short positions in shares up to 0.5% of the issued share capital will not be disclosed to the public, but will solely be included in the private AFM register. Net short positions in shares equal to or exceeding the 0.5% threshold will be disclosed to the public via the 'Register net short positions' as published on the AFM website⁴. In the event a significant net short position falls below the 0.5% threshold, the notification will continue to be visible in the current notifications section of the register for another business day. The notification will then be moved to the archive section of the register.

When processing the notifications, the AFM performs checks on the completed notification forms. Two of the most common errors in the reported net short positions are rounding errors and the usage of an incorrect issued share capital. The AFM emphasises that for the calculation of a net short position in shares, the issued share capital as published in the 'Register issued capital'⁵ of the AFM should be used. The rounding errors are mostly due to the fact that the position to report should be rounded to the first two decimal places by truncating the other decimal places, as explained by ESMA in the *Questions and Answers*⁶. For example, a net short position of 0.2498% should be reported as 0.24%.

4.2 Supervision of the Short Sell Regulation by the AFM

Since the application of Short Sell Regulation, the AFM has imposed one administrative fine and has issued 26 official warnings in respect of late notifications of net short positions. The decision to impose such an administrative fine has been published on the AFM website on 28 August 2015.

Furthermore, in the course of the supervision of the Short Sell Regulation, the AFM examines whether significant net short positions are disclosed timely and monitors whether market parties comply with the other provisions of the Short Sell Regulation. In light of this examination, the AFM has requested several market parties to provide information in relation to net short positions held by such parties. The information requested by the AFM inter alia relates to the considerations that have led to the short positions and the arrangements made with respect to

⁴ The register net short positions can be found by using the following link: www.afm.nl/registers

⁵ The register issued capital can be found by using the following link: www.afm.nl/register-issued-capital

⁶ The ESMA Questions and Answers can be found by using the following link: www.esma.europa.eu/system/files/2013-159.pdf

the restrictions on uncovered short sales. From the moment of the Short Sell Regulation entering into effect, the AFM has sent nearly 40 information requests.

5. Conclusion

The introduction of the Short Sell Regulation has had a positive impact in terms of greater transparency on the short positions held by investors, given the significant number of notifications made to the AFM and the fact that the 'Register net short positions' is frequently consulted by various parties. Several financial bloggers and tweeters use the information contained in the AFM register on a daily basis. Furthermore, statistics show that the number of notifications of net short positions in shares has increased during the past years. The AFM is of the opinion that the objective of the Short Sell Regulation to increase transparency on short positions held by investors is achieved.

The same applies to the other objectives of the Short Sell Regulation. Since the application of the Short Sell Regulation, several competent authorities have used their powers to intervene in exceptional situations and have thus been able to reduce systemic risks and risks to financial stability and market confidence. Also, the introduction of restrictions on uncovered short sales has, in the view of the AFM, contributed to the reduction of settlement risks.

The AFM aims to contribute to the objectives of the Short Sell Regulation by closely monitoring whether significant net short positions in shares are disclosed on time, and by obtaining information from market parties in order to establish whether the Short Sell Regulation is complied with. In the event a market party has violated the Short Sell Regulation, the AFM will impose an appropriate measure. The AFM will continue to contribute to the objectives of the Short Sell Regulation in its own supervision and will, together with ESMA and other relevant competent authorities, make sure that the Short Sell Regulation remains in line with future (economic) developments.

6. Samenvatting

Op 1 november 2012 is de Short Sell Verordening (Verordening) in werking getreden. De belangrijkste doeleinden van de Verordening zijn te komen tot een grotere transparantie van short posities, Europese bevoegde autoriteiten en ESMA (de Europese toezichthouder) te voorzien van interventiebevoegdheden in exceptionele situaties en de risico's die zijn verbonden aan ongedekte shorttransacties te beperken.

