Bundesverband der Wertpapierfirmen e.V.
Friedrichstraße 52, 60323 Frankfurt/Main

**ESMA**
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07
France

*Via Internet*

your reference
ESMA 70-145-127

your message of
07 July 2017

city_date
**Frankfurt/Main, 04.09.2017**

# Consultation Paper – On the evaluation of certain elements of the Short Selling Regulation

**Dear Sir, dear Madam,**

in its capacity as a trade association representing the common professional interests of securities trading firms and market specialists at the securities exchanges throughout Germany the bwf welcomes the opportunity to comment on the Consultation Paper on the evaluation of certain elements of the Short Selling Regulation, ESMA 70-145-127, dated 07 July 2017. The task to evaluate to what extent the SSR has achieved its original objectives in terms of relevance, effectiveness, coherence and efficiency clearly deserves to be endorsed.

Like all previous consultation on short selling regulation, we consider this evaluation to be of great importance since the majority of bwf member firms provide market making services on the various German securities exchanges or – to a lesser extent – "OTC", either as their core business or as a business unit within a broader securities services offering. It should be noted that compared to their European peers, most bwf member firms could be categorized as comparably small or mid-size investment firms. However, despite of their limited size, bwf members are usually completely "wholesale" firms. While the markets they serve might be of particular importance for retail investors, their immediate clients and market counterparts are German and international banks, UCITS, insurance companies and other investment firms alike.

This said, we would like to comment on the questions raised by ESMA as follows. Hereby, we would like to restrict our answers to questions which are directly relevant for the market making business of our members:

**Bundesverband der Wertpapierfirmen e.V.**

*Federal Association of Securities Trading Firms – a registered association*

**Registered Seat**
Kurfürstendamm 151
D-10709 Berlin

**Postal Address & Office**
Friedrichstraße 52
D-60323 Frankfurt/Main

Tel.: +49 (0) 69 92 10 16 91
Fax: +49 (0) 69 92 10 16 92
mail@bwf-verband.de
www.bwf-verband.de

**Board of Governors**
Prof. Dr. Jörg Franke (Chair)
Carsten Bokelmann
Stefan Bolle
Daniel Förtsch
Dirk Freitag
Holger Gröber
Kai Jordan
Torsten Klanten
Dr. Annette Kliffmüller-Frank

**Secretary General**
Michael H. Sterzenbach
m.sterzenbach@bwf-verband.de

**Legal Adviser**
Dr. Hans Mewes
Am Sandtorkai 44, D-20457 Hamburg
Tel.: +49 (0) 40 36 80 5 - 132
Fax: +49 (0) 40 36 80 5 - 333
h.mewes@bwf-verband.de

**Banking-Account**
Deutsche Bank PGK Frankfurt
**IBAN** DE08500700240018321000
**BIC** DEUTDEDBFRA

**Exemption for market making activities**

***Q1: Taking into account the different regulatory approaches and purposes of MiFID II and SSR, what are your views on the absence of alignment between the definition of 'market making activities' in each of the capacities specified in Article 2(1)(k) of SSR and that of 'market maker' in Article 4(1)(7) of MiFID II ? Do you consider that this absence of alignment is not appropriate, and if so what would you suggest?***

We think that the differences in scope and factual conditions between the definitions of 'market making activities' in Article 2(1)(k) of SSR and that of 'market maker' in Article 4(1)(7) of MiFID II are comprehensible, appropriate and necessary.

While the scope of definitions of (various) 'market making activities' according Article 2(1)(k) of SSR is wider[1] than the definition given in Article 4(1)(7) of MiFID II[2], the functional requisites of the SSR which a market maker as defined by MiFID II would have to fulfil in order to benefit from the market maker exemption under SSR are significantly higher.[3]

Article 2(1)(k) of SSR on the one hand intends to comprehensively cover all activities which – in the context of the regulation – are considered to be generally beneficial because they provide liquidity to the markets[4] and on the other hand introduces further qualifying functional requirements in order to ensure that only those activities might profit from the privileges granted under the market making exemption which endorse that liquidity is provided not only on a continuous basis but in an overall effective and competitive way. Therefore, despite of the continuity requirement in both legal regimes, the necessary standards to be fulfilled as stipulated by Article 2(1)(k) of SSR are still above those of Article 4(1)(7) of MiFID II.

