afme/ Finance for Europe

ISDA Safe, Efficient Markets

4 September 2017

European Securities and Markets Authority (ESMA)
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07

Dear Madam/Sir,

ESMA call for evidence on the evaluation of the Regulation (EU) 236/2012 of the European Parliament and the Council on Short Selling and certain aspects of Credit Default Swaps

The Association for Financial Markets in Europe ("**AFME**") and the International Swaps and Derivatives Association, Inc. ("**ISDA**") [1] thank the European Securities and Markets Authority ("**ESMA**") for the opportunity to comment on the ESMA Consultation Paper on the evaluation of certain elements of the Short Selling Regulation (the "**Regulation**", "**SSR**', "**Level 1**").

The comments in this response reflect the membership of AFME and ISDA which together represent global and European banks and other significant participants in Europe's wholesale financial markets, many of whom serve as market makers to asset managers, insurance companies, pension funds, corporate, end users, sovereign debt management offices as well as other issuers, investors and market participants. AFME, ISDA and its members are keen to be a part of any future ongoing dialogue in relation to this issue and would welcome an opportunity to meet with ESMA and other authorities to discuss our views in more detail.

[1] **About AFME**
AFME promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information please visit the AFME website www.afme.eu.

About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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Introductory remarks

AFME-ISDA welcome the opportunity to provide feedback to ESMA on the evaluation of certain elements of the SSR that became applicable on 1 November 2012. We hope that the feedback below is timely and helpful to ESMA in preparing its advice to the European Commission.

Our views below take into consideration the following:

- ESMA's Guidelines on the exemption for market making activities and primary market operations under the SSR (issued in April 2013 ("ESMA's Guidelines");
- ESMA's Technical Advice to the European Commission on the evaluation of the SSR in a number of areas (transmitted to the Commission in June 2013);
- ESMA's Guidelines compliance table (dated 2 August 2017) ("Guidelines Compliance Table");
- Ongoing work in relation to the implementation of MiFID II/MiFIR and views formulated by AFME and ISDA in the context of that framework. As the implementation of MiFID II/MiFIR remains an ongoing workstream it is possible that we may have further points in the near future on the interaction between SSR and MiFID II/MiFIR.

We look forward to engaging in a dialogue with ESMA on the issues addressed in this response and stand ready to discuss our views in more detail and consider providing further information if useful to ESMA.

Exemption for market making activities – general views

By way of introduction, AFME-ISDA stress that key views we have expressed to ESMA and the Commission on the exemption for market making activities and ESMA's Guidelines remain unchanged. We take the opportunity to reiterate some of these views as they inform our thinking in responding to ESMA's questions in the consultation paper.

We remain strongly of the view that there has been an overly narrow interpretation in ESMA's Guidelines of how the market making exemption in the SSR should be applied. We believe that the introduction of requirements in ESMA's Guidelines that go beyond what was required in the Level 1 text has led to the situation in which ESMA's Guidelines are not followed in full by all EU Member States.

The first key issue with the ESMA Guidelines is the narrow interpretation of the "market making activities" definition with regard to the trading venue membership requirement. Based on this interpretation, the exemption can only be used by market makers when carrying on market making activity in relation to a financial instrument that is traded on or admitted to trading on a

trading venue – therefore the exemption cannot be used in relation to OTC derivatives transactions (and associated hedging of such transactions). We see no basis in the Level 1 text for this distinction between instruments which trade on a trading venue and those which do not, nor for any implication that market making needs to be linked to a particular trading venue. The inclusion of the trading venue membership requirement in the Guidelines goes against the objective of the exemption set out in Recital 26 of the Regulation and has the effect of excluding legitimate market making activity. The provision of liquidity (in particular for some sovereign debt and sovereign CDS instruments) outside of trading venues is important, as such venues may not provide enough liquidity, flexibility or tailored solutions to support all trading needs in large, bespoke and/or illiquid transactions. It is also worth noting – and giving due recognition to – the fact that it is not necessary to utilise an exchange/trading venue to make a market in a particular instrument and that OTC markets are extremely important in providing liquidity to clients.

We made representations to ESMA and the European Commission at the time when the Guidelines were being developed explaining our concerns and providing legal analysis supporting our interpretation of the Level 1 text. The problems with the current Guidelines may be in part a result of an interpretation issue in the English language version of the SSR: the Guidelines incorrectly interpret the word "where" of the definition in Article 2(1)(k) of the SSR to mean a geographical reference linking the market and the instrument.