De Verordening verplicht marktpartijen melding te doen van netto short sell aandelenposities in het geplaatste kapitaal van beursvennootschappen vanaf 0,2% (en elke volgende 0,1%) aan de toezichthouder en vanaf 0,5% publiekelijk. Ook netto shortposities in overheidsschulden moeten bij het over- of onderschrijden van bepaalde drempelwaarden gemeld worden, maar worden niet openbaar gemaakt. De meldingsplicht en bepaalde beperkingen daarop zijn niet van toepassing op marketmakers en liquidity providers die transacties verrichten. De Verordening bepaalt daarnaast dat een shorttransactie in een aandeel alleen mag worden aangegaan als men aannemelijk kan maken dat de verkochte aandelen daadwerkelijk geleverd kunnen worden. Ditzelfde geldt voor een shorttransactie in overheidsschuld.

In de drie jaar dat de Verordening van kracht is, heeft de AFM een groei in het aantal meldingen van netto short aandelenposities geconstateerd. Werd aanvankelijk verwacht dat de AFM 5 tot 10 meldingen per dag zou ontvangen, inmiddels blijken dit er gemiddeld 25 per dag te zijn. De groei in het aantal meldingen heeft ertoe geleid dat de AFM in de zomer van 2015 de 10.000^e melding heeft ontvangen. De hoogste short sell positie gedurende één dag sinds de inwerkingtreding van de Verordening is gelijk aan 6.27%. De AFM heeft ook geconstateerd dat bijna de helft van de meldingsplichtigen over een netto short positie in het aandelenkapitaal van één onderneming beschikt en dat ruim 50% van de meldingsplichtigen afkomstig is uit de Verenigde Staten.

Sinds de inwerkingtreding van de Verordening hebben enkele bevoegde autoriteiten gebruik gemaakt van hun interventiebevoegdheden. Dit heeft geleid tot enkele kortdurende maatregelen (gedurende één handelsdag) en drie langdurende maatregelen (gedurende een periode van maximaal drie maanden). Thans is er één langlopende maatregel van kracht. Deze is geldig tot 9 november 2015.

Netto short posities dienen aan de AFM gemeld te worden via het daartoe bestemde formulier dat beschikbaar is op de AFM website. Meldingen vanaf 0.5% en elke 0.1% daarboven worden openbaar gemaakt via het register short selling.

Voor het te laat melden van netto shortposities heeft de AFM tot nu toe één bestuurlijke boete opgelegd en 26 waarschuwingen gegeven. In haar toezicht heeft de AFM daarnaast bij meerdere marktpartijen informatie opgevraagd over gedane short transacties. De opgevraagde informatie ziet op basis van welke informatie de marktpartijen tot een short positie zijn gekomen, geeft inzicht in de gedane transacties en geeft inzicht in welke regelingen de partijen hebben getroffen zodat men gedekt een short positie is aangegaan.

Het beoogde effect van de Verordening om te komen tot een grotere transparantie van short posities is gezien (de groei van) het aantal meldingen en het aantal bezoekers van het register volgens de AFM gerealiseerd. De AFM is daarnaast van mening dat kan worden geconcludeerd dat de overige doelstellingen van de Verordening ook zijn behaald. Enkele bevoegde autoriteiten hebben gebruikt gemaakt van hun interventiebevoegdheden en zijn op deze manier in staat geweest om risico's voor de financiële stabiliteit en het marktvertrouwen te beperken. Bovendien dragen de geïntroduceerde beperkingen op ongedekte shorttransacties bij aan de afname van ontwikkelingsrisico's.

Door strikt toe te zien op de naleving van de Verordening en door passende sancties op te leggen indien de Verordening wordt overtreden, draagt de AFM bij aan de doelstellingen van de Verordening. De AFM zal dit blijven doen en zal, samen met ESMA en andere bevoegde autoriteiten, erop toezien dat de Verordening in lijn blijft met toekomstige (economische) ontwikkelingen.

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