The European Regulation on Short Selling & certain aspects or Credit Default Swaps

DILLON EUSTACE

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The European Regulation on short selling and certain aspects of credit default swaps

Introduction

Regulation (EU) No. 236/2012 of the European Parliament and of Council on short selling and certain aspects of credit default swaps (the "EU Short Selling Regulation") was published in the Official Journal on 24 March 2012 and came into operation on 1 November 2012. The EU Short Selling Regulation could have implications for investment managers who are involved in the short selling of EU listed shares or sovereign debt.

The EU Short Selling Regulation; (i) requires persons (both legal and natural) to disclose net short positions in EU listed shares and EU sovereign debt[1]; (ii) restricts uncovered short sales of EU listed shares and EU sovereign debt; (iii) prohibits uncovered credit default swaps ("CDS") in EU sovereign debt which broadly speaking does not serve to hedge against exposure to the underlying sovereign debt; (iv) requires central counterparties that provide clearing services for shares to ensure that there are adequate arrangements for buy-in of securities where there is a failure to settle a transaction within four business days after the day on which settlement is due; and (iv) creates new powers for national regulators and for the European Securities and Markets Authority ("ESMA").

As this measure is enacted through an EU regulation, it is directly applicable in all EU Member States and no national measures are required to implement its requirements. This means that, for the first time, the rules relating to short selling are harmonized across the EU and the divergent rules in relation to short selling which were applied by individual EU Member States have been superseded.

The EU Short Selling Regulation is supplemented by a European delegated regulation as well as regulatory and implementing technical standards (collectively referred to as the "Level 2 Regulations") comprised of the following:-

(i) Commission Delegated Regulation (EU) No 826/2012 of 29 June 2012 supplementing the EU Short Selling Regulation with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to ESMA in relation to net short positions and the method for calculating turnover to determine exempted shares ("RTS 1 Regulation");

[1] For the purposes of this article, the term EU should be understood to mean all member states of the European Union plus Norway, Iceland and Liechtenstein.

(ii) Commission implementing Regulation (EU) No 827/2012 of 29 June 2012 laying down implementing technical standards with regard to the means for public disclosure of net position in shares, the format of the information to be provided to ESMA in relation to net short positions, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and period for the determination of the principal venue for a share according to the EU Short Selling Regulation (the "ITS Regulation");

(iii) Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012 supplementing the EU Short Selling Regulation with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events (the "Delegated Acts Regulation"); and

(iv) Commission Delegated Regulation (EU) No 919/2012 of 5 July 2012 supplementing the EU Short Selling Regulation with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments (the "RTS 2 Regulation").

In addition to the above, ESMA has adopted a Q&A which will be updated and expanded on from time to time, the purpose of which is to promote common supervisory approaches and practices in the application of the European short selling regulatory regime. It provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of the short selling framework.

This article seeks to summarise the main requirements of the EU Short Selling Regulation.

Scope of the EU Short Selling Regulation

The financial instruments concerned by the net short position notification and disclosure requirements, and the restrictions on uncovered short sales are:

(i) shares admitted to trading on a European regulated market or a multilateral trading facility ("MTF"), provided that, in case they are also traded on a third country venue (outside the EU/EEA), their principal trading venue is not located in that third country;

(ii) sovereign debt issued by a sovereign issuer as defined by the EU Short Selling Regulation; and

(iii) CDS on sovereign debt of a sovereign issuer as defined by the EU Short Selling Regulation.

With respect to shares, the EU Short Selling Regulation requires that a list of exempted shares is published by ESMA on its website on the basis of the information provided by national competent authorities[2]. It is intended that ESMA will update this list every two years. However, the list will also be updated by national competent authorities when required by Article 12(2) of the ITS Regulation. Therefore, any share not mentioned in that list that is admitted to trading on a regulated market in the EEA or traded on a MTF in the EEA is subject to the requirements of the EU Short Selling Regulation. It should be noted that ESMA has already published a list of shares admitted to trading on an EEA regulated market (http://mifiddatabase.esma.europa.eu/) which identifies the relevant competent authority for each share for the purpose of the EU Short Selling Regulation.

The rules relating to short positions and CDS on sovereign debt apply to sovereign debt instruments issued by any EU Member State (including any ministry, agency or special purpose vehicle) or by any EU institution such as the European Financial Stability Facility, the European Investment Bank or the European Financial Stability Mechanism.

