



European Securities and
Markets Authority

Peer Review Report

Compliance with SSR as regards Market Making activities



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1 EXECUTIVE SUMMARY

1. This Peer Review was carried out by an Assessment Group appointed by the Board of Supervisors of ESMA.
2. The Peer Review aimed at assessing how national competent authorities (NCAs) apply the exemption for market making activities foreseen in Article 17 of the Short Selling Regulation (the SSR). Exempted market makers are not subject to the restrictions on uncovered short sales nor are they subject to the reporting and public disclosure obligations of significant net short positions in shares or sovereign debt.
3. The Assessment Group scrutinized in particular whether the NCAs are applying the general principles and criteria of eligibility for the exemption in compliance with the corresponding ESMA Guidelines¹ (the Guidelines). The objective of the review was also to identify good practices and to inform future discussions on the upcoming evaluation of the SSR to be conducted by the European Commission².
4. The Peer Review focused on those markets with the highest number of market makers benefiting from the exemption, and the markets in which market makers have notified the highest number of instruments. For practical and resource reasons, the Peer Review was limited to 5 authorities. Based on information then available at ESMA³, the review was therefore limited to the following NCAs:
 - Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin, DE)
 - Commissione Nazionale per le Società e la Borsa (Consob, IT)
 - Financial Conduct Authority (FCA, UK)
 - Finansinspektionen (FI, SE)
 - Magyar Nemzeti Bank (MNB, HU),
5. In 2012, when the Compliance Table for the Guidelines was being prepared, five NCAs (among them BaFin, FI and the FCA) reported that they were not going to comply with certain provisions of the Guidelines as they disagreed with the interpretations set out by ESMA in those Guidelines. This was the case in particular for (i) the so called “membership” requirement, i.e. the requirement that the exemption

¹ Guidelines on the “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” – ESMA/2013/74.

² http://ec.europa.eu/finance/securities/docs/short_selling/131213_report_en.pdf

³ The countries with the highest number of Market Makers benefiting from the exemption were the following: UK (81), DE (44), IT (17) HU (15). The market in which Market Makers have notified the highest number of instruments is the Swedish market, which also reported a significant number of exemptions (10).

would be granted for market making on financial instruments notified only to the extent that the market maker would be a member of the trading venue on which market making is performed – a condition which cannot be met for OTC derivatives, and (ii) the “product scope” requirement, which would not allow to exempt instruments other than share or sovereign debt (e.g. corporate bonds).

6. The conclusions of the Assessment Group following this review are that:
- All NCAs have dedicated resources and have designed processes to handle the notification of exemptions, and the notification functions are staffed with capable, knowledgeable and committed staff;
 - There is a great diversity of robustness in the approaches and intensity of the scrutiny of notifications and firms;
 - All NCAs managed the transition to the new notification process well, seeking to ensure that market participants were aware of the law and of their obligations. All NCAs had a proactive approach, held meetings with industry, held workshops and seminars;
 - Best efforts have been made by each NCA to comply with the Guidelines, although the Assessment Group notes a different interpretation amongst NCAs of the standards of supervision required of competent authorities;
 - FCA, FI and BaFin acknowledged, and the Assessment Group confirmed, that they do not comply with the provisions of the ESMA Guidelines where they reported non-compliance in the ‘Guidelines compliance table’ (dated 19 June 2013 reference ESMA/2013/765);
 - Other areas of concern were identified that will deserve further consideration. In particular:
 - NCAs are not properly seeking assurance, in advance, that market makers intending to avail themselves of the exemption comply with the organizational requirements of the ESMA Guidelines;
 - Many NCAs are applying a “per firm” approach to processing notifications for exemptions rather than a review of the notifications instrument by instrument, which is required by the Guidelines;

- Many NCAs place an overreliance on monitoring by trading venues, instead of monitoring by NCAs themselves to check compliance with the Guidelines⁴;
- Last, different interpretations of the SSR persist resulting in different practices among NCAs. This is an unsatisfactory state of affairs and should be clarified when the SSR is being reviewed.

Compliance assessment

7. The Peer Review found that all of the reviewed NCAs had established functions to deal with market-making notifications, and were for the most part cognisant of the responsibilities under the SSR and the Guidelines.
8. The Assessment Group has concluded that, of the five NCAs reviewed, only Consob is compliant with the Guidelines. This assessment is based on both supervisory practices and policy positions adopted by NCAs. The remaining NCAs are partially non-compliant to differing degrees as explained below.

Compliance of supervisory practices

9. The Assessment Group analysed the level of practical arrangements for processing and scrutinising notifications for an exemption and found diverse approaches among the competent authorities reflecting the different market structures as well as characteristics of the market participants and volume of financial instruments notified. In particular, what emerged were different levels of scrutiny and granularity of the checks performed. All NCAs have established processes and are resourced to some extent to carry out the function of receiving and assessing notifications although to differing degrees, with robust procedures and processes in place at BaFin or the FCA for example and a less formalized but clearly risk-driven approach at Consob.

Compliance with organisational criteria

10. The Guidelines require that an assessment is made by the NCAs of the notifier against certain organisational criteria set out in the Guidelines (paragraph 43). The Assessment Group found that no NCA entirely scrutinises each aspect of the organisational criteria upon notification.
11. In practice the approach adopted by NCAs is that some criteria are only monitored through ongoing monitoring tools, but these are not designed to pre-empt a non-compliant firm nor did the Assessment Group receive evidence of systematic ongoing checks of compliance with the organizational criteria. So, for example, an important criteria in the Guidelines that exempted firms must maintain records of orders and transactions relating to market making activities so that they can be easily

⁴ It should be noted that the Guidelines do not apply to trading venues, and do not therefore require trading venues to ensure their members' compliance with the Guidelines.

distinguished from proprietary trading activities, are not being scrutinised at the time of assessment of notifications. While most market makers are also regulated entities such as credit institutions or investment firms, which may provide a certain reassurance that these criteria are already met, the Assessment Group nevertheless is of the opinion that NCAs would be expected to at least seek formal confirmation thereof before granting the exemption.

Compliance with the “per instrument” approach

12. In addition, all the NCAs, apart from Consob, were assessed not to be strictly following the Guidelines in the notification process and were assessed to be applying a per firm approach rather than the per instrument approach required by paragraph 31 of the Guidelines, which prescribe that each notification should be made and assessed on a per instrument basis. There is an obligation for firms to notify on an instrument by instrument basis. As the modalities for assessing the notification by the competent authority are not prescribed by the SSR, the Assessment Group cannot conclude on whether non-compliance with the Guidelines implies non-compliance with the SSR on this particular point.
13. The Assessment Group found that where there is a large number of instruments notified to a competent authority (such as in BaFin, FI and the FCA), the level of scrutiny of the notification, is not as thorough as it could be – all that is checked are membership requirements of one trading venue and a sampling approach to the instruments notified. This is more a *per firm* approach and not a *per instrument* approach.
14. The Assessment Group finds that the *per firm* approach is not in compliance with the Guidelines. In times, such as in 2012 when the bulk of the notifications were made, this might be regarded as an understandable prioritisation of resources, considering the low risk assessment by the NCAs of this area. However, where the flow of notifications is substantially less and is more regularly spaced, all NCAs should be able to process the notifications in accordance with the Guidelines.
15. In respect of the MNB, although a *per instrument* approach was applied initially, this was not sustained as there was no follow up with market makers following initial notifications, and no steps taken to ensure that the list of instruments notified was kept up to date.
16. Apart from the assessment of compliance, and without calling into question the merit of the “per instrument” approach, which is especially important for market makers providing liquidity to the markets, exemption requirements to be met by this category of market makers are substantially more demanding than those for market makers acting on behalf of their clients. This tension, which is linked to the broad definition of market makers in the SSR, might deserve further reflection as part of the review of the SSR.

