European Securities and Markets Authority

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OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY

of 4 October 2016

on a proposed emergency measure by CONSOB under Section 1 of Chapter V of Regulation (EU) No 236/2012

In accordance with Article 44(1) of Regulation (EU) No 1095/2010, the **Board of Supervisors** has adopted the following opinion:

I. Legal basis

According to Article 27(2) of Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps[1], the European Securities and Markets Authority (ESMA) shall within 24 hours of the notification made by a competent authority under Article 26 of that Regulation, issue an opinion on whether it considers the measure or proposed measure is necessary to address the exceptional circumstances.

II. Background

1. On 6 July 2016, ESMA issued a positive opinion (ESMA/2016/1078) on an emergency measure proposed by CONSOB under Article 20(2)(a) and (b) of Regulation (EU) No 236/2012. The measure consisted of a ban on net short positions on Banca Monte dei Paschi di Siena spa ("BMPS" - ISIN IT0005092165) shares, either directly or through related instruments and irrespectively of the venue or market in which the transactions leading to those positions are conducted. The measure did not apply to trading in index-related instruments and CONSOB did not exempt entities performing market making activities from the scope of the prohibition. The measure was applied from 7 July 2016 at 00:00:01 CET and is applicable until 5 October 2016 at 24:00:00 CET.

2. In the notification of 5 July 2016, CONSOB explained the reason for the measure was linked to the request from the European Central Bank (ECB) to BMPS to submit a credible plan outlining the measures to be taken in order to reduce the non-performing loans (NPL) compared to the total loans (i.e. by close to 15 billion EUR, from an actual

[1] OJ L 86, 24.3.2012, p. 1–24.

ratio NPL/total loans of 42% to a target ratio of 20%, by 2018). In the days following the announcement by BMPS of the ECB's request, BMPS's share price fell sharply. Furthermore, large net short positions were taken on BMPS shares.

3. In accordance with Article 26 of Regulation (EU) No 236/2012, on 3 October 2016, CONSOB notified ESMA of its intention to make use of its powers of intervention in exceptional circumstances and to renew the current emergency measure introduced on 6 July 2016.

4. Since the introduction of the ban, the results of the EBA stress tests published on 29 July 2016 showed that BMPS was the bank with the lowest results of the panel of 51 banks examined.

5. On the same day, BMPS announced publicly a complex plan allowing for the de-recognition of the bank's entire bad loan portfolio through a securitization transaction. The bank also indicated this transaction will create a capital shortfall, which will be filled in by a new capital increase of around 5 billion EUR through a rights issue. An indicative timeline was provided. By the end of September 2016, the board of directors intended to approve a business plan for the bank and call a General meeting of BMPS for October/November to approve the transaction which is expected to be completed (rights issue and de-recognition of the bad loans) by the end of 2016.

6. In the course of September 2016, important changes in the top management of BMPS occurred: resignations of the Chief Executive Officer (CEO) and the Chairman of BMPS as well as the appointment of a new CEO. To date, no new Chairman has been chosen.

7. On 26 September 2016, BMPS's board of directors announced a delay in the adoption of the business plan to enable further analysis of the possibility to modify the de-recognition plan in order to include the conversion of bonds into new shares. The approval of the new business plan is expected on 24 October 2016.

8. After the adoption of the ban, CONSOB noted in the period from 7 July to 23 September 2016 a substantial reduction of the net short positions in BMPS from 7.19% to 4.55% of the share capital and a lower settlement fail ratio on BMPS shares compared to the average Italian equity settlement fail ratio. Despite these effects of the ban, the price of BMPS shares has fallen over the same period by 33%, compared to a 7% increase in the main Italian index FTSEMIB.

9. The emergency measure notified by CONSOB consists of a ban on net short positions on Banca Monte dei Paschi di Siena spa ("BMPS" - ISIN IT0005092165) shares, either directly or through related instruments and irrespectively of the venue or market in which the transactions leading to those positions are conducted. The notification also includes in the scope the financial instruments which give claims to new BMPS shares. This is included to cater for the possibility that BMPS raises capital through a rights issue or the conversion of bonds and to avoid that the build-up of short positions could be channeled

through those instruments, circumventing the effectiveness of the ban. The measure does not apply to trading in index-related instruments and CONSOB does not exempt entities performing market making activities from the scope of the prohibition.

10. The proposed measure is expected to enter into force on 6 October 2016 at 00:00:01 CET and to be applicable until 5 January 2017 at 24:00:00 CET.

III. On the adverse events or developments

11. ESMA considers that the circumstances described above are adverse events or developments which constitute a serious threat to market confidence and to financial stability in Italy.

12. More specifically, despite the noticeable effect of the ban introduced on 7 July 2016 on short selling activities on BMPS (the decrease of the overall net short positions in BMPS share capital and the level of fail ratio), the price of BMPS shares has continued to fall (-33% between 7 July and 23 September 2016), although to a lesser extent than in the weeks before the introduction of the ban in July 2016. This denotes that there is still considerable selling pressure on BMPS shares as market uncertainties remain. Besides, although the situation has improved, BMPS remains an issuer with high net short positions, more than 4.5% of the share capital.

