

## **This is not intended to constitute FSA Guidance**

### **Short Selling (No. 2) Instrument 2008 - FAQs Version 5 - Issued 25 November 2008.**

Further to our press release dated 18 September 2008, we have set out some indicative answers to what we expect will be frequently asked questions.

**The only substantive change in this version of the FAQs compared to Version 4 (issued on 31 October 2008) is the following:**

**We have replaced the previous FAQ 42. with a new FAQ 42. that sets out in more detail the interaction of the provisions of Short Selling (No. 1) Instrument 2008 (relating to companies in rights issue periods) and the provisions of Short Selling (No. 2) Instrument 2008 (relating to UK financial sector companies) in circumstances where a UK financial sector company enters into a rights issue period.**

We will continue to review this information over time and may further update the list to address any other frequently asked questions that arise. The list is not intended to be exhaustive and persons will need to consider how the instrument applies to their particular circumstances taking into account that the purpose of the measures is to prevent potentially abusive behaviour.

We have split the FAQs into a number of sections.

#### **General**

1. At what time do the new short selling provisions come into force?  
**The provisions preventing short selling in UK financial services companies came into effect at 00.01 a.m. on Friday 19 September 2008. The provisions governing the disclosure obligation take effect at the same time.**
2. When do these measures end?  
**The new provisions are currently set to cease to have effect on 16 January 2009.**
3. Will the FSA extend these measures?  
**We will keep this under review in the light of market conditions.**
4. What is the effect of the new measures?  
**They are evidential provisions describing behaviour that in the opinion of the FSA constitutes market abuse. Accordingly they have the effect described in MAR 1.1.**
5. Do the new prohibition and disclosure requirements apply to both “covered” and “uncovered” short positions?  
**Yes**
6. Have these measures changed the suspicious transaction reporting regime?  
**The reporting obligations under the suspicious transaction reporting regime remain unchanged, but these evidential provisions newly describe a behaviour that in the opinion of the FSA constitutes market abuse.**
7. Can a person increase their net short position intra-day, provided that the disclosable position held at the end of that day does not exceed the position disclosed at the end of the previous day?  
**No. Although only a significant net short position held at the end of a day requires disclosure, the short selling requirements do not allow a person to actively increase their net short position intra-day.**
8. Are issuers of convertible bonds considered to be short selling for these purposes?

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No.

9. Are there any exemptions to these new measures?

**Market makers are exempt from the new short selling measures. The term ‘market maker’ is not linked to the definition in the FSA’s Handbook. Our indicative view for the purposes of this instrument on market making is as follows:**

- **A market maker is an entity that, ordinarily as part of their business, deals as principal in equities, options or derivatives (whether OTC or exchange-traded):**
  - a) **to fulfil orders received from clients, in response to a client's request to trade or to hedge positions arising out of those dealings; and/or**
  - b) **in a way that ordinarily has the effect of providing liquidity on a regular basis to the market on both bid and offer sides of the market in comparable size. Trading in circumstances other than genuinely for the provision of liquidity is not exempt.**

**This exemption covers market makers only when, in the particular circumstances of each transaction, they are acting in that capacity. Market makers are afforded a certain level of flexibility in anticipating sales as long as this activity is genuine market making in line with its existing general levels of business. Consequently, we would not expect market makers to hold significant short positions, other than for brief periods. Proprietary trading strategies where the main intention is to create a short position are not market makers and are not exempt.**

**Registration as a “market maker” with an exchange or trading platform is not relevant for the purposes of this definition.**

10. What will be the consequences of non-compliance with the new measures?

**The potential consequences of non-compliance will be the same as for any other breach of the market abuse regime. We have a range of actions at our disposal. These include Enforcement action, which could culminate in a fine or a public censure.**

11. In the case of investment managers and authorised fund managers who act on behalf of clients, to whom do the short selling measures apply?

### **Non-discretionary**

**Where an investment manager manages on a non-discretionary basis, both the short selling prohibition and disclosure requirements apply to the client. The investment manager may make a net short position disclosure on behalf of its client, but this disclosure must clearly identify that it is the client who holds the disclosable position.**

### **Discretionary**

#### **Prohibition**

**Where an investment manager manages on a discretionary basis and where client positions are segregated from the investment manager and from each other in one or more accounts, the prohibition applies at the level of the individual clients.**

**Where an authorised fund manager or investment manager manages collective investment schemes on a discretionary basis, the prohibition applies at the fund level. Where the fund**

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in question is an umbrella fund with a number of sub-funds, the prohibition applies at the sub-fund level.