Compliance with ongoing monitoring

17. Another area of analysis covered by the Assessment Group is the monitoring by competent authorities of the activities of exempted market makers after having processed the initial notification, and the use of the data collected through the notification for purposes such as identification of uncovered short positions or general inspections of market participants.
18. Some NCAs were found to be overly reliant on monitoring by trading venues. Both during the processing of the notification and the monitoring of the activity of the exempted market makers, the Assessment Group noted that competent authorities rely, to a greater or lesser extent, on local trading venues where the market making activities take place, on the internal rules of those trading venues, and the direct monitoring by the trading venues of compliance with those internal rules. Paragraph 51 of the Guidelines allows NCAs to rely on this feature at the time of notification, as long as the internal rules of the trading venue require standards of market making performance that, at least, matches the minimum requirements of paragraphs 44 to 52 of the Guidelines. The reliance by NCAs on this 'supervision by proxy' can undermine proper supervision. The Assessment Group believes that NCAs need to ensure that compliance with the Guidelines continues to occur after the notification, and the Guidelines themselves specifically require firms to be able *at any time* to demonstrate to the competent authority that its market making activity meets the principles and criteria in the Guidelines. So, reliance on paragraph 51 of the Guidelines at the time of a notification does not remove the supervisory obligation to monitor what firms are doing when making use of the market making exemption.
19. There also exist cases where market participants notify their home NCA of the intention to make use of the market making exemption under the SSR by carrying out on-market activities, but where these market participants do so upon their own initiative and without entering into an agreement with the trading venue to provide market making services on that market, nor with an issuer to provide liquidity provision services. In these cases, the market makers must comply on an ongoing basis with certain minimum requirements of the Guidelines relating to minimum presence, the competitiveness of the spread and the size of the orders filled. However, these firms will not be monitored by the trading venue for any of this market making activity as they are not official market makers in these venues.
20. In the case of the FCA, the amount of instruments that fell into this category was sizeable (approximately 4,500 instruments, even if it represented only about 4% of a total of approximately 120,000 instruments notified to the FCA). Since the onsite visit, the FCA has launched a review to assess the size of the problem, and where firms are carrying out this market making on their own initiative have put in place a requirement for periodic information updates from firms, and a process to ensure that the initial applications for such business models are challenged and scrutinised.

21. Furthermore, reliance by NCAs on paragraph 51⁵ of the Guidelines is further weakened where firms are also market making on trading venues outside the jurisdiction of their home Member State. In these cases, the home Member State NCA will not have any oversight powers or role in supervising the trading venues concerned, and therefore there will be no reporting of market making activity performed on these venues.
22. In other cases, the Assessment Group uncovered instances where the internal rules of a trading venue did not meet the minimum requirements of the Guidelines, and therefore in these cases the Assessment Group considered that reliance solely on monitoring by the trading venues was not appropriate without additional checks by the competent authority(ies). In these cases, it is very important that the NCA receives regular and frequent market data, and trading venue reports on the performance of market makers, enabling the competent authorities to assess if the exempted market makers do indeed comply with the Guidelines (minimum required presence in the market, spread, size etc.). Although in these cases, no significant issues were evidenced with the performance of market makers.

Previously reported non-compliance

23. Apart from what is done in practice, in 2012 some NCAs (including BaFin, FI and FCA) reported non-compliance with some aspects of the Guidelines. In relation to the reported non-compliance, these departures from the Guidelines still exist. However, some elements of the reported non-compliance might be more limited in practice than initially thought.
24. First, there is a stated non-compliance with membership requirements of the Guidelines. That is, BaFin, the FCA and the FI only require a notifying entity to be a member of a trading venue in the EU. They do not require, as the Guidelines request, that membership must be of the trading venue where the instruments are listed and where market making is performed. However, the evidence does not reveal to the Assessment Group that entities are availing themselves of the exemption where they are not members of the main market for trading the instrument. In fact, at least in Germany, most instruments are listed and market making activities are undertaken by firms on trading venues and in respect of instruments listed on those venues where the firms in question are members of the trading venue. As such the impact for the market of this reported non-compliance is small, but again it is unsatisfactory that a difference of interpretation is allowed to persist.
25. Second, as regards the scope of instruments eligible for the exemption, non-compliance stems from the opinion of some NCAs that market making activity in

⁵ presumption that the exemption should be accepted in case the notifying entity is a party to a market making or liquidity provision contract with a trading venue which meets or exceeds the criteria set in the GL

relation to corporate bonds and OTC derivatives should be permitted under the SSR, and that restrictions under the Guidelines are not warranted by the SSR.

26. In relation to corporate bonds, the contention of non-compliant NCAs is that market making in corporate bonds should be recognised under the Guidelines so that entities that undertake market making activities in corporate bonds should be permitted to use sovereign debt to hedge against exposures arising.
27. The Assessment Group contends that a strict application of Article 13 of the SSR would already allow for short sales of sovereign debt to hedge exposures to corporate bonds where there is a high correlation. As such, there ought not to be an issue of non-compliance on this point. This proposal is consistent with the technical advice of ESMA on the evaluation of the SSR, published in June 2013.
28. Another implication of the non-compliant stance on membership is in relation to OTC derivatives. BaFin, FCA and FI also permit the exemption for market making on OTC derivatives, for which the trading venue membership requirement of the Guidelines cannot be complied with. The reported non-compliance by these three NCAs with regard to this scope and by other competent authorities (the FSA in Denmark, the AMF in France) as evidenced by the published compliance table, will mean that entities that have notified the intention to carry out market making activities in OTC derivative instruments will not be objected to by those NCAs.
29. Consob and the MNB do not permit such notifications as compliance with the Guidelines, and the strict membership requirement therein, would mean that exempted market making on OTC derivatives would not be possible. This divergence is a consequence of the different interpretations of the definition of market making activities in the SSR which was not within the scope of this Peer Review.
30. In this regard, the differences of opinion on the application of the SSR between ESMA Guidelines and the practices of some NCAs need to be resolved, since the different implementation of the Guidelines at Union level is far from ideal.

Enforcement

31. Although several NCAs referred to one or more investigations that have taken place or enquiries that have been made or are being made, none of the NCAs under review have to date publicised any financial penalties or other sanctions for breach of the SSR on the use of exemptions (although BaFin has indicated that it is in the process of finalising a sanctions case against one firm).

General recommendations

32. Specific recommendations for, and good practices identified at, the NCAs under review are provided throughout the report.
33. However, the following more general recommendations can be highlighted here:

- NCAs must enhance their processes and procedures to ensure that, at the time of each notification under Article 17 of the SSR, some form of reasonable assurance can be given or obtained that the notifier meets the pre-qualifying requirements set out in paragraph 43 of the Guidelines, specifically those requirements dealing with organisational set-up. The Assessment Group would like to draw the attention of NCAs to the importance of checking that market makers effectively maintain their records of orders and transactions relating to market making activities benefiting from the exemption, so that they can be easily distinguished from their proprietary trading activity. This is equally important for market makers who notified their intention to perform market making activities both as liquidity provider to the market and on behalf of clients. Also, this is only one of a number of organisational requirements in respect of which assurance should be sought by NCAs upon notification.
- All notifications must be assessed on a *per instrument* basis. Reviews of notifications made should not be limited to a simple assessment of the notifier, but rather an assessment of the intentions with regard to *each* instrument must be made. Sampling of instruments would mean that other instruments not in the sample will not be assessed.
- NCAs should ensure that their procedures require some form of follow-up with notifying entities especially where there are no subsequent notifications. The obligations with regard notifications are ongoing, and NCAs must ensure that market participants are attentive to their obligations and their notified lists of instruments are up to date.
- NCAs should ensure that their procedures include some form of periodic or ongoing monitoring of market makers, and should not seek to rely wholly on trading venues.
- If NCAs rely on trading venues regarding the continuous monitoring of compliance with the requirements for market makers, then those NCAs should ensure that, at a minimum, the rules for market makers in that trading venue must require at least the performance criteria of the Guidelines.
- Where a notification is made by a market participant of the intention to carry out market making activities on-market, either a contract or programme must be in place, or the NCA must have alternative arrangements in place to allow it to monitor the activities of the notifier on an ongoing basis.
- There is a need for enhancement of the current shared information in relation to market makers. NCAs must ensure that the information that is gathered pursuant to the SSR, and the notifications of use of exemptions, must be made widely available to other functions of market supervision. Improving interactions between staff handling notifications and teams in charge of monitoring the market or looking at compliance with Market Abuse and Transparency Directive would enrich the process and facilitate the identification of suspicious transactions,

potential non-compliance and help turn monitoring under the SSR into a practical risk-oriented process instead of a single bureaucratic process.