The EU Short Selling Regulation expressly provides that the disclosure requirements (as outlined below) will apply to any person (whether a natural person or a legal person) anywhere in the world who has a net short position in EU shares, in EU sovereign debt or who shorts EU sovereign debt using CDS.

An exemption applies for shares that are principally traded outside the EU but are also traded on an EU trading venue. Notably issuers domiciled outside the EU whose principal trading venue is inside the EU are covered. Article 16 of the EU Short Selling Regulation provides that the principal trading venue will be that which has the largest volume of trading over the previous 24 months.

The disclosure requirements and the uncovered short sale rules also do not apply to transactions performed due to market making activities, since market makers often need to take short positions to perform their crucial role of providing liquidity.

Transparency – Disclosure Requirements

(i) EU listed Shares

The EU Short Selling Regulation requires firms to disclose net short positions in EU listed shares as follows:

- A net short of 0.2% or more of the issued share capital of a company whose shares are admitted to trading on a regulated market or MTF must be reported privately to the relevant national regulator (i.e. the competent authority where the underlying shares are listed). Any

[2] A list of the exempted instruments is available online at; http://www.esma.europa.eu/page/List-exempted-shares.

0.1% increment over 0.2% in the net short position must also be disclosed to the relevant competent authority, (i.e. (i.e. 0.3%, 0.4% and 0.5%). A report must also be made where the net short position falls below any of the aforementioned thresholds.

- A net short of 0.5% of the issued share capital of a company whose shares are admitted to trading on a regulated market or MTF must be reported publically to the market. Any 0.1% increment over 0.5% in the net short position must also be reported to the market (i.e. 0.6%, 0.7% and 0.8%). A report must also be made where the net short position falls below any of the aforementioned thresholds. All disclosures must include the identity of the person holding the short position.

The EU Short Selling Regulation provides that the calculation of a long or a short position shall not only include direct long or short positions, but all transactions the effect of which is to confer a financial advantage in the event of an increase/decrease in the price or value of the share. Calculations should also take into account any indirect positions such as by way of any index, basket of securities, futures, options, contracts for differences, spread bets, interest in any exchange traded funds or similar entity relating to shares. There is no *de minimis* threshold even for broad-based indices. Calculations of such indirect long or short positions must be made reasonably having regard to publically available information. There is no distinction between short positions which are investment positions and those which are hedges. As outlined above, disclosure is required in respect of all short positions regardless of whether the short position is accumulated on a trading venue or outside trading venues and regardless of whether the person effecting the short sale is domiciled outside the EU.

The Delegated Acts Regulation sets out the method for the calculation and netting of short positions in shares and in this regard a net short position is calculated by netting long and short positions in a given issuer using a delta adjusted model.

(ii) Sovereign Debt

The EU Short Selling Regulation requires firms to disclose net short positions in EU sovereign debt to the national regulator of the relevant sovereign issuer as follows:

- an initial reporting threshold of 0.1% of the total amount of the outstanding issued sovereign debt where the sovereign debt issued is between EUR 0 and EUR 500 billion and an ongoing reporting requirement for each 0.05% increment over 0.1%.

- a reporting threshold of 0.5% of the total amount of the outstanding issued sovereign debt where the sovereign debt issued is more than EUR 500 billion or if there is a “liquid futures market” for the particular sovereign debt. There is an ongoing reporting requirement for each 0.025% increment over 0.05%.

The total amount of the outstanding issued sovereign debt for each sovereign issuer will be rounded up to the nearest million euro and will be calculated and published quarterly by ESMA. There is no requirement to disclose publically the level of sovereign debt which a firm holds.

The EU Short Selling Regulation provides that in determining a person's long position in the sovereign debt of a particular issuer, the person is to include any net long position it has in the sovereign debt of any other sovereign issuer, the pricing of which is "highly correlated" to the pricing of the first sovereign issuer. Derivative positions must also be taken into account.

From a practical perspective firms, which are involved in the short selling of EU sovereign debt will need to ensure that their internal systems can track cases where "high correlation" may occur. The Delegated Acts Regulation provides that a high correlation means a Person's correlation coefficient of at least 80% between the pricing of the debt instrument of another sovereign issuer and the pricing of the given sovereign debt for the relevant period.

