German Banking Industry Committee

Die Deutsche Kreditwirtschaft

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12-02-13

Comments on "ESMA's Draft technical standards on Regulation (EU) XXXX/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps"

Dear Sir or Madam,

please find enclosed the German Banking Industry Commitee's comments on "ESMA's Draft technical standards on Regulation (EU) XXXX/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps".

We would like to express our gratitude for this opportunity to respond to the planned technical standards for regulating short selling. We welcome ESMA's approach of including market participants' suggestions in its developing of such standards.

In general, clarification of the affected financial instruments and harmonisation are to be welcomed, whereby it should not be overlooked that the new standards will entail considerable costs. In addition, a certain degree of flexibility would be welcome so that market participants can react to changing market conditions.

Yours faithfully,
on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks

by proxy
Dr. Klaus Möller

by proxy
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Comments

on "ESMA's Draft technical standards on Regulation (EU) XXXX/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps"

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Berlin, 12-02-13

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

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Preliminary remarks

We would like to express our gratitude for this opportunity to respond to the planned technical standards for regulating short selling. We welcome ESMA's approach of including market participants' suggestions in its developing of such standards.

Yet, the limited time in which ESMA has had to prepare the technical requirements and the 3-week consultation period available to market participants is insufficient for adequately considering the impact that the ESMA proposals will have on the market.

In general, clarification of the affected financial instruments and harmonisation are to be welcomed, whereby it should not be overlooked that the new standards will entail considerable costs. In addition, a certain degree of flexibility would be welcomed so that market participants can react to changing market conditions.

We regard ESMA's interpretation of Article 12 (1) (c) and 13 (1) (c) with respect to the various departments within a legal unit as problematic. In our view, the rules address legal persons as a whole and the test whether there is a long or a short position applies at the legal person's level, not at the desk level. This means that the question of an arrangement intra-desk is of a purely organisational level and immaterial for the purpose of the short selling regulation as long as there is a long position in an instrument.

In general, we would also like to point out that the information which ESMA can request ad hoc (para. 92), should be restricted to that which national supervisory authorities also regularly request.

Besides, the explanations in Recital 7 are inconsistent with those in Recital 20 of the Regulation. Recital 7 states that "*one of the conditions set out in Article 12(1) for shares and Article 13(1) for sovereign debt must be fulfilled prior to entering into any short sale*". On the other hand, Recital 20 of the Regulation specifies that "*in relation to uncovered short selling of sovereign debt, the fact that a short sale will be covered by a purchase of the sovereign debt during the same day can be considered as an example of offering a reasonable expectation that settlement can be effected when due*". The repurchase at the same day, however, cannot be carried out prior to the short sale since in that case it would not be a short sale. We would like to ask ESMA for aligning Recital 7 in respect of content to be in accordance with the Regulation.

We now turn to a detailed response to the questions.

Comments on "ESMA's Draft technical standards on Regulation (EU) XXXX/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps"

II: Agreements, arrangements and measures that adequately ensure that the share or the sovereign debt will be available for settlement

Q1: Do you agree with the approach of providing an exhaustive list of types of agreement, arrangement and measures that adequately ensure shares or sovereign debt instruments will be available for settlement and setting out the criteria these should fulfil?

We appreciate a harmonized approach with regard to short selling regulation across EU membership countries. We also believe that an exhaustive list of types of agreement, arrangement and measure provides certainty and clarity to all market participants. However, as markets will change over time, some degree of flexibility should be built in by a review of the list on a regular basis, i.e. yearly.

Q2: Do you agree with the proposed list of agreements and enforceable claims and the criteria they should meet? Are there any other types of agreements or enforceable claims or criteria which should be added?

Instruments with embedded options, futures, equity swaps etc. should be included. Agreements with cash settlement for liquid shares or sovereign debt, where it is easy to borrow or buy the securities, should also be covered.

We would welcome it if the "Securities Lending Agreements" already included in the corrigendum of the Regulation by the European Parliament in Art. 2 (1) (b) (ii) were supplemented by the automated procedure as part of the Technical Standards. The automated securities lending programmes of the pertinent ICSD are in practice used by many institutions and therefore of considerable relevance. We regard a clarification that these constitute contractual relationships are accepted by ESMA to be necessary.

Q3: Do you consider that these criteria will entail additional costs as compared to current practices on the market? If so, could you specify the drivers for those additional costs and any indication of their amount?

These criteria will entail additional costs compared to current practices as the processes for covering new or existing short positions must be aligned with the new and more stringent regulatory requirements. Moreover, setting up and maintaining new agreements and arrangements will create administrative costs. The costs will increase considerably because third parties having no direct benefit from the agreements or confirmations can demand fees for them. In addition, the documentation and verification expense will rise considerably.
The additional costs will be caused inter alia due to more and more frequently traded covering transactions (on trade basis compared to end of day basis). There is currently no information available that would indicate the additional amount.