Consequently, somebody who qualifies as market maker according to Article 4(1)(7) of MiFID II would not necessarily fulfil all requirements required by Article 2(1)(k) of SSR. Therefore, we think that the "non-alignment" is intended and appropriate. Furthermore, the definitions used in Article 2(1)(k) of SSR have already proven in a practical context that they provide a useful classification of market making activities for the intended purpose while – at the same time – being demanding enough to effectively impede abusive behaviour. We also cannot see any negative effect which could result from the simultaneous application of the two regimes (i.e. MiFID II and SRR) with its slightly differing definition of market making.

Accordingly, we do not suggest to change the current differentiation.

[1] In particular because of the inclusion of transactions facilitated by clients and hedging transactions.

[2] Which is limited to two sided dealing on own account.

[3] By requiring the posting of *"firm, simultaneous two-way quotes of comparable size and at competitive prices"*, the effectual *"provision of liquidity on a regular and ongoing basis"*.

[4] As very clearly stated in recital 26 SSR.

***Q2: Considering the new regulatory framework under the MiFID II/MiFIR, how do you suggest addressing the issue of the membership requirement in relation to those instruments that will remain pure OTC instruments despite the MiFID II/MiFIR framework? Should the membership requirement not apply to those pure OTC instruments? Please provide justifications.***

As a general remark, we would like to re-emphasize that we do not agree with ESMA conclusion that according to Article 2(1)(k) of SSR the membership requirement should be considered in relation to the trading venue on which the financial instrument of the exemption[5] is traded.[6]

Here we would like to recall our considerations presented originally in our comments provide on 5 October 2012 in response to ESMA's Consultation Paper - Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps:

Our objection to ESMA's conclusion that the market making exemption can only be granted for those financial instruments in which market making activities are in some form also conducted on a trading venue[7], arises from the fact that it cannot be derived from the text of the SSR without a semantic misinterpretation, resulting most likely from an isolated reference to the English language version of the regulation:

Article 2 (1) (k) in the English language version defines *"market making"* as

> *"[…] the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC, which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities: […]"*

At first glance, one could suppose that *"where"* refers to the *"trading venue"* mentioned above. However, for at least two reasons, this cannot be the case, because otherwise:

– the interposed clause "*whether traded on or outside a trading venue"* would be semantically inconsistent within the compound sentence, because it clearly states that it is not required to trade on a trading venue in

---

[5] Which needs to be an instrument in which market making activities are conducted, of course.

[6] Cf. Paragraph 16 of the Consultation Paper, ESMA70-145-127.

[7] Even though ESMA concludes that this activity does not need to be in the form of a "recognized market maker" and there is also no need for a "separate contractual obligation" (cf. Paragraph 16 of the Consultation Paper, ESMA70-145-127).

order to conduct *market making activities*. Very obviously, something cannot be not required and required at the same time,

– furthermore, an analysis of the different text versions in all official languages in which the Regulation was published, reveals that aside from the English version, only the Irish text uses a conjunction which principally would allow a reference to a place or location. In all the other 21 languages, a term equivalent to *"when"*, *"if"*, *"provided"*, *"supposed"* or *"in case"* is used[8], clearly indicating that the conjunction fulfils the function of subordinating the following clause "*it deals as principal […]"*. Since the reference to a location which is possible (even though not necessary) following the English text cannot be divergent from the other official languages, it becomes evident that *"where"*, in Article 2(1)(k), does not serve as a reference to a place (*"trading venue"*) but defines a limiting conditionality with respect to "where *it deals as principal […]"*, similar to the terms *"where justified"*, *"where appropriate"*, *"where applicable"* or *"where the condition is met"*.

Therefore, ESMA's view provided in the guidelines that one needs to be a member of a trading venue on which he deals on own account in at least one capacity listed under the definition of the market making activities in the financial instrument for which he intends to benefit from the market making exemption[9] cannot be derived from the text of the regulation. Therefore, if ESMA intends to keep its guidelines unchanged with respect to the interpretation of the membership requirement, Article 2 (1) (k) of SSR should be redrafted in order to avoid any possible semantic disaccord.