(iii) Timing of disclosure of a net short position

The EU Short Selling Regulation provides that calculations of a net short position must be made by midnight at the end of the trading day. The notification or disclosure shall be made not later than 15.30 on the following trading day. All times are calculated according to the time in the EU Member State of the relevant competent authority to whom the relevant position must be notified. The RTS 1 Regulation sets out the format of the information to be provided in the notifications to the regulators and public disclosures. This means that all EU Member States have a harmonised form of disclosure. The information must include:

- The identity of the person who has the relevant disclosable net short position;
- The size of the position;
- The issuer in relation to which the position is held;
- The date the position was created, changed or ceased to be held;
- The date that the applicable net short position was reached; and
- The dated of any previous notification made by the investment manager on the fund's behalf.

Notifications of net short positions must be made through the reporting mechanism designated by the relevant EU regulator. Public disclosures of net short positions in shares will be made on the website maintained by the relevant regulator. Regulation 41 of the EU Short Selling Regulation

provides that EU Member States must establish rules on penalties for those persons who fail to comply with the disclosure requirements.

The EU Short Selling Regulation provides that records of gross positions which support net short position calculations must be retained for a period of five years.

(iv) Fund management activities and group entities

Articles 12 and 13 of the Delegated Acts Regulation details how net short positions should be calculated by different funds managed by the same fund manager or by different entities within a group company.

An entity which is performing management activities (i.e. portfolio management) must aggregate the net short position of the funds and portfolios under its management for which the same investment strategy is pursued in relation to a particular issuer. For the purposes of the EU Short Selling Regulation, an investment strategy is whether the fund (portfolio) is long or short in a particular issuer. In terms of reporting, we understand that the entity performing the management activities would be disclosed as the "position holder" for the purposes of the notification form (i.e. no need to name the individual funds). Annex 1 provides an example of this type of calculation.

In this case of an entity performing non-management activities (i.e. proprietary trading) the legal entity should calculate its net short position in each particular issuer, excluding the management activities. Annex 2 provides an example of this type of calculation.

If a discretionary manager delegates certain fund management activities to a third party, that third party will be responsible for calculating and reporting net short positions in relation to the delegated fund/managed account and the discretionary manager will not be required to include positions in the delegated fund/managed account in its own calculations.

Articles 12(5) and 12(6) of the Delegated Acts Regulation provide that in the case of an entity which performs both management activities and non-management activities it should conduct two separate calculations and this may mean that two reports may need to be made in certain circumstances (i.e. one report would detail with the net short position resulting from management activities in a particular issues and another report would detail the net short position resulting from non-management activities).

Article 12(2) of the Delegated Acts Regulation further provides that in the case of a group which performs management and non-management activities, the net short and long positions of all the legal entities constituting a group of companies must be aggregated and netted, with the exception of the positions of the management entities that perform management activities. In this instance if a threshold is reached (at group level) it would be the group's responsibility to report the relevant net

short position in a particular issuer, i.e. the group reports the position if the group alone has a disclosable position. Where a threshold is crossed by a single entity belonging to a group and at group level, the group reports the position.

Normally the legal entity would only report and disclose when no net short position calculated at the group level reached a notification or disclosure threshold; i.e. when an individual legal entity belonging to a group reaches a relevant threshold but the group does not, the legal entity makes a report.

Restrictions on uncovered short sales of EU listed shares and sovereign debt

(i) Meaning of the term "short sale"

A short sale is defined in the EU Short Selling Regulation as any sale of a share or debt instrument which the seller does not own at the time of entering into the agreement to sell, including where the seller has borrowed or agreed to borrow the share or debt instrument for delivery at settlement. The definition of short sale does not include; (i) a sale by either party under a repurchase agreement where one party has agreed to sell to the other a security at a specified price with a commitment from the other party to sell the security back at a later date at another specified price; (ii) transfers of securities under a securities lending agreement; or (iii) the entry into a futures contract or other derivative contract where it is agreed to sell securities at a specified price at a future date.

(ii) EU Listed Shares

Short sales of EU listed shares require the person entering into the short sale to:

- borrow the share or make alternative provisions resulting in a similar effect;
- enter into an "agreement" to borrow the share or otherwise have an absolutely enforceable claim under contract or property law to be transferred ownership of a corresponding number of securities of the same class so that settlement can be effected when it is due; or
- enter into 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 so that it can be reasonably expected that settlement will occur when it is due.