### **Disclosure**

The disclosure obligation applies at the level of **both** the entity to which the prohibition applies and at the level of the investment manager or authorised fund manager. The investment manager or authorised fund manager may make a net short position disclosure on behalf of its client. In respect of itself, the investment manager or authorised fund manager is required to disclose its aggregate net short position across all of the funds it manages on a discretionary basis.

Where a disclosure by an investment manager or authorised fund manager is the same as that being made for its client/fund/sub-fund, it is permitted to make a single disclosure **provided** that the disclosure makes it clear that it applies to both parties.

12. How do the short selling requirements apply across different trading desks?  
**If trading desks within a firm are housed within the same legal entity, the aggregate position of the legal entity (across all desks holding positions in UK financial sector companies) would be expected to apply for these purposes, excluding positions taken under the market maker exemption.**
13. When calculating a net short position should financial instruments be accounted for on a notional basis or a delta adjusted basis?  
**Any financial instruments should be accounted for on a delta adjusted basis.**
14. What does “economic exposure in the issued share capital of a company” mean?  
**It means any instrument (contracts for differences, spread bets, options etc) giving rise to an exposure, whether direct or indirect, to the issued share capital of a company.**
- The issued share capital of a company would include ordinary shares and preference shares but would exclude debt securities.**
15. Should any holdings in a UK financial sector company that are held as part of a basket of shares or a share index be included in any aggregation of a person's economic interest in the company?  
**Any economic interest held as part of a basket, index or exchange traded fund (‘ETF’) where the predominance of the components in the basket, index or ETF are UK financial sector companies must be included.**

Market participants should be aware of their overall position and the effect of their trading strategy on their net short positions in UK financial sector companies. For example, a short sale of an index that does not have a predominance of UK financial sector companies within it, which creates a new or increased net short position in one or more UK financial sector companies, on its own would be permitted. But, where a market participant goes short of an index and offsets positions in that index, by going long in its constituents other than one or more UK financial sector companies, he is not permitted to obtain a new or increased net short position in one or more UK financial sector companies. This would apply to trading in any derivatives products relating to an index.

Where an index is exempt from the prohibition on short selling because the predominance of its components are not UK financial sector companies, it is not necessary to take into account the UK financial sector company components of the holding in the index when making calculations to determine whether there is an obligation to disclose net short positions.

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16. Is stock lending caught by the prohibition?

**No, the FSA is not imposing any additional restrictions on stock lending activities. However, we would urge firms that do lend stock to be vigilant and, where they suspect that stock is being borrowed for the purpose of prohibited short selling, to alert the FSA.**

**NB, in making this call for vigilance, the FSA is not seeking to extend the current suspicious transaction reporting regime or firms' general obligations under Principle 11.**

**Stock lenders should also note that a sale of lent stock would not create a short position for the stock lender but would for the borrower.**

17. If I transfer a short position from one counter-party to another with no change in the net short position would this constitute market abuse?

**Where the position is transferred to the new counterparty on the same terms it will not be treated as creating or increasing a net short position. Any net short position will still be subject to the new disclosure requirements.**

18. Do these new provisions apply to black box trading?

**Yes. Firms must make the changes necessary to ensure that any black box trading complies with the new measures.**

### **Derivatives**

19. How do these provisions apply to derivatives?

**Any derivative trades that are either delta neutral or delta positive at the time the orders are entered into are permitted.**

**Please be aware that when rolling derivative positions expire, the delta position should not create a new overall net short position in a UK financial sector company.**

### **Prohibition**

20. Which UK financial sector companies are subject to the prohibition?

**We have published a list of UK financial sector companies on our website: [http://www.fsa.gov.uk/pubs/handbook/list\\_instrument200850.pdf](http://www.fsa.gov.uk/pubs/handbook/list_instrument200850.pdf). The list has been prepared on a best endeavours basis.**