However, as stated before in our comment letter of 5 October 2012 mentioned above, we remain critical of the practical implication of ESMA's interpretation of the membership requirement. Even though most bwf members conduct their business as recognized market makers on regulated markets or MTFs and therefore do not face any immediate problems resulting from ESMA's interpretation, we think that it does not reflect appropriately the structure of financial markets within the Union.

It needs to be recognized that market making on regulated markets and other trading venues is very often conducted by different firms than those who provide market making activities "OTC". Such differentiated structures, which become most prominent in the sovereign debt markets, can be described as a "division of labour" among different firms providing liquidity in different market segments and for different groups of investors ("retail" and "institutional") with different needs and expectations with respect to market models, trading sizes etc. Togeth-

---

8 [bg] *"когато"*, [cs] *"pokud"*, [da] *"når"*, [de] *"wenn"*, [el] *"όταν"*, [en] *"where"*, [es] *"si"*, [et] *"eeldusel"*, [fi] *"jos"*, [fr] *« et que »*, [ga] *« i gcás »*, [hu] *"ha"*, [it] *"quando"*, [lt] *"kai"*, [lv] *"ja"*, [mt] *"meta"*, [nl] *"wanneer"*, [pl] *"w przypadku"*, [pt] *"caso"*, [ro] *"atunci când"*, [sk] *"ak"*, [sl] *"kadar"*, [sv] *"när"*

9 Cf. Consultation Paper, ESMA70-145-127, Paragraph 17.

er, these different market segments form a stable pattern of interlinked liquidity pools which can be regarded as essential for the orderly function and efficiency of the Union's markets.

Furthermore, the Commission services analysis mentioned by ESMA and ESMA itself have recognized that ESMA's current interpretation of the membership requirement de facto leads to a discrimination of "pure OTC Instruments" which as a result of this (as demonstrated above false) interpretation currently cannot benefit from the exemptions provided in Article 17(1) of the SSR.[10]

As a result, several competent authorities declared their "non-compliance" with – among other provision – in particular the membership requirement[11]. This results in a heterogeneous landscape with different legal requirements within the Union. While such a non-uniform application of European law might be seen as undesirable, we think the "non-compliance" was clearly justified in order to avoid unintended negative consequences arising from the discrimination of OTC market segments.

Furthermore, the practical experience of those jurisdictions which did not impose the membership requirement provide evidence that it is an unnecessarily overly restrictive and needless provision altogether.

***Q3: Where market making activities on exchange-traded instruments are carried out OTC only, should they be able to benefit from the exemptions? Do you consider that the application of the exemptions in those cases can be detrimental to the interest of investor and consumers? Please provide justifications.***

While we advocate the usefulness of regulated trading venues in general and of regulated markets in particular, we also recognize that different types of trading benefit the different needs of various groups of investors. Market making plays an important role in all market segments and trading models, including OTC. Furthermore, it is simply not the role of the SSR to intervene into the "eco-system" between the various trading venues and OTC-trading.[12]

Furthermore, we have no indications that granting the benefits from the exemption to "OTC only" instruments would cause any negative effects for investors or consumers. On the contrary, the predictable and continuous provision of liquidity which is facilitated by the exemption is equally important and beneficial to the market as a whole regardless of the segment.

---

[10] Cf. Consultation Paper, ESMA70-145-127, Paragraph 23.

[11] Cf. ibid, Paragraph 25

[12] Where regulatory intervention with respect to market structure is desired, it should and is effectively addressed by MiFID II, in particular by introducing a "trading obligation" and by defining standards, different venues and different forms of trading have to comply with.

Therefore, OTC and "OTC only" market makers should be able to benefit from the market making exemption under SSR in the same way as their on-exchange / on-venue equivalents. Technically, this could be achieved either by waiving the membership requirement for "OTC only" instruments or by deleting the membership requirement altogether, whereby we would opt clearly for the latter option.