- The fact that there persists a difference in application of the SSR due to differences of opinion of the interpretation of certain provisions of the SSR is something that should be viewed as a concern and the Assessment Group recommends that any review of the SSR that is undertaken must ensure that these difficulties in interpretation be removed.
- Lastly, the Assessment Group would like to remind all competent authorities that
 - (i) the list of market makers published by ESMA distinguishes between market makers and authorised primary dealers in sovereign debt, and
 - (ii) this list needs to be updated on an ongoing basis.

NCA's are therefore invited to inform ESMA within two weeks of any change in the list of exempted market makers and authorised primary dealers in sovereign debt. This is to ensure that the list of market makers and authorised primary dealers that are using the exemption under the SSR is up-to-date and reliable. This list is published on ESMA's dedicated "short selling" webpage⁶.

34. During the review, some NCA's requested ESMA to facilitate the creation of a database, accessible to competent authorities, to include all exempted market makers who have notified their home competent authority of the intention to carry on market making in sovereign debt of any Member State. This database would include the relevant sovereign issuer for that sovereign debt instrument, and the competent authority who received the notification. This would provide NCA's with visibility on those firms active in the market making in the debt of their own sovereign – information of particular relevance in periods of stress and for those Member States whose sovereign debt is traded in multiple jurisdictions across the EU. However, no budget is available for such a project and ESMA is not in a position to recommend that this initiative be taken up.
35. Notwithstanding the conclusions of the Peer Review, the Assessment Group is not recommending that any further action be taken by ESMA at this time due to the upcoming review of the SSR by the EU Commission. Within that review the differing interpretations of Article 2(1)(k) of the SSR and the scope of market making should be considered.

⁶ <http://www.esma.europa.eu/fr/page/Short-selling>

2 Introduction

36. This report has been prepared as part of the ESMA Peer Review on the Short Selling Regulation⁷ (SSR) and Guidelines issued by ESMA⁸ on the exemption in the SSR for market making activities and primary market operations. The scope of the Peer Review as defined in the mandate approved by the ESMA Board of Supervisors (Annex 1) was focused on the use of exemptions for market making activities, and does not include authorised primary dealers in sovereign debt.
37. ESMA received in July 2013 a letter from the European Commission's DG MARKT under the subject "Instances of inconsistent application of the Short Selling Regulation (SSR)". In relation to the market making guidelines issued by ESMA, the Commission noted that several Member States have explained their non-compliance with the Guidelines. The Commission said that its preliminary assessment was that the explanations given by Competent Authorities for their partial non-compliance raise questions about their compliance with the requirements of the SSR itself.
38. The ESMA Board of Supervisors decided therefore that ESMA should undertake a review regarding the use of exemptions for market making. The agreed proposal included a review of application of the general principles and qualifying criteria of eligibility for the exemption specified in Section VIII of the Guidelines and under Article 17(5) of the SSR
39. The Peer Review focused on assessing the effectiveness of supervisory practices put in place to ensure compliance with the provisions of Article 17 of the SSR as that Article applies to entities seeking to benefit from an exemption under Article 17(1) by making a notification under Article 17(5) – the 'market making exemption'.
40. Entities availing of the exemption are not required to notify NCAs of significant net short positions in the exempted shares or sovereign debt, and they are also exempted from publicly disclosing their significant net short positions in the exempted shares. Restrictions on uncovered short sales in shares, sovereign debt and sovereign credit default swap do not apply to financial instruments for which entities benefit from the exemption.
41. Specifically, this report aims at assessing whether the handling of notifications is being done in a consistent manner, at identifying possible cases of non-compliance with the Guidelines going beyond the reported non-compliance with specific provisions of the Guidelines declared by some NCAs, as well as at identifying good practices.

⁷ Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.

⁸ <http://www.esma.europa.eu/system/files/2013-74.pdf>

42. The peer review was carried out in accordance with the methodology of the Review Panel, by which the peer review is complemented by an on-site visit programme, and the mandate of the Board of Supervisors of 7 October 2014. These visits constitute an additional stage in, and an integral part of, ESMA's process of assessing the level of implementation of legislation, the quality of supervisory practices, and the degree of supervisory convergence.
43. In particular, on-site visits have the key objectives of learning more about the practices and supervisory tools used by the reviewed national competent authorities (NCAs), and to reveal potential difficulties in the implementation of the provisions under review. For the first time, there have been interactions between the Assessment Group and stakeholders, organised by each of the visited NCAs. These stakeholder meetings were very valuable to better understand the specificities of the local markets and of the supervision where responsibilities were shared between NCAs and other authorities or where a high degree of reliance was placed by NCAs on the monitoring of market making by the trading venues.
44. The mandate identified five competent authorities to be reviewed, each of which was to be visited by the Assessment Group established to carry out the Peer Review. These competent authorities were identified based on those markets with the highest number of market-makers, and that have notified the highest number of financial instruments under the market making exemption. Those markets cover 69% of the exempted market makers in the European Union: BaFin (Germany), Consob (Italy), MNB (Hungary), FI (Sweden) and the FCA (UK). Although these NCAs supervise financial sectors that present different dimensions and level of sophistications, they can be compared in terms of process to handle the notifications received by market makers and compliance with the relevant section of the Guidelines.
45. Out of the 155⁹ market makers concerned in these five countries, the review assessed a sample of those, being 10% of the market makers active in that jurisdiction, with a minimum of three market makers per jurisdiction, hence eight files for the UK, four for Germany and three each for the other countries. The sampling of files was made by the Assessment Group.
46. The Peer Review was confined to the exemption available for market makers, and did not cover the practices of NCAs with regard to granting exemptions from the SSR for the primary and secondary market operations of authorised primary dealers in sovereign debt.
47. As the Peer Review was limited to 5 NCAs, each NCA was the subject of a planned visit onsite by the Assessment Group. During the early part of the onsite visit at the offices of the MNB, it became apparent that the information lists provided by the MNB to ESMA were incorrect. The MNB had included in its list of exempted market makers all authorised primary dealers in Hungary. Following an analysis by the Assessment

⁹ Unless otherwise specified, any figures related to the review date from November 2014.

Group, it transpired that there were only two (2) exempted market makers in Hungary, and not 15 as first thought. The Assessment Group continued nevertheless to assess the supervisory practices of the MNB.

48. As a consequence of including all authorised primary dealers in the list of market makers reported to ESMA the sampling could not be fully respected for the review of (MNB). Hence only 2 (and not 3) files could be reviewed eventually.
49. The information and methodology used for the assessment are among others: the Review Panel methodology (ESMA/2013/1709); the mandate of the Board of Supervisors of 7 October 2014, the documents sent and provided on-site by the visited competent authorities.
50. Each member of the Assessment Group signed a confidentiality agreement. All the confidentiality agreements were sent to each visited competent authority with the initial questionnaire.

