INTESA SANPAOLO

International Regulatory and Antitrust Affairs

Intesa Sanpaolo Response to the ESMA Consultation Paper on Draft Technical Standards on the Regulation xxxx/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps January 2012/ESMA/2012/30

The Intesa Sanpaolo Group is one of the largest European banking groups active in different EU markets both through Banca IMI, its investment bank and through its subsidiaries based in Central and Eastern Europe.

Intesa Sanpaolo is an active participant in European financial markets, both as a market maker and a trader.

We welcome the opportunity to comment on the ESMA consultation on draft technical standards on the regulation on shortselling and on certain aspects of CDS. We regret that the limited time ESMA was given to prepare the draft technical standards and the consequent short consultation period, does not allow us to make a thorough analysis of the impact that the proposed measures would have on the different markets and to provide data on the costs that the proposed standards will generate for our firm.

General comments

While we support the policy goals of limiting the potential risks of settlement failures and volatility in the market, we observe that the implementation of measures bearing an economic impact on shortsellers could more effectively achieve the a.m. goals, rather than those provided for in Article 12 of the Shortselling Regulation. Shortening buy-in periods – as it is provided for in Article 15 of the Shortselling regulation and toughening penalties for settlement fails are strong and effective tools for discouraging settlement fails.

Buy-in procedures and penalties: Article 15 of the Shortselling regulation does not provide for any implementing measure in relation to buy-in procedures. In this respect, we believe that it is crucial that buy-ins procedures are introduced in all EU markets and are consistently and concomitantly applied across the EU. ESMA could play an important coordination role with national competent authorities, in order to make sure that the buy-in procedures are implemented and applied by CCPs in a consistent and concomitant way across the EU. We have concerns that an uncoordinated implementation of the buy-in provision could have distortive effects on the market. In fact, a lack of harmonization on buy-ins could allow regulatory arbitrages, where market participants shortening instruments traded in different trading venues and different member States could choose the settlement place with the looser penalty regime.

In the same vein we also believe that a **harmonized regime of penalties** should be introduced and applied in all Member states. Currently, the situation differs from market/country to country. For example, within the EU, Italy is the only member State that has implemented a penalty regime which is very harsh. The lack of uniform rules entails an unlevelled playing field, which is not acceptable in a single market context. The issue should be addressed at EU level. Also in this respect ESMA could play an important coordination role.

Against this background, we also believe that **cross border settlements need be harmonized** at EU level. In this respect we are aware that the Commission will address the issue in the forthcoming regulation on CSDs, where settlement cycles will be harmonized at T+2.
In our view, requiring agent banks to insert in the transactions' matching message the beneficial owner would greatly help market participants and supervisors in identifying the failing counterparty

either because it does not hand the securities over or because it has not received them on time because of third parties.

Definition of short sale: Article 2 of the Shortselling regulation provides for that a short sale is any sale of the share or debt instrument which the seller does not own at the time of entering into the agreement to sell. In our view, the definition fails to acknowledge the fact that securities can be recalled, thus ensuring that settlement can be achieved in time.

Article 6 of Draft ITS (1) i) – Arrangements and measures to be taken in relation to shares[1] : when requesting the confirmation the draft text requires the investor a statement that the short sale will be covered by purchase during the same day of the short sale. We would like to raise the attention that there is no definition of investor in the draft ITSs; in our view investors should be defined for legal certainty reasons.

We note that **securities lending is not mentioned** in recital 18 of the Shortselling regulation. Since the list mentioned in the recital is clearly not exhaustive, and considering the relevance of this activity in the business, we would suggest this activity to be taken into account in Art. 5 of the ITS.

Finally, in relation to the arrangements with a third party, we believe that Articles 6 and 7 of the ITS should clearly state that if the shares are not transferred to the short seller in due time for settlement, this should amount for the short seller neither to a breach of the Shortselling regulation nor to the breach of the arrangement with the third party. Penalties should be applied in this case, as a deterrent measure.

Responses to questions

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

We do not agree with the proposed approach of providing an exhaustive list of types of agreements. We believe ESMA should adopt a more flexible approach allowing firms to put in place any arrangement meeting the criteria of paragraph 12 that enable them to comply with the Shortselling regulation.

We also observe that the list of types of agreements set out in paragraph 11 of the consultation document does not include securities lending agreements, which are of common practice in the market. Accordingly, we would suggest ESMA to include it in the list and in Article 5 of the draft ITS.

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 agreement or enforceable claims or criteria which should be added?

While we agree with the proposed list of agreements and enforceable claims, we observe that settlement fails related to short sales can be better effectively achieved by shortening the buy –in procedures and implementing them consistently.