***Q4: Do you think that the membership requirement should be deleted where the market making activity in relation to exchange-traded instruments is carried out OTC as well as on a trading venue? Please explain.***

As already mentioned in our answer to question 3, we are of the opinion that in the context of the SSR any membership requirement is clearly dispensable. Where such a membership is economically useful, e.g. for an OTC market maker to cover or unwind a position resulting from his OTC activities on a venue – e.g. because the OTC liquidity is temporarily low – the market maker will seek a membership (or another form of access) to trading venues where his instruments are traded anyway. Where this is not the case, it can be reasonably assumed that such a membership is not deemed necessary to effectively fulfil his market making activities.

Taking into account the newly introduced minimum standards for on-exchange / on-venue "shadow market makers"[13] stipulated by Article 17 MiFID II and Delegated Regulation 2017/578 does not lead to any other conclusion. These provisions are intended to further enhance the continuous provision of liquidity and to countervail possible volatility hikes caused by liquidity shortages as a result of "shadow market makers'" unpredicted withdrawal from the market.

Aside from the fact that this new peace of regulation still has to prove its effectiveness in practice, its application is limited to certain liquid instruments[14] and certain forms of on exchange trading (namely continuous auction order book trading systems).[15] Obviously, this provision will have no traceable impact on the quality of OTC market making, no matter whether the OTC market maker has to become a member of a trading venue in order to benefit from the market making exemption under SSR or not. Moreover, to our understanding, the requirement to enter into a "binding written agreement with the trading venue"[16] would arise only from dealing on own account in the capacity defined by Article 2 (1) (k) (i) of the SSR (posting firm, simultaneous two-way quotes) but not if the OTC market

[13] Here, the term „shadow market maker" shall refer to a market participant who de facto acts like a market maker without being mandated or recognized by a trading venue and does not conduct its business on the basis of any binding agreement with respect to presence, trading size, quote quality etc.

[14] Cf. Delegated Regulation 2017/578, Article 5.

[15] Cf. ibid.

[16] Assuming that instruments traded and the market model applied falls into the scope defined by Article 5 of Delegated Regulation 2017/578.

maker uses his membership solely for the purpose of Article 2 (1) (k) (iii) (hedging positions resulting from his OTC market making).

Last but not least, as mentioned before, there is no evidence that the quality of OTC market making is lower in jurisdictions which did not implement the membership requirement. Therefore, we think that the membership requirement is a confusing and unnecessary peace of regulation which should be deleted.

***Q5: Do you have proposals in relation to the improvement of the transparency of market making activities conducted OTC and exempted under the SSR? Do you think that requiring a firm willing to benefit from the exemption for its market making activities conducted OTC to qualify as systematic internaliser is a viable option that would improve the transparency of their activity? Please provide justifications.***

While there is no doubt that systematic internalisers (Sis) can principally qualify as entities conducting market making activities according to Article 2 (1) (k) of the SSR, we cannot see why granting a market making exemption for OTC activities should be limited to systematic internalisers.

The set-up costs and the ongoing administrative burden to comply with SI-requirements are substantial. Therefore, according to MiFID II the internalized trading volume has to exceed firm- and market-based thresholds before a firm qualifies as systematic internaliser and has to comply with the relevant provisions. The thresholds, very obviously are intended to prevent small firms (or small business units within larger firms) to be confronted with levels of expenditures which would render these business models uneconomical.

Therefore, while OTC firms whose own account business exceeds the MiFID II thresholds will "automatically" qualify as Sis anyway, small firms might find a requirement to "opt in" the SI-regime just to make use from the market making exemption under SSR prohibitive in the light of the scale of their business. The consequence would be a competitive distortion where large OTC market making firms could benefit from the exemption while smaller firms could not. Not only would the ability to provide liquidity to the market for smaller firms de facto be restricted but it is even possible that the overall market liquidity might shrink to the extent that smaller firms (or business units) might have to cease trading. – Very obviously, this could not be regarded as an intended consequence of the SSR.