Need for enhancement of the current shared information in relation to market makers and lack of update of the list of market makers (and primary dealers) using the exemption

51. According to Article 17(13) of the SSR, ESMA shall publish and keep up to date on its website a list of market makers and authorised primary dealers who are using the exemption under the SSR. To this end, all competent authorities have to inform ESMA within 2 weeks of the notification of exemptions for market makers and authorised primary dealers. The list is published on the short selling section of the ESMA website and is regularly updated. For each Member State, the list is organised in two separate sections: one for market makers and the other for authorised primary dealers.
52. During the onsite visit in Hungary, the Assessment Group came to understand that the names reported as market makers by the MNB also contained authorised primary dealers, also due to the fact that in Hungary all primary dealers must sign a separate market-making contract with the Government Debt Management Agency. In fact, for all authorised primary dealers exempted under the SSR, the MNB reported their names both as market makers and as authorised primary dealers, although most of the reported names held an exemption from the SSR only as authorised primary dealers. It is correct to say that authorised primary dealers are also acting in the secondary market in relation to sovereign debt (and this is foreseen also by Article 17(3) of the SSR), however ESMA considers that primary dealers should not be included in the list of market makers exempted under Articles 17(1) and 17(5) of the SSR. It should be noted that the published list distinguishes between market makers and authorised primary dealers. In particular, when one entity has notified the relevant authority that it intends to make use of the exemption in relation only to its activities as authorised primary dealer, the name of such entity should be included exclusively in the sections of authorised primary dealers, even when the entity carries out secondary market operations when acting as authorised primary dealer. On 2 November 2015, an accurate list of market makers was sent by the MNB to ESMA.

Keeping this in mind, the Assessment Group recommends that all national competent authorities under the SSR should review the lists of authorised primary dealers and market makers reported to ESMA.

53. As a result of this, the Assessment Group reminded all the visited authorities to inform ESMA of any new notification within two weeks.

Proposal to enhance transparency on exemption granted to market maker in sovereign debt of a Member State

54. Italian authorities, and in particular the Banca d'Italia, called for information of the market authority of the Member State on the sovereign debt of which market making is performed with the benefit of the exemption and this exemption has been granted by another EU market authority.. In particular, it was noted that this opaqueness was problematic when the Italian sovereign debt market was under stress. At the moment there is no available database collecting the list of all market makers benefiting from the exemption and the financial instruments for which they notified the exemption. ESMA publishes and updates on its website the list of market makers for each Member State¹⁰, with no information on the financial instruments notified by those market makers.
55. In the context of the list of market makers, it should also be noted that today there is no European-wide database collecting the list of all financial instruments for which market makers have notified their intention to make use of the exemption. However, in the Final Report accompanying the Market Making Guidelines (2013/158), it is stated, in paragraph 19, that: “ESMA will publish on its website the lists of the relevant entities without further details on the financial instruments and markets, though this latter information will be made available and accessible to competent authorities”.
56. Currently competent authorities are able to get the information on whether a specific financial instrument is covered by a market making exemption in another European jurisdiction only through a specific request to the competent authority of that jurisdiction.
57. A proposed outcome of this Peer Review, which has already been discussed with the five authorities participating in the exercise, is the creation of a database, accessible to competent authorities only, including: all exempted market makers who have notified sovereign debt of a Member State, the relevant sovereign issuer for that sovereign debt instrument, and the competent authority who received the notification for such market maker exemption. The proposed database would increase the level of transparency regarding market making activities on sovereign instruments in the Union, and it would be particularly beneficial to those Member States whose sovereign debt is traded in multiple jurisdictions within the EU.

¹⁰ The list is regularly updated on the ESMA website: <http://www.esma.europa.eu/fr/page/Short-selling>

Assessment of compliance

58. Regarding compliance with Articles 17(9) and 17(10) of the SSR and paragraph 68 of the Guidelines, BaFin and Consob can be considered as fully compliant, FCA and FI partially compliant since further to their thematic reviews launched at the end of 2014 they have taken steps to raise awareness of the silent market participants in relation to the requirement they have to fulfil where there is any changes affecting their eligibility to use the exemption or if it no longer wishes to benefit from the exemption. MNB has never been provided with market participants' updates when changes occurred, and therefore market makers' compliance cannot be considered satisfactory in this regard. As a result and as a consequence, the list published by ESMA on its website cannot be up to date. It should be noted that following the preliminary findings of the on-site visit, MNB has taken action to address this issue with the relevant market makers.

Observations

59. In order to keep the list of market makers and authorised primary dealers, published on the ESMA website, up to date, it should be noted that when an entity acts as authorised primary dealer, the name of such entity should be exclusively included in the list of authorised primary dealers (and not in the market making list), even if it also performs secondary market operations relating to the sovereign debt. The Assessment Group recommends that all national competent authorities under the SSR should review the lists of authorised primary dealers and market makers reported to ESMA.
60. It would help to improve market participants' awareness in certain jurisdictions to have bilateral meeting, training sessions, conferences, and to issue general reminders depending on the context.
61. Practices such as requesting the market maker to provide updated inventory list every time they notified a new financial instrument (BaFin), carrying out silent review (FCA) are regarded as good practices by the assessment group.

3 Background information

62. As reported by NCAs to ESMA, the countries with the highest number of Market Makers benefiting from the exemption were the following: UK (77), DE (49), IT (17) HU (2¹¹). The market in which market makers have notified the highest number of

¹¹ At the time of the mandate, the number of exempted market makers reported by the MNB was 15 but this number included authorised primary dealers in error.

instruments is the Swedish market, which also reported a significant number of exempted market makers (10).

63. Three out of the five NCAs had already declared in 2013 their partial non-compliance with some of the provisions of the Guidelines subject to this Peer Review¹². In particular, BaFin, FI and the FCA declared non-compliance with the “*trading venue membership requirement*” of the Guidelines, obliging market makers to be a member of the market where the financial instrument is traded (para. 20-22 of the Guidelines), which *de facto* excludes OTC products from the scope of the Guidelines. One of the findings of this peer review is that the extent of the non-compliance vis-à-vis this requirement is mainly limited to market making activity in OTC financial instruments, for which this criterion could not be met by definition, while for listed financial instruments, such as shares traded in Regulated Markets or MTFs, the trading venue membership is met in the vast majority of cases in Germany, Sweden and the UK.
64. BaFin and the FCA also declared non-compliance with the “product scope” of the Guidelines. The Guidelines limit the applicability of the SSR, besides shares and sovereign debt instruments, to instruments which must be taken into account when calculating a net short position in shares or sovereign debt (para. 30-32 of the Guidelines). When declaring non-compliance, and during the Peer Review, Germany and the UK mentioned corporate bonds and subscription rights as financial instruments that they consider covered by the permitted scope of the exemption. They also suggested that, in terms of scope, the Guidelines should refer to the definition of financial instrument for the purpose of the SSR, i.e. those financial instruments listed in Section C of Annex I to MiFID – as suggested in the first draft of the ESMA Guidelines -, and not just financial instruments that create long or short positions in shares or sovereign debt (Part 1 and 2 of Annex I of Commission Delegated Regulation (EU) No 918/2012).
65. Market making, as defined under the SSR (Article 2.1.k) covers different activities, which are subject to different requirements under the exemption regime of the ESMA Guidelines. In the Guidelines, beside the General Principles applicable to all types of market making activities (see section VIII.I.), there are specific criteria for each sub-point of the definition of Level 1. In particular, the criteria for market making activities carried out “*by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market*” (point (i) of Article 2.1.k) are more specific and stringent if compared with the criteria for the other types of market making activities (see section VIII.II., VIII.III. and VIII.IV.), with additional requirements for shares qualifying as liquid shares under MiFID.

¹² See ESMA Guidelines compliance table:
http://www.esma.europa.eu/system/files/2013-765_guidelines_compliance_table_-_market_making_guidelines.pdf

3.1 Overview of the flow of notifications in the five NCAs under review

Distribution of the flow differs from one market to another

66. Following the implementation of the SSR, most entities (150 entities out of 155 within the 5 NCAs under review) made their first notifications in 2012 in accordance with article 17(14) of the SSR stating that a notification could be made by a person to a competent authority at any time within 60 calendar days before 1 November 2012.
67. The large majority of those notifying entities in the five targeted jurisdictions are credit institutions or investment firms regulated by the notified competent authority whereas less than 5% of the entities benefiting from the exemption are third country entities¹³ (7 out of 148 in 2012, 8 out of 155 in 2014).