In our letter to ESMA of 5 October 2012 we stated:

"As an initial matter, we believe that this is a misunderstanding of the definition of market-making activities in Article 2(1)(k) of the Regulation and that it (a) hinders the clear purpose of the legislator; and (b) cannot be reconciled with the language of the regulation in other language versions of the text.

"Our interpretation of market-making activities is that there is no requirement for a link between the trading venue of which the relevant party is a member and the financial instrument in which it deals. We can reasonably assume that the approach in the ESMA draft Guidance is based on the use of the word "where" in the English language version of the definition in 2(1)(k). ESMA has interpreted this as a geographical reference linking the market and the instrument. But for the reasons set out below, this interpretation cannot be supported. Instead, the word "where" should be interpreted as "in circumstances in which" or "when". Accordingly the pre-conditions should be that (a) the relevant party is a member of **a** trading venue; and (b) that it deals as principal in the relevant financial instrument, but not that the instrument be dealt in on that venue (or indeed on any venue).

"We provide the following to further support our view:

"Other language versions of the Regulation (such as the French, German, Dutch, Polish, Slovakian, Romanian and Spanish versions) would not support the existing ESMA interpretation. These versions do not impose any requirement between the trading venue and the instrument, but instead are consistent with the interpretation which we set out above. They state that the requirement for membership of a trading venue and the requirement to deal as principal in the financial instrument, are unconnected tests. The ESMA reading conflicts with non-English versions of the Regulation and therefore we do not believe is appropriate for guidance to regulators on the market-making exemption."

We note that the above view is shared by other competent authorities in the feedback published in the Guidelines Compliance Table.

The second issue in the Guidelines is the unavailability of the market making exemption in respect of certain instruments (and associated hedging of such instruments) which do not themselves create positions in relevant companies or sovereign debt for the purposes of the Regulation's disclosure regime – for example corporate debt, convertible bonds and rights. We support ESMA's assessment of the impact of this provision in the Guidelines, and its recommendation that the scope of the financial instruments eligible for the market maker exemption be expanded to include the aforementioned instruments. See also our thoughts on corporate bonds and unlisted structured products in the sections below.

Our clear view is that the above concerns regarding the market making exemption stem from the interpretation of the SSR adopted in ESMA's Guidelines, and therefore do not require a revision of the Level 1 text.

It could thus be argued that ESMA's Guidelines could be subject to revision in relation to the above points, rather than the Level 1 text. We therefore call on ESMA and the Commission to consider this option to address concerns in this area.

Should the Commission and the co-legislators agree that it may be desirable to amend the Level 1 text in order to provide additional clarity on the market making exemption, we would support such an approach as long as it is aimed at removing the above-mentioned requirements introduced in ESMA's Guidelines. While a Level 1 review in this area is unnecessary in our view, AFME-ISDA would support such a review if it is conducive to having an appropriate interpretation of market making under the SSR that can be followed with full consistency across the EU. We do support ESMA's supervisory convergence mandate and regret that a flawed interpretation of the Level 1 text has been an impediment to achieving convergence across the EU.

We would argue for the definition of "market making activities" under Article 2(k) of the SSR text to be amended such that:

- it is clearer that the market making exemption only requires a firm to be a member of a trading venue, rather than be a member of a trading venue where each instrument in which the firm makes markets is traded; and
- it is clearer that the exemption is available in relation to market making in any "financial instrument" (as per the MiFID definition – see our comments under question 6), rather than only in relation to market making in financial instruments positions in which must be taken into account when calculating a net short position in shares or sovereign debt.

Such amendments would in turn allow ESMA to revise its Guidelines on the exemption.

