

HOUSE OF LORDS

Secondary Legislation Scrutiny Committee

11th Report of Session 2012-13

**Financial Services and Markets
Act 2000 (Short Selling)
Regulations 2012**

Plus Information Paragraphs on 5 Instruments

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Secondary Legislation Scrutiny Committee (formerly Merits of Statutory Instruments Committee)

The Committee has the following terms of reference:

- (1) The Committee shall, with the exception of those instruments in paragraphs (3) and (4), scrutinise—
 - (a) every instrument (whether or not a statutory instrument), or draft of an instrument, which is laid before each House of Parliament and upon which proceedings may be, or might have been, taken in either House of Parliament under an Act of Parliament;
 - (b) every proposal which is in the form of a draft of such an instrument and is laid before each House of Parliament under an Act of Parliament,
 with a view to determining whether or not the special attention of the House should be drawn to it on any of the grounds specified in paragraph (2).
- (2) The grounds on which an instrument, draft or proposal may be drawn to the special attention of the House are—
 - (a) that it is politically or legally important or gives rise to issues of public policy likely to be of interest to the House;
 - (b) that it may be inappropriate in view of changed circumstances since the enactment of the parent Act;
 - (c) that it may inappropriately implement European Union legislation;
 - (d) that it may imperfectly achieve its policy objectives.
- (3) The exceptions are—
 - (a) remedial orders, and draft remedial orders, under section 10 of the Human Rights Act 1998;
 - (b) draft orders under sections 14 and 18 of the Legislative and Regulatory Reform Act 2006, and subordinate provisions orders made or proposed to be made under the Regulatory Reform Act 2001;
 - (c) Measures under the Church of England Assembly (Powers) Act 1919 and instruments made, and drafts of instruments to be made, under them.
- (4) The Committee shall report on draft orders and documents laid before Parliament under section 11(1) of the Public Bodies Act 2011 in accordance with the procedures set out in sections 11(5) and (6). The Committee may also consider and report on any material changes in a draft order laid under section 11(8) of the Act.
- (5) The Committee shall also consider such other general matters relating to the effective scrutiny of secondary legislation and arising from the performance of its functions under paragraphs (1) to (4) as the Committee considers appropriate, except matters within the orders of reference of the Joint Committee on Statutory Instruments.

Members

Lord Bichard	Lord Methuen
Baroness Eaton	Rt Hon. Baroness Morris of Yardley
Lord Eames	Lord Norton of Louth
Rt Hon. Lord Goodlad (<i>Chairman</i>)	Lord Plant of Highfield
Baroness Hamwee	Rt Hon. Lord Scott of Foscote
Lord Hart of Chilton	

Registered interests

Information about interests of Committee Members can be found in Appendix 2.

Publications

The Committee's Reports are published on the internet at www.parliament.uk/seclegpublications

Information and Contacts

If you have a query about the Committee or its work, including concerns or opinions on any new item of secondary legislation, please contact the Clerk of the Secondary Legislation Scrutiny Committee, Legislation Office, House of Lords, London SW1A 0PW; telephone 020-7219 8821; fax 020-7219 2571; email seclegscrutiny@parliament.uk.

Statutory instruments

The National Archives publishes statutory instruments on the internet at <http://www.legislation.gov.uk/>, together with a plain English explanatory memorandum.

Eleventh Report

INSTRUMENT DRAWN TO THE SPECIAL ATTENTION OF THE HOUSE

The Committee has considered the following instrument and has determined that the special attention of the House should be drawn to it on the ground specified.

A. Financial Services and Markets Act 2000 (Short Selling) Regulations 2012 (SI 2012/2554)

Date laid: 9 October

Parliamentary Procedure: negative

Summary: The Regulations implement in part the EU Regulation on short selling and certain aspects of credit default swaps. They align with the EU Regulation the short selling regime already in place in the UK, and include provisions bearing on the relationship between the UK's regime and that of other Member States and the EU generally.

We draw this instrument to the special attention of the House on the ground that it gives rise to issues of public policy likely to be of interest to the House.