The ITS Regulation lists the following types of "agreements" for the purposes of the second criterion including; futures, swaps, options, repurchase agreements, standing agreements, rolling facilities with respect to a predefined amount of shares and other claims or agreements leading to delivery of

shares. In formulating the Level 2 Regulations, ESMA indicated that securities lending and prime brokerage agreements could fall within the list provided that they specify the number of specific securities to be sold short and the execution or delivery date.

The third criterion is commonly referred to as the "locate rule" and is understood to be similar to the borrowing and delivery requirements of the U.S. Securities and Exchange Commission in Rule 203 of Regulation SHO adopted in 2004. The ITS Regulation permits three types of arrangements for the purposes of the third criterion:

- Standard locate arrangement must consist of; (i) a confirmation from a third party that it can make the shares available for settlement and indicating a period for which the shares are located (a locate confirmation); and (ii) a confirmation that the third party has at least put the requested number of shares on hold (a put on hold confirmation);

- Standard same day locate must include a locate confirmation from a third party as above and a confirmation that the share is easy to borrow/purchase and in the absence of such a confirmation a put on hold confirmation. Further, the short seller must monitor the market and in the event of a risk of non-delivery, instruct the third party to purchase shares to cover the short sale; and

- Easy to borrow or purchase arrangements must include a locate confirmation and confirmation that the shares are easy to borrow/purchase and in the absence of such a confirmation a put on hold confirmation. The short seller must give the third party a confirmation that in the event that the short seller cannot buy the shares in the market, the short seller will instruct the third party to buy or borrow shares sufficient to cover the short sale.

(iii) EU Sovereign Debt

Similar to the position outlined above, the EU Short Selling Regulation requires a person entering into a short sale of EU sovereign debt to:

- borrow the sovereign debt or make alternative provisions resulting in a similar effect;

- enter into an "agreement" to borrow the sovereign debt or otherwise have an absolutely enforceable claim under contract or property law to be transferred ownership of a corresponding number of securities of the same class so that settlement can be effected when it is due;

- enter into an arrangement with a third party under which that third party has confirmed that the sovereign debt has been located or has taken measures vis-à-vis third parties so that it can be reasonably expected that settlement will occur when it is due.

The ITS Regulation permits four types of arrangements for the purposes of the third criterion:

- Standard sovereign debt locate arrangement; confirmation from a third party that it can make the sovereign debt available for settlement in due time taking into account market conditions and indicating the period for which the sovereign debt is located;

- Time limited confirmation arrangement; the short seller must inform the third party that the short sale will be covered by purchases during the same day of the short sale and the third party confirms that it has a reasonable expectation that the sovereign debt can be purchased in the relevant quantity taking into account the market conditions and other available information;

- Unconditional repo confirmation; confirmation from a third party prior to the short sale, that it has a reasonable expectation that settlement can be effected when due as a result of its participation in a structural based arrangement, organised or operated by a central bank, a debt management office or a securities settlement system that provides unconditional access to the sovereign debt in question for a size consistent with the size of the short sale; and

- Easy to purchase confirmation; confirmation from a third party prior to the short sale, that it has a reasonable expectation that settlement can be effected when due on the basis that the sovereign debt in question is easy to borrow or purchase in the relevant quantity taking into account the market conditions and any other information available to that third party on the supply of the sovereign debt.

The EU Short Selling Regulation provides that the restrictions on uncovered short sales in sovereign debt do not apply if the transaction serves to hedge a long position in debt instruments of an issuer, the pricing of which has a high correlation with the pricing of the given sovereign debt.

(iv) Who can perform the locate function?

The ITS Regulation also contains a list of “third parties” who can provide “locate confirmations” as follows:

- Investment firms which meet the additional requirements below;

- Central counterparties that clear the relevant shares or sovereign debt;
- Securities settlement systems that settle payments in respect of the relevant shares or sovereign debt;
- Central banks that accept the relevant shares or sovereign debt as collateral or conduct open market or repo transactions in relation to the relevant shares or sovereign debt;
- Any other person who is subject to authorisation or registration requirements by a member of the European System of Financial Supervision and who meets the additional requirements below;
- A person established outside the EU who is both authorized and registered, and is subject to supervision by an authority in that third country and who meets the additional requirements set out below, provided that the third country authority is a party to an appropriate cooperation arrangement concerning exchange of information with the relevant competent authority.