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Q4: Do you agree with the proposed list of third parties which may be parties to the arrangements or measures and the criteria proposed by ESMA that they should fulfil?

We support the list of "third parties" proposed by ESMA. The list of "third parties" should contain reliable counterparties to ensure only due settlement of agreed coverage transactions as per the regulation. We believe that pension funds, which regularly act as lenders, are among those persons mentioned in the last bullet point. A central counterparty should also include its clearing members. Furthermore, the addition "*and can provide data on its ability to deliver in time for settlement*" in the last bullet point should be deleted as this involves such considerable expense as to rule out its being used.

Q5: Are there further criteria which should be added?

No comments.

Q6: Does the fact that a third party should be a distinct legal entity from the entity entering into the short sale entail costs? If so please provide estimates of those costs.

This question is of the utmost importance for our members. We disagree with ESMA's reasoning in section II.IV.18/19. In our view, the rules address legal persons as a whole and the test whether there is a long or a short position applies at the legal person's level, not at the desk level. This means that the question of an arrangement intra-desk is of a purely organisational level and immaterial for the purpose of the short selling regulation as long as there is a long position in an instrument. In our understanding, the oversight desk (i.e. the securities financing desk in many financial institutions) is responsible for ensuring adequate coverage and settlement for the different trading desks in the whole legal entity. Moreover, the oversight desk is specialized in this particular trading segment concerning its instruments, methods, counterparties, trading rules and customs. The oversight desk acts on behalf of the various trading desks in its specialized and dedicated capacity within this same legal entity. Given the fact that there are other available long positions existing in the same legal entity, the oversight desk allocates these positions to the respective trading desk which intends to sell short. The overall position of this legal entity is still considered long and thus not in breach of the EU regulation.

Q7: Do you agree with the approach proposed by ESMA on the standard/same day/liquid shares locate confirmation arrangements and measures and the criteria that they must fulfil?

We understand and support ESMA's view that there should be criteria ensuring due settlement of shares sold short. Two aspects are the reliability of the counterparty and comprehensive contractual agreements.

However, we want to point out that ESMA should provide for certain flexibility of the market needs in applying the regulation with regard to the huge amount of daily transactions. In our understanding, the proven reliability of the counterparty should be the crucial test for both liquid and illiquid instruments.

This view is supported by Art. 12 (1) (c) of the Regulation, which does not differentiate in terms of liquidity. Furthermore, a clear cut between liquid and illiquid instruments cannot be made, MiFID's distinction serves completely different purposes (trading volume not lending), which is a highly political issue for some of the member states.

We therefore propose requiring clear internal rules for both liquid and illiquid instruments to evaluate the reliability of the counterparty and a regular ex-post control whether this evaluation and the selection hold true. Too tight requirements, such as "reservation", "icing", "put on hold" would probably have negative effects on the liquidity of such instruments and would also raise cost for market participants.

Q8: In circumstances other than intraday short selling or short selling on liquid shares, can you suggest any additions to the methods for effective allocation set out in this consultation paper which would provide the necessary comfort that shares can be delivered for settlement in due time?

See answer to Q 7.

Q9: In relation to the approach suggested for liquid shares, do you consider it appropriate to use the MiFID definition of liquid shares? Do you think ESMA should consider different approaches to determine the reasonable expectation test for liquid and illiquid shares? If not, can you provide indications as to the criteria to consider to define liquid shares or to take into account the liquidity of the shares in these circumstances?
Is securities lending activity an additional factor to consider when determining liquidity of a share?

In our view, the MiFID test is not working in the context of short selling because (1) it is not the volume of trades but the availability for lending that is decisive and (2) Art. 22 MiFID-Regulation was drafted with regard to the political interests of different member states. Furthermore, market developments and especially competition between exchanges and alternative venues may call for a different test.

Q10: Do you agree with the approach proposed by ESMA on the location confirmation and reasonable expectation arrangement in relation to sovereign debt and that the reasonable expectation test should only apply in the case of intraday short selling of sovereign debt?

Given the generally high liquidity of sovereign debt we believe that the ESMA approach on the location confirmation is appropriate and that the reasonable expectation test is sufficient to be applicable in the case of intraday short selling only. Nevertheless, due to the various customs concerning the value dates of sovereign debt transactions (national t+2 and international value date t+3) not only intraday but also overnight short selling and repurchase on the next bank working day should suffice as "reasonable expectation test".

Besides, in our view the reasonable expectation test for intraday short selling of sovereign debt could also be performed and properly documented by experienced in-house senior trading staff of the bank. Independent internal control measures by both Audit and Compliance could monitor compliance with the regulation.

III. Details of the information on net short positions to be notified to competent authorities and disclosed to the public

Q11: Do you agree that there should be one standard format for notifying relevant competent authority for each type of instrument?