1. HM Treasury (HMT) has laid these Regulations (SI 2012/2554), with an accompanying Explanatory Memorandum (EM) and impact assessment (IA).
2. In March of this year, the EU agreed a Regulation¹ on short selling² and certain aspects of credit default swaps³ (“the EU Regulation”). The objectives of the EU Regulation are to lay down a common regulatory framework for the requirements and powers relating to short selling and credit default swaps (CDS), and to ensure a more coordinated and consistent approach by Member States when measures need to be taken in exceptional situations. In the recitals to the EU Regulation, mention is made of concern that, at a time of considerable financial instability, short selling could aggravate the downward spiral in the prices of shares, notably in financial institutions, in a way which could ultimately threaten their viability.
3. In its EM, HMT states that SI 2012/2554 implements the EU Regulation in part. It explains that the UK already has in place a short selling regime, and that the Financial Services and Markets Act 2000 (“the 2000 Act”) gives the Financial Services Authority (FSA) the power to make short selling rules. SI 2012/2554 repeals sections of the 2000 Act which gave the FSA the power to make short selling rules, because this power is superseded by the EU Regulation and is inconsistent with it. The FSA is designated to be the UK’s competent authority for purposes of the EU Regulation.

¹ Regulation EU No 236/2012

² Short selling is the practice where an investor sells an asset that he or she does not own, with the intention of buying identical assets back at a later date.

³ Credit default swaps are derivative contracts which act as insurance or a hedge against an issuer’s debt in case of a credit event (e.g. a default or debt restructuring).

4. HMT also states that the EU Regulation requires competent authorities to have all the supervisory and investigatory powers necessary for the exercise of their functions, and Member States to ensure that there are effective, proportionate and dissuasive penalties in place. SI 2012/2554 contains provisions to meet these requirements. Section 176 of the 2000 Act already gives the FSA a power of entry to premises, where certain information requirements have been imposed but not complied with. SI 2012/2554 provides that this power of entry is available where short selling information requirements have been imposed but not complied with, in relation to the premises only of persons authorised under the 2000 Act.
5. In the EM, HMT also summarises the process by which the House of Lords EU Select Committee, through its Economic and Financial Affairs and International Trade Sub-Committee, scrutinised the proposal for the EU Regulation in 2010-11. HMT states that the proposal was cleared by the EU Select Committee in November 2011.
6. We note that, in clearing the proposal from scrutiny, the letter from the Committee Chairman (of 8 November 2011) referred specifically to the issue of the powers that the proposal envisaged should be conferred on the European Securities and Markets Authority (ESMA). The Chairman noted that the Government did “not intend to support that part of the agreement which confers powers on ESMA to ban or restrict short selling under certain circumstances”. He added that the Committee did not find the Government’s argument convincing: “our view is that, due to the highly cross-border nature of the CDS trade, giving ESMA such intervention powers might be necessary to preserve financial stability in the EU”.⁴
7. In the EM to SI 2012/2554, HMT states that the EU Regulation sets out a number of actions that can be taken where a competent authority receives a request from a competent authority of another Member State to carry out an on-site inspection or an investigation; and that SI 2012/2554 makes provision for the FSA to cooperate with the competent authority of another Member State, or ESMA, where they require assistance for inspections or investigations. We sought further information from HMT on the division of powers between ESMA and Member States’ competent authorities, and this is enclosed as Appendix 1.
8. HM Treasury has told us that SI 2012/2554 deals only with aspects of the EU Regulation which need implementing in the UK. We note that statement without further comment. However, we are not persuaded by the claim in the Explanatory Memorandum that there is no significant public interest in the policy. The potential impact of short selling on financial stability is a matter of some concern; and, though the Government state that the changes made by these Regulations in essence carry forward the short selling regime already in place in the UK, while aligning that regime with the EU Regulation, the relationship between the UK’s regime and that of other Member States and the EU generally is also of interest, and indeed may evolve further.

⁴ <http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/CWM/CwMSubAJun11-Nov11.pdf>

OTHER INSTRUMENTS OF INTEREST

Draft Official Secrets Act 1989 (Prescription) (Amendment) Order 2012

9. This instrument was laid on 2 July and originally cleared at the Scrutiny Committee's meeting on 17 July. However subsequent enquiries by the Joint Committee on Statutory Instruments about the drafting of the instrument resulted in the Explanatory Memorandum (EM) having to be re-laid on 16 October in a corrected form to reflect more accurately the operation of the instrument. In particular the revised EM now gives an undertaking that the instrument will not be brought into effect until an officer of the Court of Common Council has been appointed – the appointment does not currently exist. Although we are satisfied that the original EM was not intentionally misleading it was inadequate and poorly drafted. We remind the Department of the need for all supporting material provided to Parliament with instruments to be accurate, clear and complete, and we expect Departments to ensure that appropriate clearance and checking procedures are in place to achieve this.