13. It is noted that on 29 July 2016 BMPS has already communicated a plan to reduce the amount of non-performing loans. In this respect, the BMPS announced plan seeks to provide a structural and definitive solution to the entire bad loan portfolio (27.7 billion EUR gross and 9.2 billion EUR net), through the increase in the coverage ratios of impaired exposures and the transfer of the entire bad loan portfolio to a securitization structure. This is considered to be the most important operation of this kind ever on the Italian market. As this would result in a capital shortfall estimated at 5 billion EUR, the plan includes a recapitalization action through a rights issue.

14. However, the developments that affected the top management of BMPS, the resignation of the CEO and the chairman in the course of September 2016, the appointment of a new CEO and the on-going process for the designation of a new Chairman, have led to a delay in the finalisation and approval of the BMPS business plan as publicly acknowledged by BMPS in its press release of 26 September 2016. In addition, the same announcement indicated the plan initially disclosed late July 2016 could still be modified in order to include the conversion of bonds into new shares for the envisaged capital increase. Therefore, important uncertainties remain as to the final definition and implementation timing of the plan and a threat to market confidence persists regarding BMPS shares.

15. The combination of still large - though less significant than before - net short positions, the continuous selling pressure of BMPS shares, and the uncertainties of the final content and timing of the plan, which requires significant adjustments to be taken by BMPS,

constitute in ESMA´s view a clearly adverse scenario for the stability of the bank and, given its relative size, of the Italian banking sector - BMPS being the third largest Italian bank for total asset value and the value of clients' deposit. The measure proposed is intended to address this scenario of selling pressure and unusual volatility in the price of BMPS shares.

IV. On the appropriateness and proportionality of the measure

16. ESMA considers that the emergency measure under Article 20(2)(a) and (b) of Regulation (EU) No 236/2012 in relation to BMPS shares is appropriate and proportionate to address the threat in the Italian financial markets.

17. The renewal of the measure is appropriate to help address the expected substantial selling pressures and the unusual volatility causing significant downward spirals in BMPS shares (adverse events and developments as indicated in subparagraph (c) of Article 24(1) of Commission Delegated Regulation (EU) No 918/2012[2]), given that it limits the ability to enter into short positions, which may be a relevant factor behind the significant falls experienced in the past. In that sense, to the extent that the measure restricts the ability to adopt short positions, it may also indirectly reduce the risk of a contagion effect to other shares of the Italian banking sector.

18. The measure remains appropriate compared to other alternatives that would address the threat. A temporary restriction on short selling according to Article 23 of Regulation (EU) No 236/2012 (which CONSOB also adopted on 5 July 2016 before introducing the net short position ban) would not address the extended period of risk resulting from the delays in finalizing the plan. Similarly, a mere short sale prohibition would not cover activities through derivatives. Beyond that, a total ban including all products could have been considered, but CONSOB has decided to minimise possible detrimental effects on the efficiency of financial markets, and does not extend the restrictions to index-related instruments.

19. The inclusion in the scope of the financial instruments which gives claims to new shares is appropriate considering the high likelihood of a new capital increase to be undertaken by BMPS, even though it is not yet certain that it would be conducted through a rights issue or the conversion of bonds. Not including such financial instruments could make more complex the decision that has to be taken on the final form of the capital increase and prove detrimental to the successful conclusion of the capital increase.

20. As to the non-exemption for entities performing market making activities (market makers), ESMA notes that CONSOB considers that, given the broad dispersion of what is considered a market maker in different Member States, should the exemption be introduced, it would apply to a potentially very wide number of entities, affecting therefore

[2] OJ L 274, 9.10.2012, p. 1.

the effectiveness of the prohibition. On the one hand, ESMA acknowledges that such a diversity exists and that the exemption for market makers could reach a wide number of entities compared to those that usually perform market making on a regular basis. On the other hand, ESMA considers that the non-application of the exemption to active market makers could have dis-incentivised or made more complex the quoting of BMPS shares by market makers active in this specific share, which could reduce additional liquidity from the market. However, ESMA notes that the introduction of the net short position ban since 7 July 2016 does not seem to have affected the liquidity of BMPS shares. Although the daily average traded quantity of BMPS shares has reduced by 31% in the period from 7 July to 23 September 2016 compared to a pre-ban period from 16 April 2016 to 6 July 2016, it is noted that the average daily traded quantity of all shares traded on the Italian regulated market MTA decreased by 24% and that BMPS shares accounted for less than 1% of total traded volume over the post-ban period. The fall in trading activity seems attributable to external factors (high overall volumes due to Brexit late June/early July and the traditionally low volume period of August) rather than to the introduction of the ban on BMPS.

V. On the duration of the measure

21. ESMA considers that the duration of the measure, although it is proposed for the maximum period envisaged in the Regulation and is therefore a long-lasting measure, is justified, given the lack of certainty on the timing for the finalisation and approval of the plan to reduce the amount of non-performing loans. Despite the announcements made at the end of July 2016 which included an indicative timeline for the approval of the disclosed plan (October/November 2016) and the implementation of this intended plan (by the end of 2016), the BMPS announcement of late July 2016 reflected the delays experienced by BMPS in finalising the plan, notably resulting from the changes of BMPS top management, but has not provided any renewed indicative timeline.

22. The measure may in any event be lifted before the end of the established period if circumstances that justified the renewal of the measure improve. ESMA recommends CONSOB to monitor closely the situation and to consider lifting the measure before the deadline if the situation so permits, to ensure that the restrictions remain in place for the shortest possible time.

This opinion will be published on ESMA's website.

Done at Paris, 4 October 2016

For the Board of Supervisors

Steven Maijoor

Chairperson