



Deutsche Börse Group

Deutsche Börse Group
Response to
European Securities and Markets Authority
(ESMA)
Consultation Paper ESMA/2012/236

Call for Evidence of European Short Selling Regulation

Frankfurt / Main, 15 March 2013

Introductory remarks

Deutsche Börse Group (DBG) appreciates the opportunity to respond to ESMA's call for evidence.

During the financial crisis, exchanges with their transparent and regulated markets have proven to be resilient and have had a stabilizing effect on the financial markets. Established and proven security mechanisms exist in a transparent on-exchange environment. Settlement takes place within two or three days and there are buy-in mechanisms and penalties by central counterparties in place to ensure high settlement discipline, both for long and short trades. The OTC market does not follow similar standards yet.

DBG welcomes the European regulation on short selling as it has led to a harmonization of the different national rules.

We note that the provisions in article 15 only cover trades in shares that are cleared through a CCP. This excludes all transactions that are not cleared by CCPs (including OTC transactions and all transactions on regulated markets that are not cleared by a CCP). This can a large market share, implying that a large part of the market will be exempted from the legislation. We want to emphasize that transactions cleared by a CCP already follow a strict buy-in regime and in contrast all transactions outside a CCP have no consistent regimes to enforce high settlement efficiency. With the current provisions there will be incentives to perform transactions OTC or on platforms without CCP clearing. There will as well be incentives for platforms to move trade flows out of a CCP into non-guaranteed post-trade processes.

We elaborate on questions raised in the ESMA's call for evidence in more detail below.

Detailed remarks

V. Settlement discipline including buy-in procedures

Q19 What is your assessment of the effect on settlement discipline in shares since the application of the Regulation?

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We note that the provisions in article 15 only cover trades in shares that are cleared through a CCP. This excludes all transactions that are not cleared by CCPs (including OTC transactions and all transactions on regulated markets that are not cleared by a CCP). This implies that a large portion of the market will be exempted from the legislation. We want to emphasize that transactions clear by a CCP already follow a strict buy-in regime and in contrast all transactions outside a CCP have no consistent regimes to enforce high settlement efficiency. With the current provisions there will be incentives to perform transactions OTC or on platforms without CCP clearing. There will as well be incentives for platforms to move trade flows out of a CCP into non-guaranteed post-trade processes.

Q20 What effect, if any, do you consider this provision of the Regulation has had on liquidity in shares since its application?

Liquidity can be estimated by different measures such as trading volumes and quoted spreads. On DAX constituents, DBG compared the aforementioned measures before and after the regulation came into force. The results are mixed: turnover increased but spreads deteriorate. Therefore, DBG cannot conclude that the settlement discipline had neither a positive nor a negative impact on market liquidity.

Liquidity measures on DAX constituents

	Average Daily Turnover (in €m)	Average Daily Spreads at touch
11 Oct-31Oct	2768.1	4.42
1st Nov-21 Nov	2853.5	4.51
Change	+3.1%	+2.0%

Source: Data provided by LiquidMetrix - LiquidMetrix Workstation

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?

No comments by DBG.

VI. Exemptions

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

Current definition and scope of the exemption for market making activities is sufficient.

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

DBG welcomes the flexibility offered by ESMA to competent authorities and supports any decision that will help to ease the notification process for market makers in the case of financial instruments, IPOs and inclusions of shares already tradable on another trading venue without having to wait for the 30 days period to expire.

With regard to the negative list according to Article 16 (shares having their principal trading venue located in a third country) and updated every 2 years only, DBG recommends the implementation of a dynamic update process which is fundamental to react to changes in the instrument data (ISIN or Name) while ensuring continuity in liquidity provision by market makers. In addition, DBG recommends that such a process is also applied for continuous inclusion of Non-EU shares newly admitted to trading. As a consequence, market makers would be able to use their exemptions with immediate effect.

Q24 Is the current unavailability of the exemption for market making activities in third country markets having any impact?

No comments by DBG.

Q25 Do you have any other comments on the provisions of the Regulation concerning exemptions or on how they have operated since 1 November 2012?

No comments by DBG.