***Q6: Do you think it would be appropriate to enlarge the set of financial instruments eligible for the exemption for market making activities? If so, which financial instrument(s) would you suggest? Please provide justifications.***

We are very much in favour of the consideration to enlarge the universe of instruments eligible for exemption which should include at least those instruments, mentioned in ESMA's discussion paper (corporate bonds, convertible bonds, subscription rights and dividend swaps).[17]

***Q7: Do you think that market makers should be able to notify the list of financial instruments by using indices, as long as they are market making in all the financial instruments included in the used indices? Besides indices, which other sectoral categories / classification could be used by market makers to indicate a group of financial instruments for which the market maker is seeking exemption? Please provide justifications.***

The current ex ante notification process on an instrument by instrument basis is possibly the most cumbersome aspect of the SSR regime for market making firms (which have to provide the data in time) and competent authorities (which have to process the data as fast as possible) alike. We therefore emphatically support ESMA's intend to reduce the administrative burden which results from the current difficult and overly detailed notification process. Therefore, the evaluation should reaccess the current procedure in all its aspects in the light of the regulatory intent which the notification serves.

To our understanding, the main purpose of the notification process lies in the possibility of ex post verification whether a transaction which leads to a naked short position was executed legitimately under the privilege granted by the exemption or not. The question to be answered is therefore, how could the notification process be simplified for market making firms and competent authorities alike without sacrificing its regulatory purpose.

We think that ESMA has correctly identified the level of detail (instrument by instrument) and the timeframe (30 days ex ante) as the main factors causing difficulties. ESMA considers to reduce the level of detail in the notification process by replacing or amending the instrument by instrument approach by a notification based on indices and/or sectoral categories. While this looks like a promising approach at first glance, such an approach would create a number of practical problems of its own:

- First of all, a surprisingly high number of financial instruments is not included in any recognized index at all. Data provided by one of bwf's member firms indicates that for the observation period 2015 till 2017 on an annual basis between 31% and 59% of shares for which the market maker exemption was utilized were not included in a recognized index.

  Even though the figures are not representative, it can be reasonably assumed that the observation that a relatively high number of shares within a market makinger's portfolio are not part of an index is far from atypical. It is more than obvious that for this and comparable firms, the possi-

[17] Cf. Consultation Paper, ESMA70-145-127, Paragraph 38 & 40.

ble reference to indices in the notification process would not bring any substantial relief since for any instrument which is not included in an index, the market maker would be still required to apply for an exemption on an instrument by instrument basis..

– Furthermore, an index based approach would require a permanent monitoring of the index composition and a mapping to the market making portfolio. In the case that an instrument will be excluded from an index, the question arises whether the market maker will not be able to benefit from market maker exemption of the SSR before he has applied for – and the competent authority has confirmed – an instrument based exemption. In any case, an index-based notification process will create an additional administrative burden which needs to be balanced against any possible simplification resulting from this approach.

– Also ESMA's second proposal to link the market making exemption to other sectoral categories or classifications might face certain difficulties in praxis, simply because no standardized, generally accepted European sector classification exists.

While our critical remarks are not intended to reject ESMA's proposals completely, they evidently demonstrate that any possible index or sector based notification can only be one contributing element among others in the overall endeavour to reduce the current undue administrative burden and the excessive level of compliance costs resulting from it.

In this context, we think that it is also worthwhile to reconsider, whether the concept that the exemption can only be applied to a predefined set of financial instruments (on an instrument by instrument basis or with respect to indices or other groupings) is the only thinkable approach which effectively serves the regulatory intention.

In our comment letter dated 5 October 2012 on the Consultation Paper ESMA/2012/580, we have argued that such an approach is not prescribed by the level one text and significantly exceeds admission restrictions in other parts of the economy. We think that the example we gave in 2012 is still worthwhile to be taken into account in today's discussion: Nobody would seriously demand that a pharmacy licensed to sell drugs and narcotics available on a prescription only basis, would need a (renewed) licence for each and every new pharmaceutical. Such a provision, for good reasons, does not exist since the license is aimed to insure the quality of the service provided in general and the compliance with any existing operational standards for handling drugs and narcotics.

Therefore, we think that an alternative approach to be considered would be a clear ex ante definition and notification of the business unit which is conducting market making activities.[18] Such a business unit based approach would also allow to clearly identify ex post all market making related transactions in order to verify whether the exemption provided by the SSR was applied correctly.