Other issues relating to the exemption for market making activities

- We strongly believe that the market making exemption should not be linked to the systematic internaliser (SI) status. The secondary markets transparency regime is already extensively addressed under MiFID II/MiFIR and additional transparency requirements are neither necessary nor appropriate under the SSR.
- We agree that market makers should be able to notify the list of financial instruments by using indices and sectoral categories/classifications, but note that these categories would need to be clearly defined. It is also important that practical challenges are considered. We make a number of recommendations under question 7.
- We agree that the 30-day period mentioned in Article 17(5) of the SSR should not apply when the notification refers to instruments admitted to trading for the first time on an EU trading venue. We advise ESMA to consider changing the requirement so that the exemption can be relied on from the time of notification, with the competent authority retaining a right to reject it within 30 days upon which time the firm would need to immediately cease relying on the exemption.
- We are not convinced that a compelling case has been made to change certain aspects of the procedure to adopt short term bans under Article 23 of the SSR.
- We wanted to take the opportunity to refer to the provisions regarding the market making exemption in relation to non-EU entities. As the Commission has not yet completed equivalence determinations under

Article 17, we recommend to amend the definition of "market making activities" to permit non-EU market making firms to make use of the exemption, by way of notification to the relevant competent authority, until such time as the Commission publishes a negative determination. Although third country equivalence is not addressed in ESMA's consultation document, we believe it is a relevant issue to consider in a future review of the SSR. In the alternative, where the Commission makes equivalence determinations for the purposes of other EU directives and/or regulations, it should extend those determinations to Article 17 of the SSR.

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

- We are not convinced that a compelling case has been made to change certain key aspects of the procedure to adopt short term bans under Article 23 of the SSR. We strongly caution against proposals which could result in bans being extended across the EU on the basis of the analysis and intentions of a single national competent authority. However, we would support any measures which would ensure that where one competent authority has adopted a short term ban, information is made available at the same time to confirm whether any other competent authorities have adopted a similar measure.

- We strongly disagree with proposals to broaden the scope of Article 23 to include OTC trading and derivatives. The trading obligations for shares and derivatives being introduced under MiFID II/MiFIR already regulate and seek to limit the scope of OTC trading in certain instruments. We do not see a regulatory justification or need for introducing further restrictions under the SSR targeting OTC trading.

Transparency of net short positions and reporting requirements

- We very much support the establishment of a centralised notification and publication system at Union level. Such a system would be highly desirable for market participants and competent authorities, and would enable a more efficient use of time and resources for notifying firms. However, the benefits would only be realised if the vast majority of competent authorities agreed to move to such a model.

- We recommend to make LEI use optional, rather than mandatory, at this stage. The LEI system may not be appropriate to all market participants at the present time, including those that may have specific

arrangements to distinguish between branches within the EU which are subject to the SSR separately.

- We do not see a case for introducing new requirements to publish anonymised aggregated net short positions by issuer on a regular basis.

- We would support an end of day notification deadline (on the following day; T+1) which would be consistent with timeframes for reporting and other obligations in other legislations.

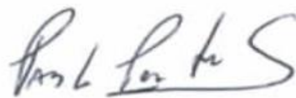
- We would recommend a harmonised registration process and standardised notification methodology; it would also be beneficial to use a central database to provide firms with access to the issued share capital of in-scope issuers for SSR net short position calculation purposes.

- We welcome ESMA's proposals for alignment of the treatment of positions in cash and positions in derivatives in relation to sovereign debt. Method (b) should be favoured – the existing "duration adjusted method" with an explicit mention to the fact that derivatives should also be adjusted by the duration of the underlying in order to have a consistent approach between cash positions and derivative positions, as identified in paragraph 176 of the consultation document.

AFME and ISDA remain ready and willing to discuss any of the matters in our response as and when convenient to ESMA. Questions or comments can be addressed to the signatories below or Will Dennis (will.dennis@afme.eu); Louise Rodger (louise.rodger@afme.eu); and Julia Rodkiewicz (jrodkiewicz@isda.org).

Yours faithfully,

AFME



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Exemption for market making activities

Q1: 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?

We do not believe that it is necessary or practical for definitions of “market making activities” or “market maker” to be identical across different pieces of EU legislation; it is sufficient for specific definitions to be particular to the related regulations and provisions where they are referenced. The definitions under the SSR and MiFID II have been drafted and debated in the context of different legislations with their respective objectives and we would see a risk of unintended consequences if word-by-word alignment was pursued. We also note that entities may be subject to the regulations of other jurisdictions which may have different definitions relating to market making.

We provide additional thoughts under question 2.

Q2: 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.

As noted in our introductory remarks, in relation to market making activities, we see no basis in the SSR text for any implication that market making needs to be linked to a particular trading venue. As the MiFID II text does not make reference to any trading venue membership requirement to undertake market making activities, we see no inconsistency between the SSR and MiFID II in this respect.

