# PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

## Seventh Delegated Legislation Committee

# DRAFT SHORT SELLING (AMENDMENT) (EU EXIT) REGULATIONS 2018

*Wednesday 21 November 2018*

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**not later than**

**Sunday 25 November 2018**

**The Committee consisted of the following Members:**

*Chair:* Mr Laurence Robertson

† Ali, Rushanara *(Bethnal Green and Bow)* (Lab)
† Double, Steve *(St Austell and Newquay)* (Con)
† Glen, John *(Economic Secretary to the Treasury)*
† Hands, Greg *(Chelsea and Fulham)* (Con)
† Keegan, Gillian *(Chichester)* (Con)
† McGinn, Conor *(St Helens North)* (Lab)
† Malhotra, Seema *(Feltham and Heston)* (Lab/Co-op)
† Merriman, Huw *(Bexhill and Battle)* (Con)
† O'Brien, Neil *(Harborough)* (Con)
† Reynolds, Jonathan *(Stalybridge and Hyde)* (Lab/Co-op)
† Shelbrooke, Alec *(Elmet and Rothwell)* (Con)
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Trevelyan, Anne-Marie *(Berwick-upon-Tweed)* (Con)
† Umunna, Chuka *(Streatham)* (Lab)
† Walker, Thelma *(Colne Valley)* (Lab)
† Whittaker, Craig *(Lord Commissioner of Her Majesty's Treasury)*

Laura-Jane Tiley, Zoe Grunewald, *Committee Clerks*

**† attended the Committee**

# Seventh Delegated Legislation Committee

*Wednesday 21 November 2018*

[Mr Laurence Robertson *in the Chair*]

## Draft Short Selling (Amendment) (EU Exit) Regulations 2018

8.55 am

**The Economic Secretary to the Treasury (John Glen):** I beg to move,

That the Committee has considered the draft Short Selling (Amendment) (EU Exit) Regulations 2018.

May I say what a pleasure it is to serve under your chairmanship, Mr Robertson? It is a pleasure to be here again to introduce a statutory instrument. I thoroughly enjoyed the preparation for this debate.

In the context of the UK's withdrawal from the EU, the Treasury has been preparing extensively for a range of potential outcomes, including a no-deal scenario. This statutory instrument forms part of the work that is necessary to ensure that there continues to be a functional regulatory and legislative regime for financial services if the UK leaves the EU with no deal and no implementation period. As colleagues are aware, we have had a number of debates in the House as part of that process. The statutory instrument is another part of that programme of legislation.

Short selling is the practice of someone selling a security that they borrowed, with the aim of buying it back at a lower price than they sold it for. Following the financial crisis, a number of countries, including the UK, acted to suspend or ban short selling due to the risks it posed to the stability of the global financial system. In response, the EU introduced the short selling regulation—the SSR—which introduced a harmonised regulatory framework for short selling and certain aspects of credit default swaps. That regulation relates to financial instruments that are admitted to trading or traded on a European economic area trading venue.

Given that the UK would be outside the EEA and the EU's legal, supervisory and regulatory framework in a no-deal scenario, the existing legislation needs to be updated to reflect that and amended to ensure that its provisions work properly in such a scenario. The statutory instrument will therefore make a number of amendments to the SSR and related legislation, including certain parts of the Financial Services and Markets Act 2000, to ensure that they continue to operate effectively in the UK once the UK has left the EU.

First, the statutory instrument amends the scope of the regulation so that it relates only to instruments admitted to trading on UK venues and UK sovereign debt. Financial instruments admitted to trading only on EU venues will no longer be in the scope of UK regulation. Additionally, the statutory instrument amends the UK's powers to address threats to financial stability or market confidence in the context of the SSR. Under the current regulation, the UK can take action on instruments for which it is the most liquid market in Europe or that were first admitted to trading in the UK. If the UK wishes to take action on an instrument that has its most liquid market elsewhere in the European Union or was first admitted to trading on an EU venue, it is required to seek consent from the relevant EU regulator. The statutory instrument deletes that provision so that those instruments will be treated in line with other third-country instruments. That means the UK will be able to take action against any instrument traded on a UK venue and, before using those powers, will consider threats solely to UK market confidence and financial stability.

