



Frequently asked questions on the temporary ban of 16 March 2020 on the creation and increase of net short positions related to shares admitted to trading on trading venues for which the CNMV is the competent authority

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This document contains a series of responses prepared by the staff of the Markets Directorate-General to questions on the interpretation of the CNMV's decision of 16 March (temporary prohibition of any increase in net short positions in shares listed on trading venues for which the CNMV is the competent authority).

Short sales rules are set out in Regulation (EU) 236/2012 of the European Parliament and of the Council, of 14 March 2012, on short sales and certain aspects of credit default swaps (hereinafter, Regulation (EU) 236/2012) and the implementing regulations thereof.

The following list of questions and answers may be updated, if necessary.

1. Who is subject to the prohibition?

The prohibition applies to any natural or legal person (hereinafter "investors"), irrespective of their country of residence, with the exception of the persons exempted (if any), regardless of whether trading takes place in Spain or in other countries, or on a regulated market or not, or outside a trading venue (OTC).

2. To what issuers and financial instruments does the prohibition apply?

The ban applies to financial instruments, including shares, whose exposure confers a financial benefit to the natural or legal person executing that transaction in the event of a decrease in the price or value of the share. Part 1 of Annex I to Commission Delegated Regulation 918/2012 contains a list of these instruments.

The prohibition refers to shares admitted to trading on Spanish trading venues (Stock Exchanges and the Alternative Stock Market, (MAB)) for which the CNMV is the

competent authority under Regulation (EU) 236/2012. In order to identify the shares listed on Spanish trading venues for which the CNMV is not the competent authority (such as IAG or Arcelor), it is recommended to consult the FIRDS database available on a daily basis in ESMA's Register, on its website: www.esma.europa.eu.

Pursuant to the CNMV's decision of 16 March 2020, transactions in financial instruments that create or increase a net short position in the shares referred to in the preceding paragraph are temporarily prohibited. Conversely, corporate debt instruments or credit default swaps (CDS) are not subject to the ban.

The creation or increase of a net short position using financial instruments other than shares includes, among others, futures, options (even if they are not admitted to trading in the EU), ADRs, GDRs and OTC swaps. With regard to certificates representing shares such as ADRs, it is important to clarify that the ban does not apply to short positions in ADRs as such or considered individually, but only when they represent short positions in the underlying share, taking into account the total position of the holder of the ADR. For example, if an entity has a long position in a share subject to the prohibition equivalent to 10 shares and short sells 10 ADRs of that same share, it would not have a net short position in the share subject to the prohibition, but rather a neutral position, which is not subject to the prohibition.

The ban also includes structured products containing derivatives whose aim is to create a net short position in the share capital of the issuer of the shares, subject to the ban.

3. Is the creation or increase of intraday net short positions allowed?

No, it is not. Creating or increasing a net short position (irrespective of the type of transaction executed) during the trading session is prohibited, even if the investor intends to close the position before the close of business of that trading session.

4. What transactions/activities are exempted from the prohibition?

As indicated in the statement issued by the CNMV on 16 March 2020, the following transactions/activities are exempted from the prohibition:

- The creation or increase of net short positions when the investor acquiring a convertible bond has a neutral position in terms of delta

considering the position in the equity element of the convertible bond and the short position that is taken to hedge the equity risk.

- The creation or increase of net short positions when the creation or increase of the short position in shares is hedged by an equivalent purchase proportionate to the subscription rights.
- The creation or increase of net short positions through derivatives in financial instruments on indexes or baskets that are not mainly composed by shares subject to the ban.
- Market-making activities under the terms of Regulation (EU) 236/2012 (Articles 2(1)(k) and 17). Please see questions 7 and 8 below.

5. What types of derivative transactions are allowed? What precautions should be taken with respect to derivatives?

Regarding derivatives on indexes or baskets of financial instruments, investors are not allowed to use derivatives to create or increase a net short position. They may only use derivatives to hedge, create or increase a net long position. Net short positions created through derivatives before the entry into force of the prohibition are not subject to the CNMV's prohibition.

Unexpected increase in net short positions as a result of variations in volatility

Investors holding a pre-existing net short position which increases exclusively due to a variation in volatility are not required to reduce their exposure; holding an unchanged net short position will not be considered as a breach of the prohibition.

Roll-over of a net short position

Investors holding a net short position in derivatives, who opened the position before the temporary prohibition adopted by the CNMV are allowed to roll over their position, even if such a roll-over creates a net short position on a future expiry date, provided that the net short position so created does not exceed the one previously held.