Our view is that the exemption for market making activities under the SSR should apply – and indeed does apply according to our interpretation of the Level 1 text – irrespective of whether the market maker is dealing in a pure OTC instrument or an instrument traded on a trading venue, and provided that the other elements of the market making definition are satisfied. We would therefore support an amendment to the drafting of the SSR text if this would serve to provide additional clarity that the market making exemption also applies to instruments that are not admitted to trading or traded on any trading venue. In our view the requirement under the Level 1 text is for the entity undertaking market making activities to be a member of a trading venue – any EU trading venue or market in a third country declared as equivalent –

and not a member of the venue on which the particular instrument for which notification is sought is traded.

The justification for this change is that under the existing ESMA Guidelines certain legitimate market making activities have been excluded from the scope of the market making exemption by virtue of an overly restrictive interpretation of the membership requirement, and this cuts across the stated purpose of the exemption in Recital 26 of the SSR.

While the future scope of trading OTC remains to be seen following MiFID II/MiFIR implementation, we believe it may not diminish – at least in the short-term – in various products. For example, OTC equity swaps (give-up flow) and other instruments are not expected to be required to trade on a trading venue in the foreseeable future. Also, in some instances, e.g. where an OTC swap/derivative is not a plain vanilla swap/derivative, it will not be required to be traded on exchange but the position will still need to be hedged and the market making exemption applied in respect of that hedge.

In relation to the sovereign CDS single name market, there is no active dealer to customer trading venue. Post MiFID II, this situation is not expected to change and hence we do not believe that the universe of these OTC instruments would necessarily shrink as a result of MiFID II. For this reason the market making exemption should equally apply to instruments that are not admitted to trading or traded on any trading venue and which are OTC in nature. Provision of liquidity outside of the trading venue is equally important and the market making definition needs to be flexible to cover not just large and standardised aspects of the market, but also bespoke and illiquid sovereign CDS products.

Q3: 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.

Yes, we agree that the market making exemption should not be limited to exchange-traded instruments and should extend to bilateral trading activities. Bilateral and on-exchange trading activities are often interlinked – e.g. one leg of a trade could be carried out OTC with a client, whilst the other leg can be done on an exchange or other venue. There are markets, particularly in fixed income areas, where OTC trading is prevalent even though there is also on-exchange trading available for certain instruments.

Q4: 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, we agree that the requirement should be deleted (or clarified that it does not apply) for the purposes of benefiting from the market making exemption under the SSR. The agreements that some firms may enter with trading venues in the context of algorithmic trading activities are subject to a separate framework under MiFID II which was drafted for a separate purpose; the two regimes should not be commingled. The market making framework in the context of algorithmic trading does not form a basis in support of having a membership requirement under the SSR.

Q5: 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.

The secondary markets transparency regime is already extensively addressed under MiFID II/MiFIR and additional transparency requirements are neither necessary nor appropriate under the SSR. We do not have further proposals to suggest.

We strongly believe that the market making exemption should not be linked to the systematic internaliser (SI) status. The requirement to be an SI is for trading that is "frequent, systematic and substantial" and not all firms will be acting on this basis in using the market making exemption under the SSR. Firms should not be prohibited from benefiting from the exemption on the basis that they do not meet the SI criteria. We note that under MiFID II market makers are a distinct execution venue from SIs, and we do not see any reason to link the concepts under the SSR.

MiFID II post trade transparency obligations apply to all investment firms and not just SIs, and as such transparency will be very broadly enhanced through MiFID II, regardless of the number of SIs, or whether any of those SIs intend to make use of the market making exemption under the SSR. It is entirely possible for firms to be a market maker without meeting the SI requirements – in particular (1) where there is a significant volume of trades on venue, (2) for firms where there is a lower level of activity in the EU, or (3) for newer entrants to a market. The criteria for SI is reviewed on a period basis depending on notionals traded and an entity may be a market maker but may not qualify as an SI due to the criteria and trading volumes. This could disqualify several participants from availing themselves of the market making exemption.

Q6: 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 in our introductory remarks, we believe that ESMA's Guidelines unduly restrict the scope of products eligible for the market maker exemption permitted under the SSR text, and the product scope requirement in the ESMA Guidelines has the effect of excluding legitimate market making activity from the exemption.