21. Is all short selling in UK financial sector companies prohibited?

**No. Persons are prohibited from entering into transactions that have the effect of creating a new net short position in a UK financial sector company post 18 September, or from increasing a net short position that was held before 19 September 2008. This means that it is still possible to hold a net short position established before 19 September. It also means that it is possible to short a UK financial sector company post 19 September, provided that the person can offset the short position with an equivalent long position in relation to that same company.**

**It should also be noted that any net short position that arises or increases, not as a result of any additional transaction, but due to a change in delta as a result of changing market conditions, is not caught by the prohibition (but may require disclosure if it is above 0.25% as a disclosable net short position).**

22. Does the prohibition apply to UK financial sector companies on all UK markets?

**This instrument applies to all "prescribed markets" under the Code of Market Conduct.**

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23. In the context of a merger, is it permissible to offset one stock against another, i.e. by going short in the offeree and long in the offeror?

**No, until the merger is complete, positions in the companies involved should be treated separately for the purposes of calculating net short positions. Accordingly, if the result of the transaction is to create a new net short position in a UK financial sector company post 18 September, or increase a net short position in a UK financial sector company that was held before 19 September 2008, this is not permitted.**

24. Can I hedge a long position in the convertible bonds of a UK financial sector company by taking a short position in the equity of that company?

**Yes, provided that this does not create a new or increased net short position in that company.**

25. Does the prohibition also cover OTC transactions?

**Yes.**

26. Does the prohibition cover trading in Credit Default Swaps?

**No.**

27. How will it apply to listings of UK companies traded on exchanges in other countries?

**The UK's market abuse regime covers not just the shares themselves but also related investments, i.e. something whose price or value depends on the price or value of the share. Common examples might include, CFDs, spread bets, options, futures, depository receipts and dual line stocks.**

28. Does the prohibition apply at the same threshold as the disclosure requirement?

**No. The disclosure requirement applies where a person holds a net short position of 0.25% or more. The prohibition applies where a person enters into a transaction that creates a new net short position in a UK financial sector company post 18 September or increases a net short position in a UK financial sector company that was held before 19 September 2008.**

29. Does the prohibition apply to orders entered prior to 00.01am on 19 September 2008?

**No**

29.A Is a person permitted to swap an existing instrument that gives rise to a net short position in a UK financial sector company with another type of instrument in the same UK financial sector company?

**Yes, provided the existing short instrument is swapped with a new short instrument simultaneously and in doing this transaction, the person's overall delta has not moved from positive to negative (or if already negative, does not become more negative). Examples where this FAQ would apply include:**

- a. When an existing derivative contract giving rise to the net short position is rolled over into a new derivative contract simultaneously and in doing this transaction, the person's overall delta has not moved from positive to negative (or if already negative, does not worsen). This situation is also covered by FAQ19; and**
- b. When an existing derivative contract giving rise to the net short position, is swapped into a direct cash position and in doing this transaction, the person's overall delta has not moved from positive to negative (or if already negative, does not become more negative).**

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### **Disclosure**

30. Why is disclosure required if there is a general prohibition against creating or increasing a net short position?  
**People should have regard to the guidance in MAR 1.9.2E which makes clear that a person may have a disclosable interest despite MAR 1.9.2C E because they had a disclosable short position before 19 September 2008 or because they had a net short position before that date which due to other extraneous factors becomes a disclosable net short position.**
31. How is the relevant denominator calculated?  
**The relevant denominator for the calculation of net short positions is the entire issued share capital of the company comprising ordinary shares or preference shares.**
32. To whom does the disclosure responsibility apply (e.g. the UK financial sector company or the holder of the short position in that company)?  
**The disclosure obligation applies to the holder of the net short position. See also FAQ 10.**
33. In what format must the disclosure be made?  
**The disclosure must be made by means of a Regulatory Information Service (RIS) announcement. Persons making a disclosure may use the TR4 form on the FSA website or may choose a different format. However, all disclosures should include the information required by the TR4 form. The form, or the required information, should be disclosed using the RIS short code SSD.**
34. What is the process for making an RIS disclosure?  
**To make an RIS disclosure, it is first necessary to register with one or more of the RIS providers. Further information can be found at <http://www.fsa.gov.uk/Pages/Doing/UKLA/ris/index.shtml>**
35. Should the disclosure be made on a gross or net basis?  
**A holder of economic interests in a UK financial sector company may net its long and short positions in that company. The disclosable position will be any net short position of 0.25% or above.**
36. When disclosing the net short position, will the holder of that position be required to include details of both short and long positions (if applicable) in order to provide a breakdown of the net economic interest?  
**No. Only the aggregate net short position of 0.25% or above will need to be disclosed. There is no requirement to disclose any individual short and long positions underlying the net position.**
37. Does an aggregated net short position need to be broken down into its component parts for the purposes of the disclosure (i.e. any positions in cash settled shares, CFDs, other derivative instruments etc)?  
**No. Only the aggregate net short position requires disclosure.**
38. What is the first deadline for announcing a net short position of 0.25% or above under the new disclosure requirements?  
**The first disclosure deadline is 3.30pm on Tuesday 23 September 2008. This disclosure should relate to any net short position of 0.25% or above held at the end of Friday 19 September 2008 and, if different, the position held at the end of Monday 22 September 2008 as well.**
39. How frequently are net short position disclosures required?

