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European Banking Authority & European Securities and Markets Authority
Sent by ESMA online submission

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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

Barclays appreciates the opportunity to respond to ESMA's call for evidence on the evaluation of the Short Selling and certain aspects of Credit Default Swaps Regulation.

For your information, Barclays Investment Bank provides large corporate, government and institutional clients with a full spectrum of solutions to their strategic advisory, financing and risk management needs. Barclays does this through the provision of ongoing liquidity to financial markets in transferable securities and related derivative products across all asset classes, as well as through the creation of individual bespoke products designed to meet the exact needs of clients.

Barclays is supportive of the objective to harmonise the rules on short selling and the tools that are available to regulators across the European Union. However, we set out some specific comments below.

Barclays has contributed to the joint AFME and ISDA submissions in response to ESMA's call for evidence and reaffirms our support for the matters raised in that submission within our summary below in relation to the provisions of the Regulation concerning exemptions.

Executive Summary

As outlined in the joint AFME/ISDA response, market making is a vital function in the effective running of the markets. We believe the narrow interpretation of market making in ESMA's final guidelines will have a detrimental effect on liquidity, competition, risk management and the ability of member states to access financing. Where firms are unable to act as market makers in certain instruments, liquidity will decrease and as a consequence execution costs will increase for the end investor.

Barclays has concerns with regard to the interpretation of trading venue and the requirement for a link between venue membership and market making in a financial instrument. It is not obvious what benefit this link provides to regulators in meeting the policy objectives or what protection it provides to the market. There are numerous instruments with significant client flow that trade solely OTC. Additionally, by requiring market makers to be a member of a venue, the guidelines reduce competition as many small and medium firms are not members of trading venues.

In addition, we believe that the narrow interpretation of related products in paragraph 32 of the final guidelines on market making is problematic. Many legitimate market making businesses hedge risk using products covered under the Short Selling Regulation; and we believe that there may be unintended consequences to these markets if participants cannot qualify for the market making exemption in respect of these related products

Barclays highlights this issue with the following examples: {delete bullets below}

a) Corporate Bonds:

If corporate bonds are outside the scope of related instruments, it is likely that this will result in a fundamental change to the way these instruments are traded. Corporate bonds are frequently traded as a package with a sovereign bond, where the price is quoted as a spread over the relevant sovereign debt. This is done to hedge the interest rate risk so that the risk remaining is purely corporate credit risk. If corporate bond trading desks can no longer benefit from the Market Maker (MM) exemption, traders will need to obtain a [†] third party sovereign debt locate prior to execution of the corporate bond trade, which as a result is likely negatively to impact the efficiency of this market. As outlined in the joint AFME/ISDA paper, this is likely to lead to increased costs to the investor and an increase in funding costs for corporates.

b) Credit Value Adjustment (CVA) Hedging:

As outlined within the AFME/ISDA response, CVA hedging is an extremely important risk management function that is likely to be negatively impacted by the narrow interpretation of MM, particularly in relation to paragraph 32. The CVA desk often uses Sovereign CDS to hedge exposure to Sovereign and related counterparties. If firms can no longer benefit from the MM exemption, it is likely that CVA cost and rebalancing cost will immediately become more expensive and cumbersome to manage. This will result in Sovereign users of derivatives and related entities experiencing higher transaction costs and a decreased ability to hedge.

c) Equity derivatives:

Given the narrow interpretation of MM with respect to the trading venue definition and the product list in paragraph 32, banks will be forced to segregate risk in order to manage the locate and reporting requirements. As a result trading desks will no longer be able to manage risk on a sector or portfolio basis and will have to create fragmented views. This is likely to increase operational risk, create sub optimal risk management structures and ultimately lead to poorer service of clients. In addition, the narrowing of MM exemption could lead to market wide overlocating which will reduce liquidity to the market and increase the costs to clients.

If you would like to discuss any aspect of our response please do let me know.

Yours sincerely,

Eric Bommensath
Head of Markets

For and on behalf of Barclays Bank PLC