Elected Local Policing Bodies (Specified Information) (Amendment) Order 2012 (SI 2012/2479)

10. In our 49th Report of session 2010-12⁵ the Committee criticised elements of the original instrument⁶ as being overly bureaucratic and was concerned that the requirement for elected local policing bodies to publish all contracts for sums over £500 was impractical. In its response to the Committee's questions the Home Office said that officials would continue to work closely with partners in assessing the application of the Order in London and amend it if needed in advance of 22 November when its provisions would also apply to all Police and Crime Commissioners. This amending Order fulfils that undertaking and seeks to maintain transparency of information whilst removing some of the bureaucracy in relation to contracts and custody visitors. In particular it increases the value threshold for publication of tenders and contracts from £500 to £10,000 to match the arrangements in place for central Government. A list of contracts with a value of £10,000 is to be published but not the documents themselves. We are grateful to the Home Office for their diligence in pursuing this matter.

Local Authority (Duty to Secure Early Years Provision Free of Charge) Regulations 2012 (SI 2012/2488)

11. Since April 2004, local authorities in England have had a statutory duty to secure free part-time early years provision for all three- and four-year-olds in their area. This is known as the "free entitlement"; since September 2010, this provides for 15 hours' free education a week. The effect of these Regulations, laid by the Department for Education (DfE), is to extend the free entitlement to eligible two-year-olds from September 2013, in a targeted approach with a primary focus on economically disadvantaged two-year-olds.

⁵ 49th Report of Session 2010-12, HL Paper 249

⁶ Elected Local Policing Bodies (Specified Information) Order 2011(SI 2012/3050)

Around 150,000 children (20% of two-year-olds) will be eligible for free early years provision from September 2013: the majority will be from workless families. DfE states that, from September 2014, the Government plan to increase further the eligibility for free places, to include around 300,000 (40%) two-year-olds. New eligibility criteria will be required for this, and the Regulations will need to be amended accordingly.

12. DfE states that English local authorities will have a statutory duty to secure free early years provision for eligible two-year-olds, in addition to the free places for three- and four-year-olds, and that the extension is fully funded. £534m has been allocated for 2013-14 and will be distributed through the Dedicated Schools Grant; funding will increase to £760m in 2014-15, when the planned increase to include around 40% of two-year-olds is introduced.

Late Night Levy (Expenses, Exemptions and Reductions) Regulations 2012 (SI 2012/2550)

13. Chapter 2 of Part 2 of the Police Reform and Social Responsibility Act 2011 sets out the framework which enables a licensing authority in England and Wales to introduce a late night levy in its area. From 31 October the levy may be introduced by a licensing authority in its area if it considers it desirable to raise revenue in relation to the costs of policing crime and disorder connected to the supply of alcohol in that area between midnight and 6am, and it is payable by the holders of premises licences or club premises certificates which authorise the supply of alcohol during those hours. These Regulations set out in more detail the expenses which licensing authorities may deduct from levy receipts to cover its administration and the permitted exemption or reduction categories.

Magistrates' Courts (Regulation of Investigatory Powers Rules) 2012 (SI 2012/2563)

14. Following criticism of the way in which certain investigatory powers were being exercised by some local authorities, provision was included in the Protection of Freedoms Act 2012 to add an element of judicial control. From 1 November local authorities will need to obtain the approval of a magistrate for the use of any one of the three covert investigatory techniques available to them under the Regulation of Investigatory Powers Act 2000 (RIPA) that is Directed Surveillance, the deployment of a Covert Human Intelligence Source (CHIS) and accessing communications data. In each case, the role of the magistrate is to ensure that the correct procedures have been followed and the relevant factors have been taken into account. These rules set out the procedure for civil cases and mirror the provision made for these applications in criminal cases by the Criminal Procedure Rules 2012 (rules 6.1(4), 6.2 to 6.5 and 6.27 to 6.28), which were laid before Parliament on 12 July. While the Government anticipate that the great majority of applications will relate to criminal proceedings, it is possible that a local authority might consider it necessary to make use of the investigatory powers in question for civil cases (an example being that a civil antisocial behaviour order might result from an investigation), and so either option should be open to the local authority.

INSTRUMENTS NOT DRAWN TO THE SPECIAL ATTENTION OF THE HOUSE

The Committee has considered the instruments set out below and has determined that the special attention of the House need not be drawn to them.