	As of November 2014				
	BaFin (GE)	Consob (IT)	FCA (UK)	FI (SW)	MNB (HU)
Market makers benefiting from the exemption	49	17	77	10	2
Number of shares exempted (since 2012 up until 30/11/2014)	20,242	2,027	123,580	39,800	31

68. In terms of financial instruments notified, FCA and BaFin are the only ones receiving a regular flow of notifications since the initial surge in 2012, with approximately 7-10 financial instruments notified daily for the FCA, and 21 notifications containing one to thirty-five financial instruments per week for BaFin. At Consob, notifications received after 2012 were quite limited both in terms of number of notifications and number of financial instruments concerned. On the contrary, the MNB did not receive any update from the market makers in Hungary and while the FI received some updates since 2012, it triggered many more when it conducted its thematic review in autumn 2014.
69. In all cases, deregistration of entities is very rare and usually due to merger, regulatory change or business strategy change. Whereas deregistration of financial instruments is more common, and notifications on this point are commonly received by BaFin, the FCA and to a lesser extent by Consob.

Rare prohibitions

70. Even if the exemption for market making activities is not an authorisation or a licensing process, the notified competent authority may prohibit the use of the exemption, as stated in paragraph 58 of the Guidelines. However, the Assessment Group noticed only a few prohibitions:
- a. In the UK, the FCA prohibited the use of the exemption in four cases: the first two prohibitions concerned notifiers unable to demonstrate that they

¹³ Four from Switzerland, two from the United States, one from Liechtenstein, and one from Norway.

satisfied the membership requirement (full prohibition); whereas the two others were not able to demonstrate that they were members of the trading venues where they were conducting activities in specific instruments.

- b. In Italy, Consob prohibited the use of the exemption in three cases. First because the instruments notified were OTC derivatives that cannot benefit from the exemption according to paragraph 22 of the Guidelines; secondly Consob redirected a third-country notifying entity which believed that it had to notify the competent authority of the securities covered by the exemption rather than the competent authority of the main EU trading venue in which it trades; thirdly, and while the notification was being processed, an issuer decided to cancel a proposed IPO, and so the exemption for the share under IPO was opposed.
- c. In Sweden, FI redirected a third country market maker that needed to notify the NCA of the market in which it was most active, which wasn't the Swedish market.
- d. BaFin, as FI, redirected 3 notifications because the entity main activity was performed in trading venues outside Germany.

Prior regime and notifications made prior to the issuance of the Guidelines

71. In general, prior to the SSR there was no regulation of short selling, or exemptions for market makers, in the Member States where the peer review was conducted. An exception is Germany where the transition from the prior existing regime was organised smoothly and efficiently by BaFin. This, this was done with the publication of a guidance notice based on the first draft of the ESMA Guidelines describing the new process and requirements, and warning that there was no grandfathering provision for activities that had already been notified to BaFin under the old German law (Wertpapierhandelsgesetz).
72. As regards the implementation of the Guidelines, all the NCAs under review published the Guidelines or implemented them in their own Recommendations on their website. Some of them also provided market makers with guidance notes (BaFin, FCA).
73. Paragraph 75 of the Guidelines provides that notifications made to a competent authority prior to the entry into force of the Guidelines, and not in compliance with requirements set out in the Guidelines, must be reviewed and assessed against the provisions of the Guidelines within 6 months after application of the Guidelines, i.e. 2 October 2013. Nonetheless, three of the five competent authorities did not intend to comply with these provisions of the Guidelines (para. 75).
74. In compliance with paragraph 75 of the Guidelines, Consob carried out a review and assessment of notifications made to it before the entry into force of the Guidelines.

75. BaFin obliged market makers to examine their submitted notifications of intent and to determine whether they met the requirements of the ESMA Guidelines. Market makers were obliged to renew the notifications of financial instruments that had already been notified since 1 September 2012 and confirm by way of written declaration their examination of compliance. These renewed notifications were checked in the usual manner.
76. The FCA did not consider it necessary to review the notifications again, considering that all initial notifications made in September and October 2012 were reviewed on the basis of the draft of the Guidelines issued in August 2012, and that there had not been important changes between the draft Guidelines and the finalised ones.
77. FI informed the Assessment Group, as was contained in the original statement of compliance from FI to ESMA that FI considered that article 17.6 and 17.7 of the SSR would be violated by the reassessment of a previously approved notification if the only reason for such reassessment was the entry into force of the Guidelines. Furthermore, the FI explained to the Assessment Group that FI may only revoke a positive decision taken through a Swedish administrative act under very specific circumstances that had not been met in this case.
78. As regards the MNB, it has officially implemented the Guidelines through its own recommendation published on the MNB website on 9 January 2014, although all notifications received before this date were made using the template of the ESMA guidelines and broadly in line with its principles. The late publication of the recommendation was mainly due to the circumstances of the merger between HFSA and MNB.
79. All in all, reported non-compliance with the duty to conduct, after the adoption of the Guidelines, a review of the notifications processed before the application of the Guidelines remains a matter of concern only in the case of Sweden, as FI had not frontloaded the draft Guidelines. However, the purpose of the desk-based review carried out by FI in the autumn 2014 and finalised in the course of 2015, was to check compliance with the Guidelines and focused on six firms out of 10 exempted market makers.

Financial instruments notified out of product scope

80. When focusing on the financial instruments notified, the Assessment Group uncovered during its file review with the five NCAs that some of the notified financial instruments were out of scope, namely non-EEA shares or debt instruments not covered by the definition of sovereign debt in the SSR. For example, some were debt instruments issued by regional or local bodies or quasi-public bodies. Although in itself, no harm will be done by incorrect notifications as no prohibitions apply in any event, when instruments notified are out of scope of the SSR, such notifications of long lists of financial instruments could impair the efficiency of the checks performed by the competent authorities, and encourage a per firm approach instead of a per instrument assessment as referred to by the Guidelines. It also seems to the

Assessment Group that some entities are prone to notify for a global exemption for market making activities whatever the product to be on the safe side.

81. NCAs under review reacted differently to this situation. For example,
 - a. A Swedish market maker notified approximately 90,000 shares which included a large number of shares out of scope. Since the onsite visit, the market maker has now been requested by FI to send a corrected list.
 - b. BaFin became aware that one market maker notified debt instruments that were not entitled to benefit from the exemption and decided to send an email to all notifying entities reminding them the scope of the exemption in relation to debt instruments.
82. The Assessment Group had confirmation that the reported non-compliance of certain NCAs in relation to the product scope led effectively to inconsistent practices across the EU, since some NCAs do not object to notification in relation to OTC derivatives (BaFin, FCA, FI) whereas others strictly prohibit them (Consob). Such a situation is clearly unsatisfactory and should be addressed as quickly as possible.

Liquid shares denominated in local currency

83. In addition, some differences were spotted by the Assessment Group in relation to shares denominated in local currency, for instance in Hungary, where European equities, considered as liquid in other trading venues in the EU, were not considered as such in the domestic market when traded in HUF. The underlying question is whether in determining whether shares are liquid, liquidity should be determined on the basis of the trading activity on those shares on the EU market or on the basis of the trading activity on the individual home market.
84. Paragraph 48 of the Guidelines refers to MiFID which includes provisions on how to calculate whether a share is a “liquid share”. For instance, Article 27(1) of MiFID specifies that “the market for each share shall be comprised of all orders executed in the European Union in respect of that share [...]”. Further requirements are set out in Articles 22(1) and 33(2) of Commission Regulation (EC) 1287/2006 of 10 August 2006 (MiFID implementing regulation) such that the necessary calculations must take into account all the orders executed in the Union in respect of the share in question.
85. These provisions do not base the calculation of liquidity only on the orders executed on an individual trading venue. Instead, they require the calculation of the market to include all orders executed in the Union. Then, once a share is classified as a “liquid share”, there is no reason not to classify as liquid shares all of the same shares making up its liquidity calculation. Moreover, to avoid any doubts on whether a share qualified as liquid or not, ESMA maintains a list of the liquid shares in the Union on its

website¹⁴. As a consequence, shares classified as liquid shares in the EU, must be considered as such even if they are denominated in local currency and not in euro.