Investment firms and other persons who are subject to the additional requirements must:

- participate in the management of borrowing or purchasing of relevant shares or sovereign debt;
- provide evidence of such participation; and
- be able, on request, to provide evidence of its ability to deliver or process the delivery of shares or sovereign debt on the dates it commits to do so to its counterparties including statistical evidence.

Restrictions on uncovered sovereign CDS positions

The EU Short Selling Regulation prohibits “uncovered” CDS on sovereign debt, however, certain transactions can be deemed to be covered if they are being used to hedge against the risk of default of an issuer where the person has a long position in the relevant sovereign debt or an exposure to assets or liabilities the value of which is correlated to the relevant sovereign debt.

The Delegated Acts Regulation provides guidance as to when a CDS position on sovereign debt can be considered to be legitimately hedged. To qualify a sovereign CDS position must have the following characteristics:

- The hedged assets and liabilities must be of certain defined types and must also bear some relation to a sovereign issuer;

- There must be a correlation between the hedged assets and liabilities and the sovereign CDS. The Delegated Acts Regulation provides that this correlation must be shown through a qualitative or a quantitative test. The qualitative test is met by showing a "meaningful" correlation based on appropriate historical data. There is no further guidance on the term meaningful correlation and this means that there is an element of uncertainty as to when a CDS position will satisfy this test. The quantitative test is met by showing a quantitative correlation of at least 70% using data for a period of 12 months;

- The sovereign CDS position must be proportionate to the size of the exposure hedged, (i.e. the exposure should not exceed the value of the hedging CDS position). On a practical level, this means that the position holder must have a continuously hedged position, proportionate to the size of the exposure. Article 19 of the Delegated Acts Regulation permits limited over-provisioning where the position holder can demonstrate that such a larger position was necessary to match a measure of risk associated with the reference portfolio taking into account; (a) the size of the nominal position; (b) the sensitivity ratio of the exposures to the obligations of the sovereign which are within the scope of the CDS; and (c) whether the hedging strategy involved is dynamic or static.

As a general rule, cross border hedging (i.e. where the exposure is to EU Member State A but the sovereign CDS position references EU Member State B) is not permitted under the EU Short Selling Regulation. However, the Delegated Acts Regulation contains certain limited exceptions allowing the hedging of multinational exposures, for example where a parent company is the issuer of a bond but the assets and revenues that are hedged are owned by the subsidiary. The entity entering into a sovereign CDS positions must be able to justify to the relevant competent authority that it is satisfied that one of the cross border exemptions are applicable to it at the time the position was entered into. It must also be able to demonstrate to the relevant competent authority that the requirements relating to proportionality and to the correlation test (as outlined above) are satisfied at any time that it holds the sovereign CDS.

Buy-in procedures and fines for late settlement

The EU Short Selling Regulation provides that central counterparties that provide clearing services for shares must ensure that there are automatic procedures in place for the buy-in of shares where there is a failure to settle a transaction within four business days after the day on which settlement is due. Where buy-in is not possible, the EU Short Selling Regulation provides that the short seller must pay to the purchaser an amount based on the value of the shares to be delivered at the delivery date plus an amount for losses incurred by the buyer as a result of the settlement failure.

The requirements relating to the buy-in procedures apply only in relation to the short sale of shares but not to the short sale of sovereign debt instruments.

The EU Short Selling Regulation also provides that central counterparties that provide clearing services for shares will be required to impose daily fines in cases of non-settlement. The daily fines shall be sufficiently high to act as a deterrent to natural or legal persons failing to settle.

Reinforced Regulatory Powers for National Regulators

The EU Short Selling Regulation provides that where there "are adverse events or developments which constitute a serious threat to financial stability or to market confidence", national regulators may impose additional disclosure requirements or ban short selling activities for an initial three month period. The Delegated Acts Regulation sets out a list of factors which must be present to justify such action. These factors include; (i) serious financial, monetary or budgetary problems; (ii) a rating action or a default by any EU Member State or a bank and other financial institutions deemed important to the global financial system; (iii) substantial selling pressures or unusual volatility causing significant downward spirals in any financial instrument related to any banks and other financial institutions deemed important to the global financial system; (iv) any relevant damage to the physical structures of important financial issuers, market infrastructures, clearing and settlement systems, and supervisors which may adversely affect markets in particular where such damage results from a natural disaster or terrorist attack; (v) any relevant disruption in any payment system or settlement process. The EU Short Selling Regulation provides that national regulators can extend the initial three month period for a further period not exceeding three months at a time if the grounds for taking the measure continue to apply.