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Subsequent to the first disclosure deadline of 23 September 2008, a person must disclose any net short position of 0.25% or above by 3:30pm on the day following each day on which the disclosable short position is held. The net short position disclosed should be that held at the end of the previous day. Disclosures are no longer required where there is no change in the size of the short position since the previous disclosure.

40. If a person's previously disclosed net short position falls below the 0.25% disclosure threshold, is a further disclosure of this fact required?

**Yes. If a person's net short position falls below 0.25%, one last disclosure of that fact is required.**

41. Where a person has a structure that includes more than one legal entity, at what level is a net short position disclosure required?

**A disclosure should be made at the level of each legal entity. It is possible for one entity within the group to disclose on behalf of each individual entity that has a disclosable net short position, provided it clearly states which position belongs to which entity.**

42. How do the provisions of Short Selling (No. 1) Instrument 2008 (relating to companies in rights issue periods) and the provisions of Short Selling (No. 2) Instrument 2008 (relating to UK financial sector companies) interact in circumstances where a UK financial sector company enters into a rights issue period?

**If a UK financial sector company enters into a rights issue period, trading in relation to its securities is subject to provisions under both Short Selling Instruments No. 1 and No. 2. In such circumstances, the provisions of MAR 1.9.2A E, MAR 1.9.2C E and MAR 1.9.2D E will apply. Consequently, a person who enters into a transaction that creates a net short position or increases an existing net short position in a UK financial sector company, will, in the view of the FSA, be engaging in behaviour that is market abuse (misleading behaviour). A person with a net short position of 0.25% or above who fails to disclose it by 3.30pm on the business day following the first day on which the position is held and on each subsequent day the position changes will also, in the view of the FSA, be engaging in behaviour that is market abuse (misleading behaviour).**

**When calculating a net short position in such circumstances, a person should only include economic interests in the pre-existing share capital of the company. Economic interests relating to share capital that will be issued in the future must be excluded from the calculation. A person cannot therefore net off a short position in the company's pre-existing share capital with a long position in the nil-paid rights. Similarly, nor can a prospective long position in the new shares arising from an underwriting/sub-underwriting commitment be netted off. This applies in respect of the provisions of MAR 1.9.2A E, MAR 1.9.2C E and MAR 1.9.2D E. The denominator for the calculation of a net short position should be the undiluted share capital.**

### **Further questions**

43. What if I have another questions not covered by the FAQs or wish to make a comment about the new rules?

**We may publish additional FAQs or clarify existing ones as further questions arise.**

**For technical questions (only) in relation to the short selling provisions (1.9.2C) please call on 020 7066 4900 or e-mail to [market.abuse@fsa.gov.uk](mailto:market.abuse@fsa.gov.uk)**

**For technical questions (only) in relation to the disclosure of pre-existing positions (1.9.2D) please call on 020 7066 8333, option 4.**

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For all other queries or comments in relation to the new rules, please write in to:

**Financial Services Authority,  
25 The North Colonnade  
Canary Wharf  
United Kingdom  
E14 5HS**