86. Considering a liquid share denominated in local currency as non-liquid implies that the requirements stated in paragraph 48 of the Guidelines do not apply and the criteria in terms of presence, size and spread are not checked. This is a situation about which Hungary has been informed following request for guidance by the Budapest Stock Exchange to ESMA.

3.2 Level of information provided to market participants by NCAs

87. In order to raise awareness prior to the application of the SSR, all the NCAs under review organised seminars, meetings, educational sessions with industry and/or participated in workshops organised by the trading venues.
88. In general, the five NCAs also dedicated a webpage to the SSR and the related notification process, some also issued specific notices/guidance in 2012 (Consob, BaFin, FCA) leveraging on ESMA's consultation paper and updated them when the Guidelines were published (BaFin). Some others put a notice on their website to advertise market participants for the issuance of the Guidelines (FI) or for the publication of a recommendation (MNB) to implement officially the Guidelines.
89. NCAs that had to deal with many entities notifying for an exemption, also indicated to the Assessment Group that they had ongoing interactions with market participants during the few weeks prior to the implementation of the SSR and in the following weeks, with a lot of questions on the process and on how to interpret some provisions of the SSR. Furthermore, BaFin and FCA which receive daily notifications on financial instruments still have quite a lot of interactions with the exempted market makers and, when it is necessary, request those market makers to provide further information to the NCA.
90. However, when reviewing the notification files, the Assessment Group identified that market participants' awareness of the requirements they have to meet to benefit from the exemption, and notably their obligations in terms of updates in accordance with Article 17(9) and 17(10) of the SSR and paragraph 68 of the Guidelines, could be improved. For instance, it resulted in Sweden in a non-systematic use of the template and forms provided in the Guidelines and in the stated intended practices of firms, covered in the thematic review, to only update FI with any changes regarding the use of the exemption on a quarterly or yearly basis. In the follow up to the thematic review carried out at the end of 2014/beginning of 2015, FI has reminded entities of their obligations. In the United Kingdom, 21 entities which had not made additional notifications or updates since their original notifications in 2012, were asked as part as a silent review performed in 2014 whether the conditions for using the exemption

¹⁴ <https://www.esma.europa.eu/page/mifid-databases>

remained the same; five companies confirmed they were no longer using the exemption. In Hungary, the obligation to directly update the MNB of any changes even in terms of instruments - for which the exemption is sought – is required by the MNB Recommendations implementing ESMA's respective Guidelines, however due to the fact that market participants did not provide updates to MNB, this issue should be further clarified this issue with market participants. German market makers regularly notify changes to BaFin (e.g. 127 notifications of changes received in 2013 and 187 in 2014).

4. Supervisory practices on the approach to the notification process

4.1 Organisational set-up, shared responsibilities

Shared responsibilities or collaboration with other institutions within the Member State

91. Depending on the Member State, there may be more than one competent authority in charge of dealing with the market making exemption. For instance, in Italy, responsibilities are shared between three different Italian institutions Banca d'Italia, Consob and the Ministry of Economy and Finance. Nonetheless, scope and perimeter are clearly delimited, a strong coordination and detailed information flows are established thanks to a MoU regarding all aspects of SSR to ensure a smooth running of the process.
92. More generally, in the absence of shared responsibility, there are some cases (BaFin, MNB) where collaboration with other public institutions (Debt Management Agency in Hungary, Trading Surveillance Offices and Special Exchange Supervisory Authorities (SESA) in Germany) is a key factor in providing the benefit of detailed information allowing authorities to investigate in depth instances of suspicious transactions. Working arrangements are in place between those institutions to facilitate interactions and meetings are regularly arranged to discuss upcoming issues, and to inform each other about any fact that might be useful. BaFin also participates in working groups with SESAs, the Federal Ministry of Finance and the Bundesbank.
93. Close collaboration also occurs, in some cases, with trading venues when it comes to measuring market makers' performances and to sharing with the NCAs some key information as regards quoting obligations. This enables NCAs to perform compliance checks. However, such regular and systematic reporting from trading venues to NCA on market makers' performances only happens on an ongoing basis in Italy.
94. Nonetheless, without any concrete and systematic reporting on the fulfilment of these specific criteria from the trading venues, the Assessment Group noted that a large majority of NCAs heavily rely on the trading venues with regard to the ability of entities to comply with the requirements of on-going presence (by undertaking at least market making activities for 80% of the overall trading time), of providing competitive

prices, and of being in a position to meet orders of sufficient size (BaFin, MNB, FCA, FI). However, BaFin and FI receive information from the trading venue when irregularities occur or when infringements are identified.

Internal cooperation, information sharing

95. Within the five NCAs, staff in charge of dealing with market making notifications are not dedicated to that process full-time except at the FCA¹⁵, but generally are also in charge of dealing with the set of issues relating to the SSR, Market Abuse and Transparency Directives. Some teams in charge of the notifications process are involved in the ongoing monitoring of the market or work in close connection with market monitoring teams (BaFin, Consob and MNB). In FI, the markets monitoring team cooperates with the capital markets law division, the division that processes the notifications. Yet, such interactions enable information sharing, use of various sources of information to complement the notification process and to check compliance with the requirements and, identification of potential suspicious transactions, uncovered short position or breaches.
96. Indeed, the Assessment Group noticed significant differences in terms of the level of cooperation internally with other teams dealing with some aspects that could be of relevance for the team handling the notification process. Similarly, information gathered through the notification process is not used and cross-checked with other sources of information available within the competent authority to identify potential issues, apart from BaFin and Consob.
97. Improving interactions between staff handling notifications and teams in charge of monitoring the market or looking at compliance with Market Abuse and Transparency Directive would enrich the process and facilitate the identification of suspicious transactions, potential non-compliance and help turn it into a practical risk-oriented process instead of a single bureaucratic approach.

4.2 The exemption process is not an authorisation or a licensing process

98. As stated in para 58 of the Guidelines, “the use of the exemption is based on the requirement for notification of the intent. It is not an authorisation or a licensing process.”
99. Considering the fact that the exemption does not take the form of an authorisation, most of the competent authorities under review stressed that notifying entities are responsible for ensuring that they meet all the requirements of the Guidelines when using the exemption. This approach is widely supported, where the entity is responsible for performing a self-assessment to ensure that all the principles and

¹⁵ A full time employee at associate grade carried out the routine daily activities and also produces the short position disclosure.

criteria are met before submitting any notification to the relevant competent authority and to continually satisfy the conditions of the exemption.