Rather than stipulating an exhaustive list, a simpler and appropriate solution is to make the exemption available to financial instruments under the scope of the MiFID II/MiFIR definition of financial instrument. We would strongly recommend that ESMA considers this option as we do not believe it will require any amendment to the Level 1 text which contains a clear definition of "financial instrument" by reference to the MiFID definition.

As examples of instruments for which the exemption is not available, which currently cause difficulties to market participants, we would note the following (please note that this is a non-exhaustive list):

-corporate bonds;
-convertible bonds;
-subscription rights;
-dividend swaps;
-unlisted structured products;
-transferable securities;
-Supranational, sub-sovereign and agency (SSA) debt.

The restricted product scope has negative consequences. In relation to corporate bonds, the following example serves to illustrate the problem. As the hedging of market making activity in corporate bonds is not included in the list, firms then have to find a locate; this takes time, affecting firms' ability to quote in a timely fashion. In periods of extreme volatility and market stress, it is expected that clients will be very active in offloading or accessing risk, but the time taken to access the locate could prevent firms from hedging and therefore being able to trade. This reduces firms' ability properly to manage risk and has potentially broader systemic risk implications. We would therefore strongly support adding corporate bonds to this list. A similar issue arises in relation to certain securities not admitted to trading on an EU trading venue (e.g. unlisted structured products).

While the solution under the second paragraph above is clearly our preferred option, we agree that criteria relating to the concept of high correlation would need to be defined and further elaborated if this concept is to be used.

We note with concern that ESMA may be considering the introduction of new reporting requirements addressed at market makers (paragraphs 42-44 of the consultation document). Extensive new reporting requirements are being introduced in other pieces of legislation (MIFID II/MiFIR, EMIR, SFTR). We do not see a justification for introducing new, likely duplicative, requirements under the SSR. Competent authorities already have access to extensive information; the amount of information and its granularity is set to significantly increase as other new regimes enter application.

Q7: 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.

AFME-ISDA have argued that the instrument-by-instrument notification procedure adopted in the ESMA Guidelines is inconsistent with how capital markets are best able to support economic activities. We have argued that a strict interpretation of the reference to “an instrument” in the Level 1 text is not required. We believe that it is sufficient that a firm can be identified as a market maker in a particular instrument on the basis of it being a market maker in a broader category of instruments – for example all shares on a given trading venue – in which that particular instrument is included. As a result, we support the use of sectoral categories/classifications, but note that these categories would need to be clearly defined.

In relation to non-equities, we would recommend consideration of the possibility to group instruments according to the asset class/sub-asset class structure being introduced under MiFID II/MiFIR (RTS 2) and enable market makers to issue notifications mirroring this classification.

In relation to equity instruments, we would agree with a suggestion that the exemption should also be capable of being granted on the basis of particular exchange indices. If this option is taken forward, it is important that the exemption is applied on an index level and should not require that firms must be market makers in all shares/financial instruments within the relevant index.

Consideration will have to be given as to how this would work in practice. For the provision to be practical and beneficial, it would be important for participants to be able to refer to indices provided by authorised benchmark administrators. We believe it would be impractical to link the provision to an officially approved list of indices maintained by ESMA or competent authorities. The indices landscape is very diverse and in constant evolution: indices are regularly created, changed or discontinued. Experience suggests that maintaining official lists is impractical in view of challenges of ensuring that this information is relevant and up-to-date.

Other practical challenges may arise in respect of index rebalancing, and we would suggest that a pragmatic approach be adopted such that firms are not required to re-submit their notifications every time a re-balancing of the relevant index occurred. Firms should be permitted to continue to apply the exemption in respect of any underliers that drop out of an index until/unless the firm making use of the exemption notifies the relevant NCA that this is no longer required. This would avoid a "cliff edge effect" and the need for bulk notifications by market makers immediately upon the occurrence of rebalances. Where underliers are being added to an index, the exemption should be available to firms which have previously notified at an index level from the point the index administrator updates the constituents. As noted above, it should not be required that firms be market makers in all shares/financial instruments within the relevant index.