VII. Intervention powers and emergency measures

The Management Board of Frankfurt Stock Exchange became competent authority for the purposes of Article 23 paragraph 1 of the EU Short Selling Regulation on 16.11.2012 through the German implementing act for the EU Short Selling Regulation ("EU-Leerverkaufs-Ausführungsgesetz"). Therefore DBG is entitled to answer the following questions.

Q26 What is your assessment of the effect of temporary restrictions imposed by competent authorities on short selling since the application of the Regulation? Please explain.

No comments by DBG.

Q27 In case of emergency bans,

a) is the information to be published according to Art. 25 of the Regulation sufficient?

b) If no, please explain what other/additional information should be provided when introducing an emergency measure.

No comments by DBG.

Q28 Do you consider the current thresholds set to identify a significant intra-day fall in the price of financial instruments are appropriate for all instruments? If not, what different thresholds should be set and why?

DBG believes that the current thresholds for shares and ETFs are reasonable. However, with regard to bonds, we would consider the current thresholds not appropriate for the reasons outlined below:

Corporate Bonds:

Based on data derived from an internal analysis, DBG believes the threshold for corporate bonds to be significantly too low. For example, on our trading venue Frankfurt, more than 8,300 events in 1,450 bonds had been triggered in the analysed time period from 15.11.2012 to 21.02.2013. In all cases the Management Board of the Frankfurt Stock Exchange as the competent authority did not observe any reasons to prohibit or restrict short sales in these instruments.

Currently, investment grade bonds offer very low yields to maturity. Hence, small absolute yield changes result in large relative yield changes. This is also the case for bonds close to their maturity as the yield to maturity approaches zero.

In case of high yield bonds, the spread between bid and ask may be so wide that an execution on the ask side followed by an execution on the bid side may already result in a significant increase in yield and hence a significant drop in price given the current thresholds.

DBG therefore would like to recommend the introduction of two yield classes (similar to the two price classes for shares) and to significantly increase the threshold. This recommendation would account for the low yield close to maturity as well as the low yield for investment grade bonds.

Proposed Methodology (parameters provided for illustration purposes only):

- Corporate bonds with yield $< 2.5\%$: 40%
- Corporate bonds with yield $\geq 2.5\%$: 20%

Government Bonds:

Similar to the results of our analysis on corporate bonds, DBG also believes the threshold for changes in the yield across the yield curve of government bonds to be too low. For example, on our trading venue Frankfurt, more than 3,500 events¹ in more than 350 government bonds had been triggered in the analysed time period from 15.11.2012 to 21.02.2013. The Management Board of Frankfurt Stock Exchange as the competent authority did not observe any reasons to prohibit or restrict short sales for the respective government issuers.

Similar to investment grade corporate bonds, short- and long-term yields in particular for AAA-rated government bonds are currently very low. Hence, also for government bonds small absolute changes in the yield curve result in large relative changes in the yield curve.

Consequently, in order to account for the heterogeneity of yields among government bond issuers, DBG would like to propose to introduce two issuer yield classes (similar to the two price classes for shares) and to increase the current threshold level in order to significantly reduce the large number of trigger events. Yield class assignments of issuers could take place according to the 10 year yield of an issuer with a higher threshold being applied to issuers with lower yields.

Furthermore, DBG considers the current methodology of applying thresholds to yield changes across the yield curve as rather complex in terms of implementation and monitoring. We therefore would like to propose applying the threshold to yield changes of a single reference maturity, such as for example 10 years, as a possible alternative aimed at reducing calculation complexity.

Proposed Methodology (parameters provided for illustration purposes only):

- Government bond issuers with 10 year yield $< 2.5\%$: 20%
- Government bond issuers with 10 year yield $\geq 2.5\%$: 10%

¹ Based on yield changes of individual government bonds.

Q29 Do you consider thresholds should be set for significant price falls in UCITS and commodity derivatives? If so, how should they be set and at what levels?

DBG does not see the need to consider thresholds for significant price falls in UCITS for the same reasons as outlined in Commission Delegated Regulation (EU) No 918/2012.

Q30 Do you have any other comments on the provisions of the Regulation concerning intervention powers and emergency measures or on how they have operated since 1 November 2012?

No comments by DBG.

We trust you would have found these comments useful and remain at your disposal for further discussion. Should you have any questions please do not hesitate to contact:

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