The EU Short Selling Regulation gives national regulators, in cases of a significant single day drop (for liquid shares a drop of at least 10% is required) in the value of a financial instrument, the power to prohibit or suspend the short selling of that instrument for one trading day. This period may be extended if after the end of the trading day following the trading day on which the fall in price occurs, there is a further significant fall in value of at least half of the decrease that originally triggered the restriction. The Delegated Acts Regulation contains information as to what constitutes a "significant fall in value" for illiquid shares and other financial instruments.

National regulators will also be allowed to suspend restrictions on sovereign debt transactions where the liquidity of sovereign debt drops below a certain threshold. Suspensions can be effective for a period of at least six months any may be extended if the grounds for taking the measure continue to apply.

Reinforced Regulatory Powers for ESMA

The EU Short Selling Regulation provides that a national regulator shall notify ESMA and other national regulators if it proposes to introduce new or additional disclosure requirements or if it proposes to ban short selling activities. The notification shall include details of the proposed measures, the classes of financial instruments and transactions for which they will apply, the evidence supporting the reasons for those measures and when the measures are intended to take effect. ESMA is required to issue an opinion within 24 hours of receipt of notification on whether it considers the measure or proposed measure is necessary in the circumstances. If a national regulator proposes to take measures contrary to ESMA's opinion, it shall publish on its website its reasons for so doing.

Article 28 of the EU Short Selling Regulation provides that ESMA may in highly exceptional circumstances prohibit or impose conditions on short selling. ESMA may only take such actions where; (i) there is a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the EU and there are cross border implications; and (ii) measures have not been taken by national regulators to address the threat or one or more national regulators have taken measures that do not adequately address the threat. A measure taken by ESMA under Regulation 28 would take precedence over any measures taken by a national regulator. This means that ESMA may take control of the regulation of short selling and may impose certain requirements which a national regulator may not agree with.

Certain EU Member States and industry leaders have expressed concerns over ESMA's interventionist powers. Both the UK and the Czech Republic have stated that they cannot support the text which is contained in Regulation 28 of the EU Short Selling Regulation and have suggested that it would contravene the principle set out in the judgment of the European Court of Justice in Meroni[3]. The Meroni doctrine is used to determine the extent to which the European Union can delegate its powers to agencies. It is possible that a person affected by the use of this power could take an action to challenge ESMA's authority in the European Court of Justice.

Conclusion

Market participants need to reassess their investment strategies that utilise short sales of EU listed shares and EU sovereign debt. For the most part, the EU Short Selling Regulation and its Level 2 Regulations are not retroactive, meaning that all uncovered positions in a sovereign CDS entered into before 25 March 2012 may be held until maturity. Any positions entered into between 25 March 2012 and 1 November 2012 are permitted but were required to be unwound before 1 November 2012 unless they fell within the hedging exemption above.