Q8: 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, we agree that the 30-day period mentioned in Article 17(5) of the SSR should not apply when the notification refers to instruments admitted to trading for the first time on an EU trading venue. We advise ESMA to consider changing the requirement so that the exemption can be relied on from the time of notification, with the competent authority retaining a right to reject it within 30 days upon which time the firm would need to immediately cease relying on the exemption. This would reduce the burden on competent authorities identified by ESMA whereby a practice has emerged for authorities to inform notifying entities that their notification meets the conditions for the exemption before the expiry of the 30-day period.

New financial instruments are created on a daily basis; it is often the case that market making is at its most active when new instruments have been created/issued. In the case of an IPO, for instance, the securities may not have an ISIN and/or the transaction may not be publicly known 30 days before trading is to start with respect to the security. In addition, it is challenging for firms to provide an indication of expected daily/weekly volumes for new instruments. We thus believe that IPO securities should be able to benefit from the market making exemption immediately upon notification.

With respect to CDS which is purely OTC in nature, there should also be consideration that there may be certain reference entities which have not been traded before or defaulted entities where trading may recommence. To some extent, these can be classified as new products and notification should possibly be as soon as commercially reasonably practicable.

Q9: 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.

Please refer to our comments under question 8.

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

Q10: What are your views on the proposal to change the procedure to adopt short term bans under Article 23 of the SSR? Please elaborate.

AFME-ISDA members are not convinced that a compelling case has been made to change certain key aspects of the procedure to adopt short term bans under Article 23 of the SSR. We would strongly caution against proposals which could result in bans being extended across the EU on the basis of the analysis and intentions of a single national competent authority. These are intended to be short term restrictions; if the relevant authorities wish to introduce more robust restrictions in their jurisdiction they can make use of their powers in exceptional circumstances to do so (Article 20 of the SSR).

We defer to competent authorities in relation to addressing their own purely administrative procedures to activate these provisions. However, we would support any measures which would ensure that where one competent authority has adopted a short term ban, information is made available at the same time to confirm whether any other competent authorities have adopted a similar measure. Under the current regime, this information is not always available on a consistent basis, and it creates uncertainty for market participants as to whether the ban exists in any other jurisdictions where the relevant instrument(s) can be traded.

We believe that this issue could be addressed through the introduction of a centralised repository or alert system for short term bans. At present, there is no standardised means of disseminating notice of the imposition, extension and/or lifting of a short term ban, which places the burden on firms to ensure that they proactively search for these notifications and/or subscribe to services which do so on their behalf.

Q11: What are your views on the proposal to change the scope of short term bans under Article 23 of the SSR? Please elaborate.

We strongly disagree with the proposal to broaden the scope of Article 23 short sale bans to include OTC trading and derivatives.

We do not believe ESMA has presented in the consultation paper evidence that OTC and derivatives use is in some way contributing to share price falls, increasing volatility or damaging liquidity in markets. The opposite may in fact be the case. A considerable amount of activity where liquidity is provided occurs away from trading venues as these venues may not provide enough liquidity, depth or customised offer to support all trading needs in large, bespoke and illiquid transactions. The OTC space enables market participants to find counterparties and support liquidity particularly in periods of stress and volatility when participants often turn to bilateral and request-for-quotes modes of trading. In relation to OTC derivatives, market participants often rely

on these instruments to hedge those risks for which there is no close match available on organised exchanges, and to satisfy hedge accounting standards.

We therefore do not agree with proposals that seek to capture OTC and derivatives trading through the bans. The trading obligations for shares and derivatives being introduced under MiFID II/MiFIR already regulate and seek to limit the scope of OTC trading in certain instruments. We do not see a regulatory justification or need for introducing further restrictions under the SSR targeting OTC trading.

If a net economic ban is pursued despite our recommendations, it is imperative that (i) the market making exemption is still available and (ii) indices (as suggested by ESMA) are not included within the net economic calculation.

We note that the preliminary economic analysis presented by ESMA under Annex III of the consultation document suggests that the effect of the bans introduced so far has been limited. AFME-ISDA would encourage ESMA and other authorities to consider whether there are fundamental economic reasons that explain the potential ineffectiveness of such restrictions. Generally, a company's share price will rise or fall due to a market reaction to an event or underlying economic situation relating to the company. Temporary short selling restrictions are unlikely on their own to remove the economic fundamentals – e.g. concerns about a company's performance – causing share prices to fall. There may thus be merit in considering whether the powers granted to authorities under Article 23 are beneficial to financial stability, investors and market functioning and whether they should be retained in the framework.