We absolutely agree with ESMA's proposal for one standard format for each type of instrument to be used for notifying all relevant authorities and for publication purposes of shares. The question as to the pertinent responsible authority (see Art. 2 (1) (q) Short Selling Directive) can lead to differing reporting channels. A uniform reporting system is therefore greatly welcomed on our part. This will reduce the administrative burden and streamline the whole process for both investors and regulatory bodies.

Q12: Do you agree that there should be one standard form for public disclosure of information on significant net short position in shares?

See answer to Q 11.

Capital investment companies are required to report net short selling positions in the funds they manage. If the positions held were disclosed together with the name of the pertinent special funds, this could give rise to misconceptions among investors who influence the investment decision. Moreover, business secrets (such as investment strategies) would be revealed. We therefore argue that there should be no disclosure of the individual identity of the special funds and that the general public should be informed only about net positions in an aggregated form.

Q13: Do you agree with the proposed way to identify natural and legal persons, including the contact information details?

In general, harmonisation of the identification of legal and natural persons is to be preferred even beyond the borders of the European Union. We would like to draw your attention to the more critical question of validating the identity of a natural or legal person sending the notification/publication. In order to prevent any misuse of the notification and publication regime (e.g. spreading false or misleading information about short positions of a market participant by a competitor, etc.) the German regulator "BaFin" established a secured personal identification process for each individual.

In our opinion, LEI coding in regulatory actions would be advantageous. The test file already developed by Sifma[1] contains a major part of the relevant market participants from the US perspective and the corresponding LEIs could be made available to ESMA relatively quickly. Using the BIC should merely be a transitional solution for the event that ESMA does not receive the LEIs in good time. In that case, we believe that the BIC should be filled from 11 to 20 places so that switching from BIC to LEI as per the ISO standard will be possible without any complications.

Concerning publication, we refer to our response to question Q12.

Q14: Do you agree with the proposed way to notify and disclose the size of the relevant position?

The proposed way to notify and disclose the size of the relevant position corresponds to our view. Disclosure should be in an aggregated form (without disclosure of various maturities and suchlike).

With respect to some already existing local reporting and disclosure regimes we would like to comment on your assumption in section III.IV.51 as follows: the simple check ESMA refers to could be performed much easier by requiring the "outstanding shares" used for calculation instead of the "equivalent number of shares". This allows the authority to make a direct comparison without further calculations. Hence, we regard the "equivalent number of shares" parameter as redundant.

Q15: Do you have any comments on the proposed way to identify the issuer in relation to which the relevant net short position is held, including how to use the ISIN code in this matter?

In terms of the unique single identifier of an issuer we are in favour of the ISIN code. Where different share classes are traded we suggest the nomination of the ordinary shares as the main class to identify the issuer. In case there are several main classes available (rarely observed) we recommend using the first class admitted to trading as the nominated main class to identify the issuer. This we consider to be a simplification of the procedure. Otherwise, we have no further comments on the proposed unique identification of the issuer of sovereign debt and uncovered sovereign CDS.

Q16: Do you agree with the use of the ISO 8601 2004 standard for specifying the date on which the relevant position was created, changed or ceased to be held?

We believe the ISO 8601 2004 standard is useful for having a common basis for notification dates taking into account the various date conventions and systems existing.

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[1] http://www.sifma.org/issues/operations-and-technology/legal-entity-identifier/legal-entity-identifier-test-file-download-and-terms/

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Q17: Do you agree that the additional information described above should be provided?

We agree to the proposed additional information in section III.VII.62.a) and c) which helps improve the process and gives the opportunity to include explanatory information about the position background for example – where applicable.
With regard to section III.VII.62.b) we believe this proposal requires additional administrative efforts for those investors who organize their notification and publication duties in different business areas or different venues. An efficient process concerning lost/missing communications could also be ensured by the competent authority sending an automated electronic receipt confirmation to the sender of a notification or publication.

IV. Means by which information on net short positions in shares may be disclosed to the Public

Q18: Do you agree that information on the central website should be provided at least in a machine-readable format?

We share your view that the information should be available on a central website operated and supervised by the relevant competent authority – without prejudice to the use of other additional mechanisms. Many market participants have already entered into agreements with data service providers for their other publication requirements (e.g. post trade transparency) which they should also be able to expand to the new short selling requirements.

We agree that the data published on the central website should allow electronic reading and download for further processing. Therefore, it should be provided in a commonly used format (e.g. csv-format). Regarding the question about authentication of the sender of a short selling publication we refer to our comments in Q13.

Q19: Do you agree that information on the central websites should at least include data as provided in Annex 1 of the draft implementing standard presented in appendix to this consultation paper?

The field with the date of the last notification involves an unbearable expense.

VI. Exemption where the principal venue is located outside the Union

Q20: Do you foresee any other situation that might merit an update of the list of exempted shares within the two-year effectiveness period?

No comments.