Amafi > Association française des marchés financiers
FINANCIAL MARKET PROFESSIONALS

AMAFI / 17-59
4th September 2017

ESMA Consultation on the evaluation of certain aspects of the Short Selling Regulation

AMAFI contribution

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

On 7th July 2017, ESMA issued a Consultation Paper (CP) on the on the evaluation of certain aspects of the Short Selling Regulation.

AMAFI welcomes the opportunity to comment on this CP. Before responding to the specific questions of ESMA's consultation document, we would like to point out the following general comments.

GENERAL COMMENTS

Since September 2008, when competent authorities in several Member States and supervisory authorities in third countries such as the United States of America and Japan adopted emergency measures to restrict or ban short selling in some or all securities, AMAFI had been very active at the national and European levels with the purpose to help putting in place a sound and reliable regulation on short selling. AMAFI had advocated an EU regulation in order to harmonise European divergent practices and to restore confidence in markets[1].

In this context, AMAFI welcomed the implementation in November 2012 of the Regulation (EU) N° 236/2012 on short selling and certain aspects of credit default swaps (SSR). In general, SSR is well calibrated and does not raise any important regulatory issue for market participants.

Having said that, AMAFI considers that some particular issues should be addressed and solved in order to improve the common application of the rules within the EU and to diminish the costs of compliance for market participants without prejudice to the current regime. Therefore the Commission mandate to ESMA to provide technical advice on SSR is very welcome since it concerns the two main drawbacks of the current regime: the exemption of market making activities (membership requirement and product scope) and the burden of the reporting of net short positions by market participants.

[1] See notably AMAFI's answer to the European Commission consultation on short selling (AMAFI / 10-37, 9 July 2010).

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On the exemption for market making

The exemption for market making activities is probably the most critical issue of the SSR regime. ESMA Guidelines issued in April 2013[2] are based on what AMAFI considers to be an excessively narrow interpretation of "market making activities": the exemption for market making activities is linked to a trading venue membership requirement and is only available for instruments which are taken into account when calculating a net short position in shares or sovereign debt[3].

This restrictive approach led some Member States to declare non compliance with these parts of the Guidelines considering that ESMA interpretation was not in line with the Level 1 provisions[4].

This is not a satisfactory situation as it creates discrepancy within the EU regulatory framework.

On the first point, AMAFI really believes that the membership test is not appropriate[5]. Indeed, and even if ESMA recognizes that the market maker is not required to conduct its market making solely on a trading venue, the exemption can only be used for financial instruments that are traded or admitted to trading on a trading venue, and, for instance, cannot be used in relation to trading in OTC derivatives, and to related hedging of such instruments.

We therefore encourage ESMA to modify its Guidelines in order to get rid of the trading venue membership requirement. Like many Member States, we consider that it would not be inconsistent with the Level 1 provisions.

But should the co-legislators and the Commission consider that it is necessary to amend the Level 1 text, AMAFI would support such an approach.

On the second point, AMAFI totally agrees with the Financial Conduct Authority (FCA) when explaining the reasons why they would not comply with this part of the Guidelines[6] *"However, the rationale for having a market maker exemption also applies to financial instruments other than equities, sovereign debt and equity/sovereign debt derivatives. For example, it is a common strategy for market makers in corporate bonds to hedge their market making risks by trading in the relevant sovereign debt: this not only hedges against changes in sovereign credit risk embedded in the corporate bond but also the general level of interest rates in the economy. It is therefore a necessary and legitimate part of the market making activity. Without the exemption, the market maker would need to meet all the conditions for undertaking a short sale in sovereign debt which would impair the market making function, increase costs to the market maker and end users and decrease liquidity in the market"*

Therefore AMAFI fully supports ESMA recommendation to enlarge the scope of the financial instruments eligible for the market making exemption, so as to encompass, *inter alia*, corporate debt instruments, convertible bonds and rights.

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[2] Guidelines on the exemption for market making activities and primary market operations under the SSR (ESMA/2013/158).

[3] These instruments are listed exclusively in part 1 (for shares) and part 2 (for sovereign debt) of Annex 1 of Commission Delegated Regulation (EU) No 918/2012.

[4] https://www.esma.europa.eu/sites/default/files/library/esma70-21038340-46_compliance_table_-_guidelines__on market making_activities_under_ssr.pdf

[5] See AMAFI response to ESMA consultation paper on the "*Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps*" (AMAFI / 12-44, 5 October 2012).

[6] https://www.esma.europa.eu/sites/default/files/library/esma70-21038340-46_compliance_table_-_guidelines_on market_making_activities_under_ssr.pdf

Ultimately, AMAFI considers that the SSR market making exemption should be available for investment firms when dealing as principal, on or outside a trading venue, in a financial instrument (given the MiFID definition of a financial instrument) in any of the following capacities:

- (i) by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
- (ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
- (iii) by hedging positions arising from the fulfillment of tasks under points (i) and (ii).

On the reporting and disclosure mechanism

AMAFI strongly supports ESMA proposal to put in place a centralized notification and publication system as it would indeed provide simplification and reduce costs for market participants.