We also suggest adding in letter f) (paragraph 11) “other claims, agreements **or arrangements** leading to physical exchanges of the shares or sovereign debt”.

[1] See page 52 of the consultation paper

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?

The new criteria will undoubtedly entail considerable costs that would span from those related to new IT architecture to human resources. Due to the limited consultation period it is difficult to provide evidence on additional costs. In any case the costs would depend on whether it will be possible to net the long and short positions of internal trading desks and allow a single lending desk to locate the shares for the whole legal entity.

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 would suggest adding to the proposed list of third parties the following entities: banks, custodian banks lending on behalf of their clients, investment funds and ICSDs operating tri-party repos.
In our view it is also crucial that non EU regulated entities such as non EU pension and mutual funds be included in the list of Article 8 of the draft ITS.

Q5: Are there further criteria which should be added?

We do not see any additional criteria.

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.

We have strong concerns on the ESMA interpretation of third party and on the fact that it should be considered as a legal entity that is different from the legal entity that will enter into the short sale.

As rightly pointed out in the consultation paper, requiring the use of a different legal entity will have an impact on banks' current business models, where banks currently use their internal securities lending desks for "locate" purposes. Requiring banks to locate with a third party for each short sale entered into by a trading desk would entail significant costs that would be proportional to volume of business of a bank. This approach fails to acknowledge that the overall position of the bank on a specific instrument could be balanced. Therefore, we would suggest ESMA to allow at least the internal netting of the positions of all trading desks, and require the securities lending desk to locate with third parties.

Requiring firms to resort to a distinct legal entity for locate purposes would have the unintended effect of increasing the risks of settlement fails because of the increase of the chain of third parties involved in the process and would definitely not be market efficient.

As previously mentioned, we are not able to provide estimates of the costs we would incur into if the ESMA interpretation would be validated; in any case costs will be proportional to the business volume.

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 concur with the fact that there should be criteria for ensuring that shortened shares are settled in time. However, we believe that the new regulatory framework should not have the effect of blocking the trading of shares during the day, which would decrease the liquidity on the market, but rather maintain some elements of flexibility that would allow trading to go on during the day. Therefore, the volumes of shares put on hold should be constantly reviewed, so as to reflect actual

trading needs, as in the end there is the risk that higher volumes of shares are “iced” than necessary.

On locate confirmation we would like to point out that the shares allocation confirmation arrangements by third parties should also include exclusive contracts and re-calls should also be considered among the possibilities of confirmation (in paragraph 23 of the consultation paper) and accordingly mentioned in the draft ITSs.

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?

As a preliminary note we would like to say that the majority of transactions are settled in due time. In our view a further suggestion would be providing for exclusive contracts and shorter buy-ins.

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?

We do not believe that the proposal to use the list of liquid shares under Mifid is appropriate for meeting the reasonable expectation test for liquid and non liquid shares. The proposed approach could be limiting and would exclude other shares that can be easily borrowed in the market. We would rather suggest a broader definition of liquid shares that would include market conditions as a criterion. In fact, in certain market conditions, shares considered to be liquid under Mifid could be difficult to be borrowed.

Finally, the security lending activity could be considered as an additional factor, although we note that currently there is no hard evidence of this activity.

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?

On the basis of our understanding that Article 13(1)(c) of the Shortselling Regulation applies to sovereign debt and not to derivatives on sovereign debt, we agree with ESMA approach on the location confirmation and we think that the reasonable expectation test is sufficient to be applicable in case of intraday short selling. However, we do not think that the responsibility with regards to locate and reasonable expectation should fall on the third party.

Q11: Do you agree that there should be one standard format for notifying relevant competent authority for each type of instrument?
Q12: Do you agree that there should be one standard form for public disclosure of information on significant net short position in shares?

We fully support the principle of defining an EU standard format for notifying the short positions to the competent authorities and to the public.

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

Yes, we support the approach proposed by ESMA and the use of the LEI code when it will be available and implemented by market participants.

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

Yes we support the proposed way of notification and disclosure of the size of the relevant position.

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?

As to the way of identifying the issuer in relation to which the relevant net short position is held, we would tend to prefer the reference of ISIN codes of ordinary shares.

Q16: Do you agree with the ISO 8601 2004 standard use to notify and publicly disclose the date on which relevant position was created, changed or ceased to be held?

Yes, we agree.

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

Yes, we agree it can be useful for supervisors to have the additional information related to the third party submitting the notification and the date of the previous notification of the net short position.

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

Yes, we do agree.

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?

Yes

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

We do not have any comment on this issue.

For any further comments or questions, please contact Intesa Sanpaolo's International Regulatory and Antitrust Affairs Office:

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