Draft Instrument subject to affirmative approval

Police and Crime Commissioner Election (Welsh Forms)
Order 2012

Instruments subject to annulment

- SI 2012/2479 Elected Local Policing Bodies (Specified Information) (Amendment) Order 2012
- SI 2012/2488 Local Authority (Duty to Secure Early Years Provision Free of Charge) Regulations 2012
- SI 2012/2522 Disclosure and Barring Service (Core Functions) Order 2012
- SI 2012/2524 Syria (European Union Financial Sanctions) (Amendment No. 2) Regulations 2012
- SI 2012/2532 Education (Educational Provision for Improving Behaviour) (Amendment) Regulations 2012
- SI 2012/2546 Medicines (Products for Human Use) (Fees) (Amendment) Regulations 2012
- SI 2012/2550 Late Night Levy (Expenses, Exemptions and Reductions) Regulations 2012
- SI 2012/2551 Licensing Act 2003 (Early Morning Alcohol Restriction Orders) Regulations 2012
- SI 2012/2552 Housing and Regeneration Act 2008 (Consequential Provisions) Order 2012
- SI 2012/2553 Police and Crime Commissioner Elections (Declaration of Acceptance of Office) Order 2012
- SI 2012/2563 Magistrates' Courts (Regulation of Investigatory Powers) Rules 2012
- SI 2012/2567 Motor Fuel (Composition and Content) (Amendment) Regulations 2012

APPENDIX 1: FINANCIAL SERVICES AND MARKETS ACT 2000 (SHORT SELLING) REGULATIONS 2012 (SI 2012/2554)

Further information from HM Treasury

Q: Did the EU Regulation as agreed not provide ESMA with powers to ban or restrict short selling under certain circumstances? Is it therefore the case that, as regards action on short selling in the UK, the FSA retains exclusive competence, and ESMA has the power only to “require assistance for inspections or investigations”? Or can ESMA’s inspections or investigations cover activity in the UK and lead to a decision by ESMA to take action in relation to the UK’s markets?

A: ESMA was granted powers in Article 28 of the Short Selling Regulation (Reg. 236/2012) to take emergency intervention measures in respect of short selling in the EU. This permits certain actions to be taken if ESMA judges that the criteria in Article 28 are met – it is possible that the reasons as to why ESMA might consider that the Article 28 criteria is met is because of certain activities in the UK, as it could be with any Member State. In considering whether to exercise that power, or in exercising it, ESMA has no powers of inspection or investigation in Member States, though it may require a Member State’s Competent Authority (e.g. the FSA in the UK) to provide it with information.

On 31 May 2012, the Financial Secretary to the Treasury, Mark Hoban MP, wrote to the House of Lords’ European Union Committee, to update the Committee on the Government’s position on Article 28: “The Government notes your view that it is necessary for ESMA to have intervention powers due to the highly cross-border nature of the CDS trade. The Government supports the creation of European Supervisory Authorities (ESAs). But it is vital that as they come into being, the valuable work of the ESAs has a sound legal basis and that ESA decisions are not subject to legal uncertainty”.

At the same time, the UK applied to the European Court of Justice to make clear the legal position on Article 28, as it does not comply with the principle set out in the CJEU case of Meroni. The Regulation will come into force on 1 November 2012, and Article 28 will stand until the ECJ come to a decision regarding our case.

The Short Selling Regulation is directly applicable so does not need to be transposed. The SI published only dealt with aspects of the short selling regulation which needed implementing in the UK. Implementation was needed for:

- a) repealing UK legislation incompatible with the short selling regulation, and
- b) giving the UK competent authority (FSA) the necessary enforcement powers.

As it was directly applicable, the Article 28 ESMA powers did not require implementing legislation. As the Committee has noted, the implementing Regulations do indeed extend the FSA’s investigatory powers to enable FSA to exercise powers at the request of ESMA (regulation 2(3)(c)). This implements Article 37 of the Short Selling Regulation (“Cooperation in case of request for on-site inspections or investigations”), rather than Article 28.

HM Treasury

16 October 2012

APPENDIX 2: INTERESTS AND ATTENDANCE

Committee Members' registered interests may be examined in the online Register of Lords' Interests at www.publications.parliament.uk/pa/ld/ldreg.htm. The Register may also be inspected in the Parliamentary Archives.

For the business taken at the meeting on 23 October 2012 Members declared the following interests:

Education (Educational Provision for Improving Behaviour) (Amendment) Regulations 2012 (SI 2012/2532)

Baroness Eaton, as Foundation Trust Governor, Bingley Grammar School, West Yorkshire, and Governor, Lady Lane Park Preparatory School, Bingley, West Yorkshire.

Lord Norton of Louth, as Governor, King Edward VI Grammar School, Louth.

Lord Plant of Highfield as Governor, Pilgrim's School, Winchester.

Attendance:

The meeting was attended by Lord Bichard, Lord Eames, Baroness Eaton, Lord Goodlad, Lord Methuen, Baroness Morris of Yardley, Lord Norton of Louth, Lord Plant of Highfield and Lord Scott of Foscote.