In addition, and it is not mentioned in the CP, we believe that it would also be very useful to centralize and make available, at ESMA level, the information on short term bans activated by competent authorities.

Questions

Exemption for market making activities

Question 1 : Taking into account the different regulatory approaches and purposes of MiFID II and SSR, what are your views on the absence of alignment between the definition of 'market making activities' in each of the capacities specified in Article 2(1)(k) of SSR and that of 'market maker' in Article 4(1)(7) of MiFID II ? Do you consider that this absence of alignment is not appropriate, and if so what would you suggest?

In general, we consider that the absence of alignment between definitions of market making activities in various pieces of legislation is not a drawback. These regulatory frameworks were developed to serve different purposes and trying to have an alignment of definitions could lead to unexpected consequences.

Further to that general comment, the definition of market maker in article 4(1)(7) of MiFID II is very broad[7] but in fact, is not used for any other provision of the MiFID II/MiFIR package. This regime only deals with the obligation of market making activities carried out on trading venues and in relation to algorithmic trading.

Therefore the alignment of definitions between both regimes is not desirable and as mentioned in the introductory remarks above, the SSR market making exemption should be available for investment firms when dealing as principal on or outside a trading venue in a financial instrument (given the MiFID definition of a financial instrument) in any of the following capacities :

- (i) by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
- (ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
- (iii) by hedging positions arising from the fulfillment of tasks under points (i) and (ii).

Question 2: Considering the new regulatory framework under the MiFID II/MiFIR, how do you suggest addressing the issue of the membership requirement in relation to those instruments that will remain pure OTC instruments despite the MiFID II/MiFIR framework? Should the membership requirement not apply to those pure OTC instruments? Please provide justifications.

AMAFI sees no basis in the SSR text for requiring that marker making activities be linked to a trading venue.

Further to that comment, we like to insist that, while the MiFID II/MiFIR framework aims at, and will likely result in, increasing transparency on non equity markets and bringing more transactions on multilateral platforms and systematic internalisers, it doesn't have the purpose to eliminate pure OTC instruments.

[7] «'*market maker' means a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against that person's proprietary capital at prices defined by that person*».

Therefore, as stated in our introductory remarks, we consider that it is crucial to remove the membership requirement from the SSR framework, independently from the purposes and outcomes of MiFID II/MiFIR.

Question 3: Where market making activities on exchange-traded instruments are carried out OTC only, should they be able to benefit from the exemptions? Do you consider that the application of the exemptions in those cases can be detrimental to the interest of investor and consumers? Please provide justifications.

AMAFI would like to point out that, while being critical for the good functioning of markets, investors and consumers protection issues are dealt with through specific EU regulations, and that the SSR regime should not to be calibrated to address these issues.

We consider that market making activities on exchange-traded instruments carried out OTC only should benefit from the exemptions.

Question 4: Do you think that the membership requirement should be deleted where the market making activity in relation to exchange-traded instruments is carried out OTC as well as on a trading venue? Please explain.

Yes. AMAFI believes that the membership requirement should be deleted in relation to the market making exemption under the SSR rules.

Question 5: Do you have proposals in relation to the improvement of the transparency of market making activities conducted OTC and exempted under the SSR? Do you think that requiring a firm willing to benefit from the exemption for its market making activities conducted OTC to qualify as systematic internaliser is a viable option that would improve the transparency of their activity? Please provide justifications.

AMAFI disagrees with ESMA's approach in that matter. The MiFID II/MiFIR framework provides for generic post-trade transparency obligation, and introduces criteria to determine which liquidity providers qualify as systematic internalisers (SI) and hence have to comply with pre-trade transparency rules. There is absolutely no reason why SSR should be used to force more liquidity providers into the SI category, in an attempt to increase the level of transparency.

Besides that, the SI regime is made for investments firms that carry out their activities on a "frequent, systematic and substantial" basis. This is totally different from the market making activities defined by SSR. It is totally possible to be a market maker according to SSR rules without meeting the SI requirements.

Question 6: Do you think it would be appropriate to enlarge the set of financial instruments eligible for the exemption for market making activities? If so, which financial instrument(s) would you suggest? Please provide justifications.

As mentioned above, AMAFI is in the view that the list of eligible instruments in the Guidelines is too restrictive and should be enlarged to other financial instruments that are used by market maker to hedge their positions. *A minima*, the new list should comprise corporate bonds, convertible bonds, subscription rights, dividend swaps…

But AMAFI does not really understand the rationale behind setting up a specific list for the SSR purposes[8]. It must be noticed that Article 2(1)(a) of the Regulation contains a straightforward definition of financial instrument for the purposes of the Short Selling Regulation (i.e. those financial instruments listed in Section C of Annex I to MiFID). AMAFI therefore considers that there is no reason to diverge from this list.

In addition and in any case, the lists (Part 1 and 2 of Annex 1 of the Commission Delegated Regulation N° 918/212) which determine the way short positions are calculated for notification purposes should be enlarged to corporate bonds, convertible bonds, subscription rights, dividend swaps. Indeed, the current regime imposes the notification of positions that are actually not short. It is burdensome and sends a misleading signal to the regulator but also in certain circumstances to the market.