***Q8: Do you think that the 30-day period mentioned in Article 17(5) of the SSR should not apply when the notification refer to instrument admitted to trading for the first time on an EU trading venue? Please provide justifications.***

It is indeed a hardly understandable consequence resulting from the current regime that the 30-day ex ante notification obligation could hinder a market maker to make use of the exemption stipulated by the SSR when an instrument is first admitted for trading – a situation where the flexibility resulting from the exemption is very often urgently needed to cope with exceptional liquidity situation resulting from the introduction. Therefore, if an instrument based notification regime would be pursued, we strongly support that the 30-day period mentioned in Article 17(5) of the SSR should not apply when an instrument is introduced to trading for the first time.

Moreover, there are other situation which also clearly ask for a waiver from the application of the 30-day period and/or other administrative facilitations. Very often, practical problems arise from corporate actions and/or the handling and maintenance of the "ESMA negative-list". While the problem of instruments newly admitted to trading, e.g. in an IPO process, resulting from a secondary listing or the inclusion in trading on the initiative of a market maker, was already discussed in the course of the SSR legislation – even though the need to find legislative solutions for the resulting difficulties was not recognized by ESMA until now – the difficulties which can result within the SSR regime from corporate actions so far were widely overlooked in the legislative debate.

However, the occurrence of corporate action related problems arising from the current requirements under the SSR are at least as frequent and pressing as those resulting from the admittance of new instruments. Generally speaking, difficulties in the context of corporate actions result from the fact that any change of company name, legal entity or identification code needs to be individually reported and in cases where the legal structure is changed requires a (re-)notification under the same 30-days ex ante requirements or may result in an exclusion of an instrument from ESMA's negative-list with the consequence that a notification needs to be filed in order to continue to utilize the market making exemption.

A non-exhaustive list of practical examples of such events includes:

– changes in the legal form of corporation,

– name changes,

[18] This could be the firm a whole if it performs market making activities only.

– splits and reverse splits,

– mergers (with or without new incorporation),

– changes from bearer shares to registered shares (or vice versa) and

– any other corporate action which results in an ISIN-change.

All these events, which are often not foreseeable and put into effect within a very short timeframe. It is immediately comprehensible that while corporate actions create "tracking problems" under the SSR regime, these events should not impose unnecessary administrative burden or impede the market makers from fulfilling their liquidity providing function.

We therefore suggest that for corporate actions which simply require an update of reference data to be send to the relevant competent authority, these reports must not be sent for every single instrument but periodically (e.g. monthly) on a consolidated basis for all corporate actions which occurred within the market making portfolio. Even more important, where as a result of a corporate action a new notification is required, e.g. because the instrument is no longer included in ESMA's negative-list, the 30-day ex ante period should not apply in order to avoid disruptive effects in trading[19].

With respect to ESMA's negative-list, an alternative solution would be that ESMA gives up the current long maintenance intervals and turns the list into a "real time" reference. However, we are aware that this would result in significant additional administrative expenditures which could be avoided if the exclusion from the application of the SSR requirements for instruments contained in the list could be automatically "passed on" to the new/changed instrument as a result of a corporate action.

However, the easiest way to avoid all these instrument related problems, would be to switch to a business unit based approach as proposed above.

***Q9: What would you suggest to reduce the 30-day period mentioned in Article 17(5) of the SSR to provide for a faster process? What are your views on a quicker procedure for market makers that have already entered into a market making agreement/scheme with a trading venue or the issuer to classify as market maker in such venue? Please explain.***

[19] To give an illustrative example: the Canadian stock Obsidian Energy Ltd. (previously Penn West Petrolium Ltd.), ISIN CA6744821043 (previously CA7078871059) was subject to a change of corporate name and ISIN. Consequently, the non-inclusion in the SSR regime for Penn West Petrolium Ltd. which was part of ESMA's negative-list ceased when the name/ISIN-change occurred. The market maker had to restrict trading in this instrument temporarily, had to file a notification with his competent authority and had to wait for its confirmation before he could utilize the market making exemption and normal trading could resume.

We think that the 30-day period always was completely unsuitable with respect to practical needs.