Secondly, the statutory instrument transfers to the appropriate UK bodies functions that are currently carried out by EU authorities. For example, there will be a transfer of powers, such as the power to specify when a sovereign credit default swap transaction is regarded as hedging against a default risk, from the European Commission to the Treasury. Powers will also be transferred to the Financial Conduct Authority from EU supervisory bodies. Those include powers that will enable the FCA to make technical standards and take action on all instruments admitted to trading on a UK venue. The FCA is the appropriate regulator to which to transfer those functions because it has the necessary technical expertise to make technical standards, due to its existing supervisory responsibilities in relation to short selling.

Thirdly, the statutory instrument deletes provisions that facilitate co-operation and co-ordination across the European Union. Currently, regulators in member states must notify their counterparts in other member states before taking action to restrict short selling, with other regulators subsequently determining whether to apply similar restrictions. This instrument removes those provisions, along with the powers of the European Securities and Markets Authority to intervene in exceptional circumstances.

The statutory instrument makes technical amendments to existing UK legislation, particularly part 8A of the Financial Services and Markets Act 2000, to ensure that the UK can continue to respond to overseas regulators' requests for information. It is the intention of the UK to preserve as far as possible a mutually beneficial working relationship with the EU, in the same way as we currently co-operate with non-EU regulators under existing provisions in the 2000 Act.

**Seema Malhotra** (Feltham and Heston) (Lab/Co-op): What assessment has the Treasury made of the likely increase in the volume of activity at the Financial Conduct Authority and whether the resources are sufficient to deal with that?

**John Glen:** I can confirm that the Treasury worked very closely with the FCA before publication of this SI on 9 August. Over the two months before the regulations were laid on 9 October, we took feedback from industry and the regulator, and we are confident that they are in a very strong position to deal with the requirements that they would be given in the context of a no-deal outcome subsequent to the SI.

Let me make some progress—I am nearly there. The instrument maintains a number of existing exemptions. The current regulation provides exemptions from certain

reporting requirements, restrictions on uncovered short selling for shares that are traded primarily in a third country, and the buy-in regime. Those will be maintained, and the FCA will now take on responsibility for publishing a list of relevant third country shares that are subject to the exemption—a responsibility that currently rests with the European Securities and Markets Authority. To ensure continuity at the point of exit, the FCA will recognise the ESMA list for two years following exit day, so that there will be no change to the exemptions.

Additionally, the SI maintains the exemption for market makers and authorised primary dealers under SSR. This exemption enables firms to carry out certain primary market operations and market-making activities without the requirement to disclose their net short position. Moreover, provided that they meet certain thresholds, those operators are not required to comply with relevant restrictions on uncovered short selling. Market makers will be required to join a UK trading venue and notify the FCA at least 30 days before exit should they wish to benefit from the exemption. However, the operators that have already done that will not experience a change.

The instrument deletes the conditions in the current regulation that must be met to be able to correlate sovereign issuer positions to sovereign debt. To determine sovereign debt correlation under SSR that can be used to offset the positions of sovereign issuers, those conditions are currently used. The deletion reflects the fact that the UK will be the sole sovereign issuer in question post-exit. The instrument will also provide the Treasury with the power after exit to set the relevant thresholds.

The instrument makes amendments that will enable UK credit default swaps to be used by market participants to hedge correlated assets and liabilities anywhere in the world, rather than solely in the EU. That will ensure that UK firms can continue to use UK sovereign credit default swaps to hedge correlated liabilities or assets issued by issuers in the EEA and, in future, across the rest of the world, too.

In summary, the Government believe that this SI is necessary to ensure that the regulatory regime relating to short selling and certain aspects of credit default swaps works effectively if the UK leaves the EU without a deal or an implementation period. I sincerely hope that colleagues will join me in supporting the regulations; I commend them to the Committee.

9.4 am

**Jonathan Reynolds** (Stalybridge and Hyde) (Lab/Co-op): It is indeed a pleasure to serve under your chairmanship, Mr Robertson. As the Minister said, this is one of a large number of SIs relating to preparations for a potential no-deal Brexit. We are enjoying doing about 70 between now and February. I think that I speak for everyone this morning when I say what a pleasure it is to have one of them immediately after two days on the Finance (No. 3) Bill. Our enthusiasm for being able to have a session this morning is evident.

As the Minister knows, the Opposition have voiced concerns about the adequacy of this process, but I will state them again for the record. The record number of Treasury statutory instruments, and the speed at which they are set to unfold, is deeply concerning when it comes to ensuring the Government are held fully accountable. As the Opposition, we commit to make every effort to do so, but this is a constitutionally unprecedented and enormously resource-intensive task that leaves room for error.