Expiry of derivatives hedging a short position

An investor may hold a long position through a derivative that is intended to hedge a net short position in a share, subject to this prohibition. As a result, the investor's net short position will be zero. If, after the entry into force of the prohibition, the long derivatives position offsetting the short position expires and the latter is not simultaneously cancelled, the investor would be creating a net short position. In this case, this new net short position would not be considered to be an unexpected short position. Since the investor did not decide to close its two opposite positions of the same strategy, it will be understood that the investor is consciously taking a new net short position in these shares. Therefore, in order to avoid breaching the prohibition the investor should keep its long position and the relevant hedge or alternatively close both positions.

Partial hedging of a long position using derivatives

An investor may hold a long position in a portfolio of shares that does not exactly replicate an index such as the IBEX-35 and chooses to hedge its position by selling futures/options on the index. This strategy may result in net short positions in the underlying shares of the derivative that are not replicated in the investor's portfolio.

In such a case, the CNMV would accept the sale of the index derivatives/futures/options only if the investor can demonstrate that, on the one hand, there is no liquid market for derivatives/futures/options of the underlying shares comprising the long position, and, on the other hand, there is a clear correlation between the portfolio of shares held and the index futures/options sold.

6. An investor may hold short positions in shares through index derivatives or a basket of financial instruments. Are these short positions allowed where the index or basket is composed of a majority of shares that are not subject to the ban?

Yes, but only for derivatives (such as futures or options) traded on trading venues but not those traded exclusively OTC.

Regarding ETFs, since they are financial instruments whose aim is to replicate the performance of an index or a basket of shares, the creation or increase of a net short

position through ETFs would also be allowed as long as the fund is not mainly composed by shares subject to the prohibition.

7. Are members of a trading venue considered as market makers just because they have a regular membership or a participant contract with the trading venue?

No, a notification must also be sent to the competent authority. Market makers' activities are defined in Article 2(1)(k) of EU Regulation 236/2012. Only entities which have notified their national competent authorities of their intention to make use of the exemption for market making activities in relation to shares under the prohibition in accordance with Article 17 of the Regulation will be considered as market makers. For these purposes, ESMA has a list of market makers available on its website. Investors must ensure that, apart from being on the list, the notification covers the instruments subject to the prohibition.

8. Does the exemption apply to third-country entities?

Market makers as defined in Article 2(1)(k) of the Regulation are exempted from the CNMV's prohibition, even if they are located outside the EU and have not been authorised in the EU, as long as they have notified their intention to perform market-making activities to the competent authority of the main EU trading venue where they trade. In that case, they will be included in ESMA's market-maker list mentioned above.

This notification should include the shares in respect of which the market maker will carry out its activity. ESMA's Guidelines¹ on exemptions for market-making activities under Regulation 236/2012 provide details on the notification procedure for entities located outside the EU (paragraphs 37 to 41). This means that entities located in third countries which are included in ESMA's list may benefit from the exemption to the CNMV's prohibition under the same conditions as EU market makers.

9. Can a market maker registered in the EU assign a net short position to another entity belonging to the same group for risk management purposes (back-to-back trades) if the latter is not a market maker?

¹ <https://www.esma.europa.eu/document/guidelines-exemption-market-making-activities-and-primary-market-operations-under-short>

An entity belonging to a group which is recognised as a market maker by a European competent authority may take short positions directly deriving from its market-making activities (as defined in Article 2(1)(k) of the Regulation); subsequently, these positions may be hedged or transferred for centralised risk management purposes, pursuant to EU Delegated Regulation 2017/2294, using back-to-back transactions, to other entities of the group that are not recognised market makers.

The above practice is not considered a breach of the prohibition as long as it is not undertaken with the intention of violating the prohibition and the connection between both flows of transactions can be demonstrated.

10. Can shares subject to the ban, which are components of an index but whose exclusion from it has already been announced/published (in order to anticipate an exclusion from the index) be sold?

Taking into account the potential impact of the change in the composition of the index (whose derivatives are quoted on trading venues) on the price of the shares to be excluded, the CNMV will accept investors, who replicate the performance of the index whose composition will be subject to changes, selling the securities even if the result of such sale is the creation, for a short period of time, of a net short position. This practice would only be allowed during the last trading session before the index's composition effectively changes.

To profit from the exemption, investors should be in a position to justify their trading to the CNMV and the closing of the resulting net short position at the latest the day before the date of the actual change of the index.