100. Furthermore, all the visited NCAs claimed that from their “risk based approach”, the notification of the exemption was not considered as a priority and generally assessed as a low risk. As a consequence, checking compliance with the SSR as regards notifications for market making activities is not seen as a priority. Furthermore, due to the fact that the exemption does not take the form of “a licensing or an authorisation process”, the approach is in general more guided by the proportionality principle as stated by BaFin with the aim to regulate “as much as necessary, but as little as possible”.
101. Furthermore, at the time of the notification it cannot be ensured that each trade performed will meet the requirements of the Guidelines. A general assessment at the time of the exemption does not mean that each short sale will be performed as market making activity and will therefore be exempted.
102. In practice, two different situations in terms of assessment of notifications can be distinguished,
 - a. some NCAs (BaFin, FCA) received notifications from more than 40 market makers seeking to benefit from the exemption for more than 10,000 financial instruments, and up to as much as and in excess of 100,000. In these cases, at the time of the implementation of the SSR, the information intended to be sought and assessed by the Guidelines was not feasible especially on a per instrument basis as regards available resources; those NCAs also at that time relied heavily on paragraph 51(a) of the Guidelines, presuming for market makers acting under Article 2(1)(k)(i) that a notification should not be objected to “*where a person can demonstrate that it is party to a market making or liquidity provision contract or programme with a trading venue or an issuer which meets or exceeds the criteria [...]*”. However, a large proportion of market makers are also acting under limb (ii) of the definition of “market making” in Article 2(1)(k) of the SSR.
 - b. some others (Consob, FI and MNB) received notifications from less than 20 entities, but encountered very different situations in terms of the number of instruments notified. Consob succeeded in reviewing all the notifications on a per instrument basis (around 2400 financial instruments notified) whereas FI favoured a per firm approach since checking notifications of more than 90,000 financial instruments was not feasible at that time. The situation of MNB different since it has the lowest level of activity with only two market makers for 23 shares. While MNB were able to assess all instruments in 2012, since then, notwithstanding that the obligation to notify rests with market makers, no follow up actions were undertaken by MNB which resulted in no updating of the information available to MNB by the market makers. Since the onsite visit, the MNB has taken steps to address this issue with the market makers active in Hungary.

103. If the difference in terms of number of notifications to be dealt with among the five competent authorities visited can explain the different degrees of intensity of scrutiny, the question should be asked what is the right level of scrutiny of information, and what is the right level of information to be requested, to be efficient and to ensure consistency with the intention of the Guidelines.

4.3 Procedure to handle the notification generally in place

104. To complement the information publicly available on each NCA's website in relation to the exemption process under the SSR and Guidelines, FCA and BaFin have put in place a specific internal procedure or guidance to help staff process the notification. At FI, there is no specific procedure for dealing with notifications for exemption, but a general guide exists on how to deal with "applications" received. At the MNB, the procedure is much more focused on the monitoring of net short positions. Consob will formalise a procedure by the end of 2015, whereas FI and MNB will evaluate the need for additional internal procedures.
105. The objective of a guidance note on how to process notifications is to ensure that decisions made in relation to notifications are consistent over time. In some competent authorities (BaFin, FCA), the guidance note is supplemented by a check list or quick guidance describing the main areas to be focused on and checks to be undertaken by the staff in charge of reviewing the notifications.
106. When seeking to avail of the exemption, entities generally use the forms and annexes provided in the Guidelines, or documents requesting similar information, to notify the competent authority. BaFin and FCA have added some columns to the templates provided in Annex III of the Guidelines to collect additional information considered useful e.g. the date of notification, and also the membership for "*instruments other than shares, sovereign debt instruments or sovereign CDS that create short or long position*".
107. In addition, BaFin also requested entities sending new notifications to complement their list of financial instruments already exempted and, to send as a follow-up, an updated inventory of all the financial instruments for which the entity avails of the exemption. The FCA manages and updates an internal template where all the changes in financial instruments notified are recorded whenever a new or "follow-up" notification is received.
108. NCAs indicated to the Assessment Group that the evidence provided with the notifications regarding membership of a trading venue, contract or programme with trading venue for liquidity providers, were satisfactory. On the basis of the information provided by the entity and taking into account internal databases, NCAs carried out the assessment of compliance with the general principles and qualifying criteria described in paragraphs 42 and 43 of the Guidelines. In general, the approach consists in verifying the status of the entity by testing if the notifying entity is a regulated one which is the case of almost all the notifying entities with the exception

of the third-country entities that are not regulated by the notified competent authority. For the latter, depending on the competent authority, checks are performed on the internet to verify the market membership and the status of the entity in its home country.

109. The level of scrutiny of information relating to the financial instruments notified, in order to check whether those instruments are eligible under the SSR, is highly linked to the number of notifications received. In Germany, Sweden and UK, where a very large number of financial instruments were notified in 2012, a review on a line-by-line basis of the notifications was not feasible. For this reason, BaFin chose a random approach consisting of reviewing only a sample of instruments notified among the lists supplied, called “plausibility checks”, and of performing consistency checks on the overall information provided.
110. The FCA approach is also to look for consistency of the information provided and to identify any gap, but does not consist in checking that each and every single financial instrument is in scope, as well as verifying ex-ante compliance with each and every criteria set out in the Guidelines. The FI also concentrated its assessment of compliance on the status of the firm, its business strategy, and its contracts as liquidity providers, without specific screening of the financial instruments notified. Consob is the only competent authority which carried out a review of the notification assessing compliance in particular with the membership requirement and the product scope given the manageable number of notifications received. In respect of the MNB, although a *per instrument* approach was applied initially, this was not sustained as there was no follow up with market makers following initial notifications, and no steps taken to ensure that the list of instruments notified was kept up to date. It should be noted that following the preliminary findings of the on-site visit, MNB has taken action to address this issue with the relevant market makers.
111. In nearly all cases, the notification handling process resulted in a “do not object” decision and rarely in a prohibition of the use of the exemption. In three NCAs (BaFin, FCA, FI), a written confirmation is sent to the notifying entity that the NCA does not object to the use of the exemption. While other NCAs (Consob, MNB) may use a silent consent. This written confirmation from the NCA that, ‘based on the information provided by the notifier in relation to instruments covered by the SSR, there is no reason to prohibit the use of the exemption’, is regarded as a good practice by the Assessment Group. For instance, the FCA also clarifies in its email that the entity itself is responsible for ensuring that it is entitled to avail of the exemption in respect of individual trades, and reminds entities that the exemption only covers market making activities as defined in the SSR and in the Guidelines.
112. Even though the notification process may appear as a very administrative process consisting in filling-in of forms, quite a lot of information is requested that may be useful not only in the exemption process but also as background information for

monitoring purposes, as well as for the conduct of investigations and market intelligence information. Some of the information¹⁶ requested though is not seemingly of use, and the question should be asked whether there is a need for such granularity. This is especially so where the information provided to the NCAs is not always fully checked and not always challenged. At least, the information should be made available to other divisions and teams within the competent authority for investigations or similar actions as it is already the case in some NCAs.

4.4 Checking compliance with the principles and criteria of the Guidelines

113. Before the exemption can apply, a competent authority must be satisfied that the applicant firm meets the conditions set out in the SSR and in the Guidelines for making use of the exemption. Paragraph 43 of the Guidelines sets out the criteria that must be taken into account by competent authorities when assessing whether an entity notifying an exemption is entitled to benefit from it.

General principles

114. As stated in paragraph 43 of the Guidelines, notifying entity must
- *“be a member of a trading venue where the financial instrument in question is admitted to trading and in which it conducts a market-making activity on that instrument”¹⁷*
 - *“comply with the general rules and particular requirements for market making activities imposed by the trading venue or market in the third country, where applicable*
 - *maintain its records of orders and transactions relating to its market making activities for which it requests the exemption so that they can be easily distinguished from its proprietary trading activities*
 - *implement internal procedures with respect to the market making activities for which it claims the exemption that allow these activities to be immediately identified and the records readily available to the competent authority upon request*
 - *possess effective compliance and audit resources and a framework to enable it to monitor the market making activities for which it requests the exemption*

¹⁶ e.g. the indication of daily volume where no previous market making activity in a particular instrument can be demonstrated (cf. para 65 xii)

¹⁷ With respect to this requirement BaFin, FCA and FI in accordance with their stated non-compliance with the Guidelines do not require a notifying entity to be a member of the trading venue where the instrument notified is in fact traded. It suffices for these authorities that the notifying entity simply be a member of a trading venue in the EU.