Today's legislation deals with the issue of short selling. As the Minister said, regulation of short selling is something that EU member states have worked collectively to achieve following the financial crisis, in line with global efforts to ensure that shorting does not exacerbate worsening market conditions for particular securities in times of volatility. The 10-year anniversary of the collapse of Lehman Brothers and the darkest moments of the financial crisis are a stark reminder that we cannot afford to be complacent on that front. It therefore makes sense that those regulations should be thoroughly enshrined in UK law, and protected in the event that we crash out without a deal.

However, I have some further questions to ask the Minister. First, which stakeholders, if any, were consulted regarding the instrument? Was there any dialogue with trading venues about implementation of these regulations from a solely UK perspective and, if so, how was their feedback taken into account? In addition, the explanatory memorandum says that

"the power to set notification thresholds for short selling positions"

will be transferred

"from the EU Commission to the Treasury."

The Minister made that point explicitly, so can he elaborate on the process for setting those thresholds in future? Will they continue to be fixed at the levels used by the EU Commission, or will the FCA or the Treasury have the power to adapt them in future? That seems to be the most substantive issue before us, and I would be grateful if the Minister provided some clarity on those points.

9.7 am

**Alison Thewliss** (Glasgow Central) (SNP): It is not just the enthusiasm from the Finance Bill but from the Scotland win last night, that has brought me here this morning. I am delighted to be here, and to report that news to the Committee, if Members have not already heard.

I have many of the same concerns about this instrument as the hon. Member for Stalybridge and Hyde. I continue to be concerned that we are putting an additional burden on the FCA and the Treasury, and I am yet to be convinced that we have not just the expertise, but the numbers of staff and the capacity, to take this on in addition to all the other SIs that have already been laid before the House, or will be in the weeks and months ahead. I would like some more information from the Minister about the detail of that.

Secondly, with all these powers going to the FCA and the Treasury, what will be the role of this House in scrutinising the measures as we go forward? Obviously, these are very important regulations, given the issues that arose in the 2008 crash, which might not have happened if we had had greater scrutiny at the time. After 10 years of progress on developing regulations, we do not want to slip back again once we fall out of the European Union mechanism for co-operation. I want safeguards to be put in place to make sure, should we move away from the current co-operation mechanism, that we do not end up in the same circumstances as we were in during the financial crash.

*[Alison Thewliss]*

I was concerned to hear the Minister discuss the deleting of co-operation provisions. Clearly, that is a result of coming out of the EU, but I want to know a bit more about what might replace those provisions in future, or what mechanisms will be set up for European co-operation in this area. It is in all of our interests to have those mechanisms—to have some means of working together—and just saying, "We will find a way of doing that in future" does not really cut it when we are talking about something that, if it is not done absolutely correctly, could bring down the entire economy.

**Seema Malhotra:** Further to my intervention on the Minister, and regarding the point that the hon. Lady has eloquently made, there appears to be an assumption that the volume of activity that this instrument may lead to will just be absorbed by the existing resources. Combined with the fact that it is not going to be business as usual post-Brexit, or indeed in the run-up to Brexit, does the hon. Lady agree that the issue of resources needs to be looked at more seriously as a result of this and other measures?

**Alison Thewliss:** I absolutely share the hon. Lady's concerns. As I said, we already have many SIs, and lots more are coming down the line. I am sure that many more exciting Committee sittings will take place to examine the details of those SIs. I would like a bit more clarity about the numbers of people who will be required to implement this regime, monitor it, and make sure that it works in future.

I would also like to know a bit more about the implications of this SI. The explanatory memorandum states:

> "Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit",

and it goes on to talk about continuity, certainty and all of those things. It would be useful to know how tightly we need to remain aligned to existing measures, now that we no longer follow those rules or have any influence in making them. I would question the whole point of leaving the EU in the first place if we have to stay that closely aligned—what is the point in leaving and having an inferior deal? Of course that is not what Scotland voted for, and that remains the case. Those are my questions. Other points were raised by other hon. Members, so I am happy to sit down and let the Minister reply.