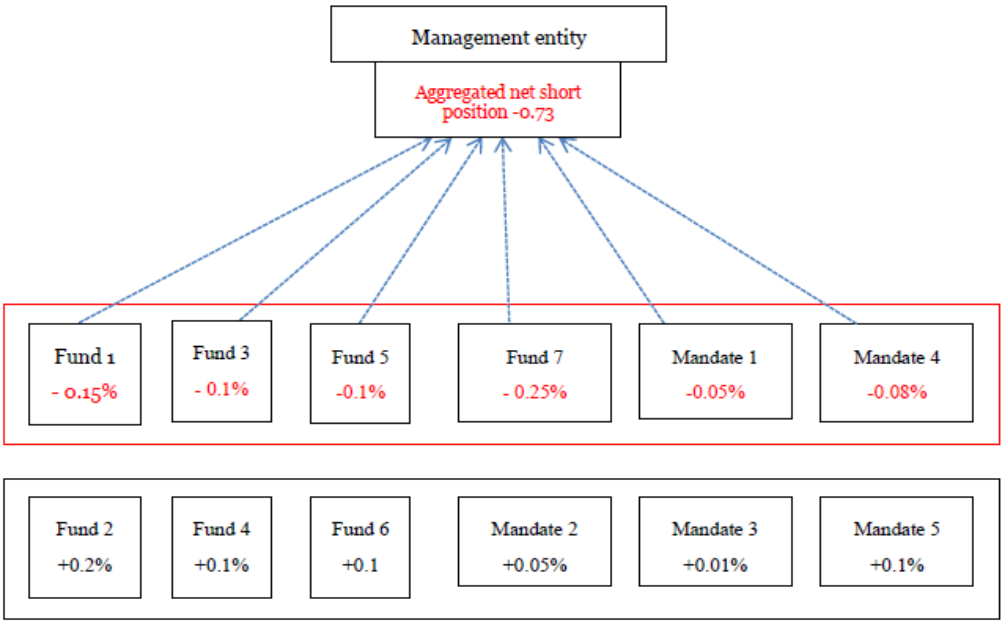
[3] Meroni v High Authority [1957 – 58] ECR 133.

Market participants need to put back-office systems in place which calculate net short positions in EU shares and EU sovereign debt at midnight of the trading day and make reports to the relevant regulators no later than 15.30 of the following trading day. They also need to ensure that any agreements will satisfy the ITS Regulation on what measures are necessary for a short seller to have a reasonable expectation that settlement can be effected when it is due. It would also be advisable to monitor any other guidance that ESMA and other national regulators may subsequently issue on the application of the EU Short Selling Regulation and the Level 2 Regulations.

Date: January 2013

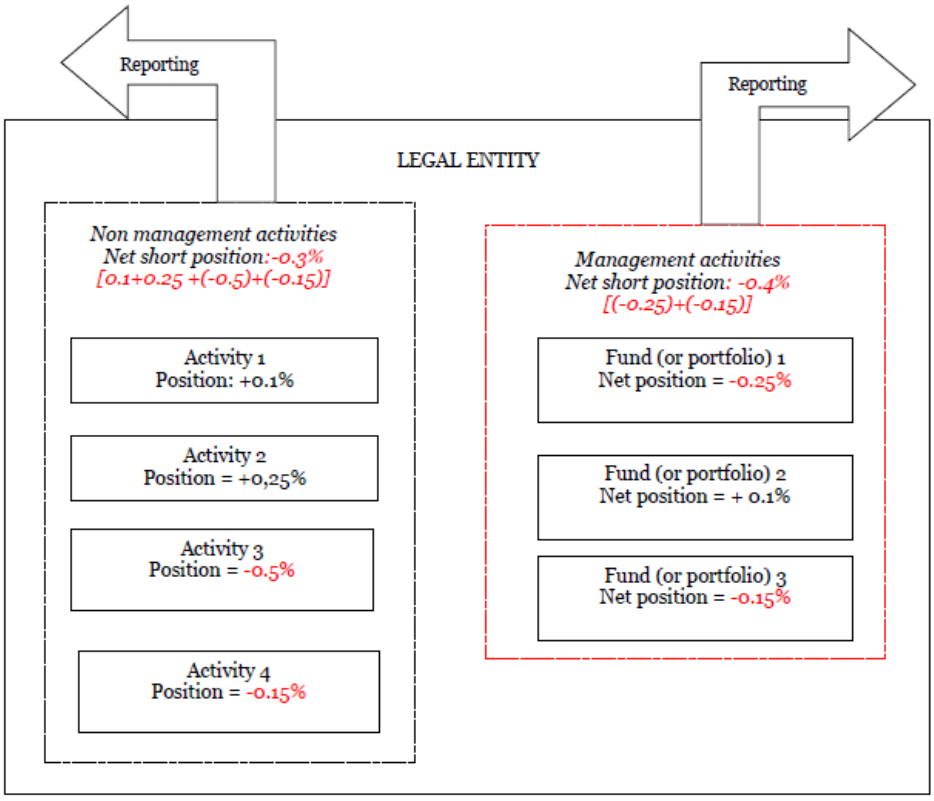
Annex 1

Annex 1: Example of calculation within a management entity



Annex 2

Annex 2 – Example of a single legal entity performing both management and non-management activities



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