While we do not have an overview about the situation in other member states, we can say that the German competent authority BaFin took very great effort from the beginning to speed up the processing of filed notifications. Based on reports by our members the actual "recognition time" actually lies between two and five days.[20] Therefore, at least for the situation in Germany, any further reduction in processing time does not seem to be realistic without dramatically increasing the resources employed.

Furthermore, while we are very grateful for the fast response time under the current rules, we think that the 30-day ex ante period creates an unnecessary and unreasonable burden for competent authorities und avoidable disruptive effects for market makers and the markets and investors they serve.

Since – as ESMA emphasizes – that the competent authority has the power to prohibit the use of the exemption at any time[21] and any potential misuse of the exemption can – realistically – be detected and enforced ex post, the usefulness and effectiveness of the whole ex ante notification regime (at least as long as it is based on instruments, rather than business units) remains highly questionable to us. If ESMA really wants to reduce the administrative burden, not only for market making firms but also for competent authorities, we therefore strongly recommend an impartial reassessment of the practicality and advisability of the current approach.

With respect to the second half of the question which raises the question of accelerated notification – or a deletion of the notification requirement[22] – we would first like to allude that the wording of the question which refers to "market makers that have already entered into a market making agreement/scheme" appears to be somewhat unfortunate or confusing since it could be misunderstood in a way that the question refers to firms pursuing a market making strategy according to Article 17(3) MiFID II only.

In the light of the considerations ESMA presents in Paragraph 57 of the Consultation Paper, this is fortunately not the case. However, for the sake of clarity we would like to remember that Article 17(3) MiFID II will set minimum standards for algorithmic traders which de facto behave like market makers without – under the current MiFID I regime – being bound by any requirements with respect to the predictability and quality of their activities. In this context, it is worthwhile remembering that recital 60 of MiFID II expressly states that the engagement in algorithmic trading by pursuing a market making strategy according to MiFID II is

---

[20] With the distribution of cases being clearly skewed to the right; in other words, notifications which need more than three to four days are rare.

[21] Cf. Consultation Paper, ESMA70-145-127, Paragraph 55.

[22] As considered in Paragraph 57 of the Consultation Paper, ESMA70-145-127.

independent of the definition of “market making activities” defined by the SSR. In other words, even after a (future) participation in a market making scheme and after entering into a written agreement with a trading venue, entities falling into the scope of Article 17(3) MiFID II would not automatically qualify for an exemption under the SSR.

However, while we think it is important to differentiate market makers which are officially mandated by exchanges and other trading venues today and whose activities unquestionably fall into the definition of “market making activities” according to Article 2 (1) (k) of the SSR[23] from those “perusing a market making strategy” according to Article 17(3) MiFID II, we think that regulators should apply a reasonable sense of proportionality in their decision if the latter should qualify for a market making exemption under the SSR. In any case, the prerequisites for Article 17(3) MiFID II firms to benefit from an exemption should not be higher than for their OTC counterparts. What is required, is a simply an unbiased judgement whether Article 2 (1) (k) SSR conditions are fulfilled no matter which categorization applies in another legal context with deviating regulatory intent.

This said, we emphatically support the idea presented by ESMA – as long as an instrument based notification regime would be pursued – that the 30-day ex ante notification requirement could be deleted for market makers “recognized” by a venue as long as their activities undoubtedly are covered by the definitions stipulated in Article 2 (1) (k) SSR and the “recognition” is based on mandates for individual instruments. Under such conditions, an objective ex post verification for which instruments the market making exemption of the SSR can be utilized at a given point in time can be always insured. In such cases, the current 30-day period ex ante notification-regime creates an unnecessary administrative burden for market making firms and competent authorities alike.

Once again, the described problems could be avoided altogether if ESMA would decide to adopt a business unit based notification approach.

We kindly ask ESMA to take our consideration into account in the further process of the further evaluation of certain elements of the Short Selling Regulation. Please do not hesitate to contact us, if you feel that any further information or elaboration of the points mentioned above could be helpful.

Yours sincerely,

Michael H. Sterzenbach
Secretary General

[23] Equally important, market makers mandated by an exchange or trading venue very often conduct their activities within a specifically designed market model which does not fall into the restricted scope defined by Article 5 of Delegated Regulation 2017/578.