9.10 am

**John Glen:** I will seek to address the specific points raised, but in response to the hon. Members for Stalybridge and Hyde and for Glasgow Central it is worth repeating that the Treasury is taking this exercise very seriously, and a lot of work and rigour is going into the SIs and the consultation process that goes with them. It is obviously exacting to get on top of all the details about what needs to happen, but each SI is taken seriously and there is a process of engagement, in this case with trading venues such as the London Stock Exchange, the FCA, the Bank of England and those who participate in the market. In response to the first question from the hon. Member for Stalybridge and Hyde, a considerable amount of work was done over that two-month period before the SI was published. An impact assessment has also been made, which will be published later today.

**Rushanara Ali** (Bethnal Green and Bow) (Lab): Usually, impact assessments are provided for these Committees. My office contacted the Treasury for an impact assessment, so can the Minister explain why it is being provided after the Committee? We do not have the opportunity properly to scrutinise SI Committee presentations of legislation, which is not acceptable.

**John Glen:** I understand the hon. Lady's concern, and this reflects the unusual nature of the process. The Treasury has made five impact assessments on these SIs, and I have been in dialogue with the Regulatory Policy Committee about the unusual nature of this process and the contingency arrangements for no deal. Those impact assessments will be published in due course.

**Rushanara Ali:** This is a broader issue that has been raised in previous debates, because we do not have the opportunity properly to scrutinise these measures with the relevant facts and information. Will the Minister give an undertaking that Committees will be provided with information in advance, to the best of the Treasury's abilities, rather than saying, "Sorry, we don't have anything to provide to you"? That is not acceptable because it means that these Committees are a rubber-stamping exercise without the relevant information and support to enable Members properly to conduct their roles and scrutinise the Government.

**John Glen:** The issues with impact assessments are extremely complicated, and we have taken the time needed to ensure that they are as robust as possible in a very constrained timeframe. This is not an optimal process, and I and my fellow Ministers and officials are doing everything we can to bring the impact assessment process to the scrutiny of the House as quickly as possible. The hon. Lady is correct—ideally we should have published these impact assessments sooner. We have proactively sought to engage Members on the issues with the SIs, anticipating concerns that may be raised, and we are doing everything we can. *[Interruption.]* I cannot give more comfort, I am afraid, but I am happy to give way if the hon. Lady thinks we can edify the Committee further.

**Rushanara Ali:** I am grateful to the Minister and apologise for taking up his time, but can he provide an undertaking that this will not happen in future? It is unacceptable that the impact assessment is provided after Committee sittings. Will the Minister give an undertaking that that will not happen, and that Committees will be held after the impact assessment has been made available?

**John Glen:** I undertake to continue to do everything I can to bring these impact assessments to the House as quickly as possible in the imperfect conditions that we have. Where possible, we will do that, but I also have to balance that with ensuring that the statutory instrument that I bring before the House is fit for purpose, because the objective is to provide a contingent regime in a no-deal scenario that is fit for the market and avoids the instability that we wish to avoid.

Turning to the second point by the hon. Member for Stalybridge and Hyde on thresholds, he asked me to elaborate on the transfer of powers from the European Commission to the Treasury. This SI onshoring process does not permit us to specify additional changes in policy. The Treasury is well equipped to make those judgments and will do so in a no-deal situation, as part of a larger piece of financial services regulation.

The hon. Member for Glasgow Central quite legitimately raised concerns, as she has done on a number of occasions, about the FCA's capacity to carry on the functions of EU bodies to implement this instrument and the resources available. I can reassure her once again that those resources are available. The FCA does have the resources to account for the additional work. Processes such as notifying a regulator of net short positions under the SSR will remain the same, and market makers in the UK will continue to report to the FCA in the same manner as they currently do under the European Security and Markets Authority, which delegates its implementation powers to the national competent authorities. In this country that is the FCA, so the FCA is equipped and ready to do that.

General concern was expressed about whether this means that we will go down a deregulatory route in a no-deal situation. It is my instinct, and, I think, that of the regulator, that we would wish to remain closely aligned. A no-deal situation, as undesirable as it is, does not mean we are in a situation of hostility. From my conversations with my counterparts in European countries, I know that they wish us to have a strong relationship even in a no-deal situation. I believe the lines of communication are open and the UK has been a force for good in securing high-quality regulations.

In conclusion, I believe that this SI is necessary to ensure that the regulatory regime relating to short selling and certain aspects of credit default swaps will work effectively if the UK leaves the EU with neither a deal nor an implementation period. I hope the Committee has found this morning's sitting informative and will join me in supporting the regulations.

*Question put and agreed to.*

9.17 am

*Committee rose.*