Question 7: Do you think that market makers should be able to notify the list of financial instruments by using indices, as long as they are market making in all the financial instruments included in the used indices? Besides indices, which other sectoral categories / classification could be used by market makers to indicate a group of financial instruments for which the market maker is seeking exemption? Please provide justifications.

Yes. AMAFI fully agrees with ESMA assessment in the CP that the instrument by instrument approach is too burdensome and difficult for market participants as well as competent authorities.

AMAFI considers that notification should be done:

- For shares on an index basis;
- For listed derivatives on a class of options basis and/or for all the maturities of a future contract;
- For sovereign bond on a sovereign issuer basis.

Question 8: Do you think that the 30-day period mentioned in Article 17(5) of the SSR should not apply when the notification refers to instrument admitted to trading for the first time on an EU trading venue? Please provide justifications.

Yes. AMAFI supports this proposal. Indeed financial instruments are created on a daily basis and market making activities are often crucial at the early stage of the life of a financial instrument. Often, the new issuance is not known 30 days in advance, does not have any ISIN code…. Moreover, it is almost impossible for firms to provide indication of expected volumes for new instruments.

[8] Part 1 and 2 of Annex 1 of the Commission Delegated Regulation N° 918/212

Question 9: What would you suggest to reduce the 30-day period mentioned in Article 17(5) of the SSR to provide for a faster process? What are your views on a quicker procedure for market makers that have already entered into a market making agreement/scheme with a trading venue or the issuer to classify as market maker in such venue? Please explain.

AMAFI considers that the 30-day period could be significantly shortened. As it is mentioned by ESMA in paragraph 55 of the CP: "*On the other hand it may not represent a major issue, provided that the competent authorities have the power to prohibit the use of the exemption at any time, thus also after the end of the notification period".*

Short term restrictions on short selling in case of a significant decline in prices: Article 23 of SSR

Question 10: What are your views on the proposal to change the procedure to adopt short term bans under Article 23 of the SSR? Please elaborate.

AMAFI does not have any particular comment on this question.

Question 11: What are your views on the proposal to change the scope of short term bans under Article 23 of the SSR? Please elaborate.

AMAFI does not have any particular comment on this question.

Transparency of net short positions and reporting requirements

Question 12: Do you see any reasons to change the current levels of the thresholds regarding the notification to competent authorities and the public disclosure of significant net short positions in shares? Please elaborate.

No. AMAFI is comfortable with the current thresholds.

Question 13: Do you see benefits in the introduction of a new requirement to publish anonymised aggregated net short positions by issuer on a regular basis? Can you provide a quantification of the benefit of such new requirement to your activity? Please elaborate.

AMAFI does not have any particular comment on this question.

Question 14: Do you agree that the notification time should be kept at no later than 15:30 on the following trading day? If not, please explain.

Yes. AMAFI agrees that the notification time should be kept at no later than 15:30 on the following day even if a later notification deadline would be preferable given the huge number of data investment firms, which operate in different jurisdictions, have to process and to check before the notification.

Question 15: Do you agree that the publication time should be changed at no later than 17:30 on the following trading day? Please elaborate.

AMAFI agrees with this proposal. Moreover, and contrary to ESMA opinion, AMAFI is in the view that the publication should be published when the markets are closed.

Question 16: What are your views on a centralised notification and publication system at Union level? Can you provide a quantification of the benefit of such centralised notification to your activity? What are your views on levying a fee on position holders to have access to and report through such a centralised system? Please elaborate.

It is obvious that a centralized notification and publication system would be highly preferable than the current decentralized one, provided it is used by all or the vast majority of NCAs. It would be more efficient for both market participants and regulatory bodies.

The question of charging fees to the system participants is important. AMAFI considers that the ongoing running costs of a central system should be significantly lower than the current costs of running separate systems. AMAFI anticipates that the moving costs to a central system should be borne by the NCAs through the amortization of the saves incurred by the migration on a central system.

Question 17: Which other amendments, if any, would you suggest to make the notification less burdensome?

Before the implementation of a central system, if any, it would be highly profitable, in order to lower the costs of the notification regime, to have harmonized registration process and notification methodologies. Currently, each regulator requires a different level of information, some more detailed than others. The submission process varies from hard copies to emails or the use of online platforms.

Moreover, it would also be very useful to centralize, at ESMA level, an information system on the short term bans activated by a competent authority.

Question 18: Do you agree that the identification code of the position holder should be the LEI and that such code should be mandatory for legal entities? Please elaborate.

Yes. AMAFI considers that LEI code could be used for legal entities considering that this code is widely used by other regulations such as EMIR, MiFID II/MiFIR or MAD/MAR.

Question 19: What are your views on the method that should be favoured, the nominal method or the duration-adjusted method as described above? In the latter case, do you think that the thresholds should be changed? Please elaborate.

AMAFI welcomes ESMA's proposal to modify the method of calculation of the net short position in debts. The existing duration-adjusted method as described by ESMA could be envisaged.