We reiterate that competent authorities already have the ability to use their powers in exceptional circumstances under Article 20 of the SSR.

Transparency of net short positions and reporting requirements

Q12: 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.

We do not oppose the current levels, provided the recommended changes to the market making exemption noted in our responses above are adopted. Any changes which could have the result of narrowing the market making exemption would lead to an increased volume of notifications, to which end it should be considered whether increasing the thresholds is necessary to avoid a disproportionate impact on notifying firms and competent authorities having to manage the notifications.

Q13: 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.

We do not see a case in terms of improving transparency or providing reliable information in mandating the publication of such information. There are likely to be multiple questions about the practical use and statistical accuracy of aggregated information on net short positions by issuer which would limit its relevance.

Q14: 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.

We would support an end of day notification deadline (on the following day; T+1) which would be consistent with timeframes for reporting and other obligations in other legislations. It would be preferable from an operational management perspective for such notifications to be effected by similar deadlines. In the SSR context, this would allow for additional headroom to perform data quality checks before undertaking notifications, which should further support their completeness and accuracy. However, in line with our response to Q12, as long as the changes we recommend to the market making exemption are adopted, notification volumes should not increase markedly and hence the current timelines are manageable. The timing should in any event be no earlier than 15.30; it is important to recall that market participants operate in different time zones.

Q15: Do you agree that the publication time should be changed at no later than 17:30 on the following trading day? Please elaborate.

We defer to competent authorities on this question.

Q16: 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.

A centralised system would be highly desirable for market participants and competent authorities, and would enable a more efficient use of time and resources for notifying firms. However, the benefits would only be realised if the vast majority of competent authorities agreed to move to such a model.

Currently the number of systems firms must have access to (and the administrative procedures to access them), the fact that they are not all necessarily in standardised format constitutes an administrative burden for firms. Having one central data base would improve input times. This would be beneficial for firms that have multiple entities that need to report to separate regulators and need to undertake separate registrations with competent authorities. A one-stop-shop would alleviate some of these burdens.

The system would also seem beneficial to competent authorities in terms of centralising the availability of information and facilitating the publication of information in consistent formats.

We would have concerns about charging fees to notifying parties however. The ongoing running costs of a central system, if appropriately designed, should be significantly lower than the sum of the costs incurred by separate national competent authorities each managing their own process. We would hope that the upfront costs of moving to a central system could be funded by amortisation over a number of years of the saves incurred by national competent authorities who migrate to the new system.

Q17: Which other amendments, if any, would you suggest to make the notification less burdensome?

We would recommend a harmonised registration process and standardised notification methodology. Currently, each regulator requires a different level of information, some more detailed than others. The submission process varies from hard copies to email or use of online platforms. It would also be helpful if the relevant authorities provided acknowledgement of notification submissions.

It would also be beneficial to use a central database to provide firms with access to the issued share capital of in-scope issuers for SSR net short position calculation purposes. At the moment (and in contrast to Transparency Directive issuers) there is no official source for this information, and it can be difficult – and costly – for firms to obtain accurate data. A centralised repository of this information would make the notification less burdensome, particularly for complex issuers which may have a number of share classes in issue.

Separately, if a central database is established, it would be helpful if a pre-loaded list of in-scope issuers was included for notification purposes, as this would reduce the likelihood of manual errors which occur when free text boxes are used.

Q18: 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.

We caution against mandating LEI use in this context at the present time. Global firms have different legal entities for diverse regulatory purposes in the jurisdictions where they operate. The LEI system may not be appropriate to all market participants at the present time, including those that may have specific arrangements to distinguish between branches within the EU which are subject to the SSR separately. Any LEI obligation at this stage would be premature, and should be considered once the LEI for branches have been fully implemented.

Our recommendation is to make LEI use optional, rather than mandatory, at this stage.

Q19: 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.

We welcome ESMA's proposals for alignment of the treatment of positions in cash and positions in derivatives in relation to sovereign debt.

Method (b) should be favoured – the existing "duration adjusted method" with an explicit mention to the fact that derivatives should also be adjusted by the duration of the underlying in order to have a consistent approach between cash positions and derivative positions, as identified in paragraph 176 of the consultation document.

However, as the exact methodology of these calculations is not clear to our members, then we feel that we cannot opine on the thresholds. We would be happy to work with ESMA further on this.