

Brussels, 15 March 2013

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

EBF response to ESMA consultation on the evaluation of the Short selling and CDS Regulation (ESMA/2013/203)

General remarks

- The European Banking Federation decided to respond to the specific questions related to the exemptions and to the settlement discipline.
- The EBF is concerned about the short time frame that ESMA is envisaging to provide its technical findings to the Commission on the impact of the short selling regulation (SSR) on liquidity.
- Many Member States are still in the process of complying with the regulation and a comprehensive assessment at European level at this point of time makes it very difficult for the EBF to judge the impact of the SSR in the European Banking Industry taking into consideration that the SSR has only been in place since 1 November 2012.
- The EBF would like to recall the importance of market making activities in financial markets. Market making is the facilitation of client trading which provides liquidity, immediacy of trading and reduces transaction costs. This activity is a vital mechanism in the efficient and effective running of the markets and should continue to be allowed under the SSR.
- Finally, the EBF would like to draw the attention of ESMA to the fact that the current discussions regarding settlement discipline in the context of the future Regulation on Central securities depositories (CSDR) will affect the existing buy-in and penalty provisions in the SSR.

Specific remarks

Settlement discipline including buy-in procedures

Q21: Do you have any other comments on the requirements of the Regulation concerning settlement discipline in shares or on how they have operated since 1 November 2012?

At this stage, the EBF has no specific comment on the effects of the requirement concerning settlement discipline under the SSR. However, the Federation is concerned by the potential lack of consistency in EU legislation as regards the regulation and harmonisation of settlement discipline regimes. Currently, Article 15 of the SSR lays down rules on buy-in for cleared shares. The future Regulation on Central securities depositories (CSDR) intends to broaden the scope of the settlement discipline measures as regards the instruments covered. The Federation asks ESMA to notably align the buy-in provision in the forthcoming CSDR with the existing buy-in provision in the SSR once ESMA starts drafting the regulatory technical standards on settlement discipline in the context of CSDR. Any discrepancy should be avoided in the application of a buy-in framework.

Exemptions

Q22: Does the current definition and scope of the exemption for market making activities allow sufficiently for liquidity provisions?

Given the fact that the SSR has been in place only since 1 November 2012, the EBF believes it is too early to fully assess the impact of this piece of legislation on liquidity. However, EBF's members warn of a rather negative impact on liquidity for the following reasons.

The provision of liquidity by a Market Maker (MM) and the related activities are closely connected. The EBF understands that the current definition and scope of the exemption for market making activities are based on following two interlinked requirements:

1. MM's activities (i.e. provide two-way quotes, trade on behalf of customers and hedging one of these) are regulatory validated by the "Instrument-Exchange membership" principle. This means that the MM activity is only possible when there is an explicit (and notified) link between Instrument-Exchange membership and the activity.
2. The Instrument-membership principle is documented by providing evidence on the MM prices, size and presence in each specific instrument on the exchange (i.e. "Qualifying criteria").

As regards **the first requirement**, there are different language versions of the definition of market making. The English version use the term "where it deals as principal", whereas other version use the term "when it deals as principal". If the definition should be read as requiring the

market making activity to take place on the trading venue where it is a member, this would effectively make it impossible to be a systematic internaliser (SI) as SI is not a trading venue in the short selling regulation and hence impossible to provide liquidity.

Furthermore, if the above mentioned definition is to be understood as “where” instead of “when” (as ESMA Guidelines¹ seems to imply), it would contradict Article 2 (k) of the SSR where it states that: “whether traded on or outside a trading venue”. The wording “when”, therefore seems to be appropriate and consistent with the Level 1 legislation and would allow for market participants to provide liquidity, including through SIs.

Additionally, when performing market maker activities, it is common to use other European government securities that are traded on exchanges where the MM is not a member in order to hedge. This is because the hedge can more effectively be made in EUR, as liquidity in euro-states is usually better. This hedge should therefore be covered by the market maker exemption. Otherwise, there is an imbalance between large and small market participants which may adversely affect liquidity as smaller market participants may be forced to give up being a MM. This means that by imposing a membership requirement for obtaining the exemption, it will force smaller banks to become members of a number of exchanges, to offer the service and liquidity to their clients.

Concerning **the second requirement** on documentation, it would be very difficult to fulfil this requirement by MM. Specifically, the EBF’s concern is related to the documentation that would be foreseen if MMs were to document size, prices and presence on all instruments and adhering to special qualifying criteria. The EBF believes that the documentation requirement of the presence in the market (i.e. be 80 % of time in market in specific instrument) risks harming the liquidity provision itself - especially in small illiquid equities (or even small exchanges). The reason for this, is that if the MM shall document presence for a substantial time on prices that are illiquid - the prices and size would risk not being competitive - which could cause MMs to avoid those, especially if MMs on top also risk losing their exemption.

Furthermore, it is doubtful how documented prices, size and presence could be validated as competitive (ex post) – especially considering smaller illiquid shares. The documentation would additionally be depending on which exchange is under consideration.

¹ <http://www.esma.europa.eu/system/files/2013-158.pdf>

Q23: Is the process for obtaining the exemption for market making activities appropriate for timely provision of liquidity in all circumstances?

The EBF believes that further clarification and flexibility, than suggested by ESMA, is needed as a notification process seems unnecessary cumbersome. We would rather suggest that a notification for exemption for market making activities can cover all current and future instruments admitted to trading on a trading venue or in an index. Otherwise, we foresee an uneven implementation of the Guidelines within the EU Member States, where some FSAs take a flexible approach and other FSAs will not, leading to an uneven playing field for market participants and issuers.

EBF's members understand that there is a 30 day provision for new IPOs, which allows for adjustment of the notification, although this also provides an administrative burden for MMs to survey, notify and receive confirmations on the notified lists of exempted instruments.