- *be able to demonstrate at any time to the competent authority that its market making activity meets the principles and criteria in the Guidelines.”*

115. Regarding the principles and criteria stated in paragraph 43 of the Guidelines, NCAs aim at determining whether it appears that the entity in question *will be able to* meet the requirements for the market making exemption. In practice, the membership criterion is assessed as described in the Guidelines only by Consob and MNB. Regarding BaFin, the trading venue membership is almost always met for listed financial instruments by the market makers who notified BaFin as these entities are members of the trading venue where the listed financial instrument is traded and have a liquidity provider contract with the trading venue. As regards the other NCAs that declared non-compliance with the membership requirement, they considered that it is sufficient for a notifying entity to be a member of a trading venue but not necessarily of the trading venue where the instrument is traded. In these circumstances, it appears not to be feasible to assess that a market maker acting under Article 2(1)(k)(i), applies the principles and qualifying criteria in relation to presence, price and size requirements since its market making activities on the exempted financial instruments can be performed on a trading venue where he has no membership and on which those criteria are not followed up.
116. Furthermore, due to the nature of the other pre-qualifying criteria in paragraph 43 of the Guidelines, NCAs explained to the Assessment Group that the assessment of a notifying entity's compliance with those criteria is performed through a variety of supervisory tools, including by on-going monitoring though broader onsite inspections or in relation to investigations carried out on suspicious transactions for which transaction records are checked. As a result, no NCA entirely scrutinises each aspect of these criteria upon notification. In particular the FCA makes it clear that persons intending to use the exemption are aware of the general principles and qualifying criteria of paragraph 43, and that these must be respected by the entity, but that it is for the entity itself to ensure that it is in compliance.
117. The Assessment Group is of the view, that NCAs' position is not robust enough with regard to the 3rd, 4th and 5th indents of paragraph 43¹⁸. These criteria are general organisational criteria that need to be checked at the time of the notification as well as part of an on-going supervision process. In particular, it appears important that before an exemption can be granted the NCA must be satisfied that records of orders and transactions relating to its market making activities for which the exemption was granted are maintained separately from its proprietary trading activities.

Posting two-way quotes of comparable size at competitive prices

118. Under the final indent of paragraph 43, entities that notify of an intention to undertake market making activities under the first limb of the definition set out in Article 2(1)(k) of

¹⁸ Set out above in paragraph 113.

the SSR must also be able to comply with the criteria of paras. 44 to 49 of the Guidelines. These paragraphs set out the criteria against which competent authorities should assess notifications in relation to equities and equity derivatives, and detail quantitative criteria dealing with regular presence on the market, and providing firm, competitive, quotes when acting as a market maker.

119. To check compliance with the presence, size and spread requirements, the NCAs, except Consob, rely primarily on the trading venues that monitor market makers' performance through its compliance with the contractual commitments set out in the contract or programme signed between the trading venue and the 'recognised' market maker or 'liquidity provider'. Most of the NCAs have ensured that the trading venue rules and criteria meet or exceed the requirements of the Guidelines. However, exceptions to this general matching were identified by the Assessment Group in Hungary and in the UK.
120. Notably in Germany, contracts concluded between exchanges and market makers according to civil law include the obligation to comply with these rules and criteria. Furthermore, the exchanges regularly audit the compliance of market makers with the defined requirements and if there are any irregularities German Exchanges will inform BaFin, which will initiate an investigation. Consob, among others, makes use of the analysis of the trading venues, which provide Consob with monthly comprehensive reports on their data on performance of all market makers. Indicators are a useful tool in relation to the Guidelines, as the elements composing them are overlapping with the criteria used in the Guidelines.
121. In Hungary and the UK, the overall assessment of the adherence by market makers to the general principles and qualifying criteria falls also mostly to trading venues, which focus on continuous presence and spread. However, some internal rules are less stringent than those included in paragraph 48.a. of the Guidelines. In one case, the minimum continuous presence criterion is set at 70%, as opposed to 80% under the Guidelines (for MiFID liquid shares only); and in another case, set at only 75%. Therefore, compliance with the rules of the trading venue need not indicate compliance with the minimum criteria set out in the Guidelines.
122. In Sweden, some of these requirements (para. 48) do not apply in practice since there are no exempted market makers on liquid shares. In relation to market making in non-liquid shares, liquidity providers are obliged by trading venue rules to quote two prices on the trading system and maintain executable quotes for at least 85% of the trading time.
123. Importantly, paragraph 51 of the Guidelines provides that where a person can demonstrate that it is a party to a market making or liquidity provision contract or programme with a trading venue or an issuer which requires the market maker to meet or exceed the quantitative criteria set out in the Guidelines, there is a presumption that the notification should be accepted as meeting the criteria of the Guidelines.

Fulfilling orders initiated by clients

124. There are conditions set out in paragraph 55 of the Guidelines that must be assessed (in addition to those set out in paragraph 43) when a person makes a notification in respect of the intention to deal as part of its usual business by fulfilling orders initiated by clients or in response to clients' requests to trade – reflecting the second limb of the definition of market making activity set out in Article 2(1)(k) of the SSR.
125. In practice, full implementation of the Guidelines does not occur. NCAs' approaches in most cases are not to fully review notifications instrument by instrument, with the exception of Consob. For this reason, the Assessment Group identified a significant number of financial instruments on the lists provided by market makers that were out of scope of the SSR. BaFin requires all its market makers to check whether all notified issuers are sovereign issuers within the meaning of Article 2(1)(d) of the SSR and to correct the notification if the market makers notify instruments that are e.g. not "sovereign issuers" or on the ESMA list of exempted shares.
126. NCAs' approaches are to ensure consistency of the information provided under the Guidelines, rather than to perform an active assessment of the notifications against the criteria set out in the Guidelines especially when it comes to the scale of activities in comparison to overall proprietary trading of the person.

Anticipatory hedging

127. The criteria in the Guidelines are not for assessment when notifications are made. Rather these criteria will depend on the circumstances of individual trades. No NCA makes an assessment of these criteria when a notification is made of intent to use the exemption under Article 2(1)(k)(iii) of the SSR.

4.5 Assessment

128. The level of practical arrangements for processing and scrutinising the notifications differs quite significantly among NCAs reflecting characteristics of the market makers and depending on the volume of instruments notified. Even if tailored approaches chosen are generally sensible and proportionate (random checks), it cannot be regarded as compliant with the Guidelines emphasising a per instrument approach. Indeed, with the exception of Consob, the approach followed by NCAs is a per firm approach rather than a per instrument approach.
129. There is an obligation for firms to notify on an instrument by instrument basis. As the modalities for assessing the notification by the competent authority are not prescribed by the SSR, the Assessment Group cannot conclude on whether non-compliance with the Guidelines implies non-compliance with the SSR on this particular point.
130. Regarding the standards that should be taken into account when assessing whether an entity notifying an exemption under Article 17(5) is entitled to benefit from it, compliance needs to be considered in relation to

- a. the membership requirement as foreseen in the Guidelines paragraph 43, *“be a member of a trading venue where the financial instrument in question is admitted to trading and in which it conducts a market-making activity on that instrument”* is only met by Consob and MNB while the others, due to their declared partial compliance, only check that the entity is a member of at least one trading venue.
 - b. the requirement to assess whether a market maker “complies with the general rules and particular requirements for market making activities imposed by a trading venue” cannot be complied with when the market maker performs ‘on-market’ activities without having a contract or programme with the trading venue (at FCA approximately 4% of the instruments notified).
 - c. there is no possibility for an NCA to rely on the trading venue when market making is performed outside the jurisdiction of the NCA, even where the market making activity might be done under a contract with the trading venue,
 - d. regarding compliance with the requirements (a) to maintain separate records for market making activities, (b) to implement internal procedures with respect to the market making activities, (c) to ensure effective compliance and audit resources and a framework enabling the entity to monitor its market making activities, and (d) to be able to demonstrate at any time that its market making activities meet the principles and criteria in the Guidelines, they must be considered both at the time of the notification and as part of on-going supervision.
131. In most of the cases for market makers activities under article 2(1)(k)(i), compliance with “the principles and qualifying criteria that should apply when posting firm, simultaneous two way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market” is generally observed and largely because the rules of the trading venues where market making activities are exercised meet or exceed the requirements of the Guidelines, However in Hungary, MNB does not ensure compliance with the GL since there are no direct checks in place and reliance on monitoring by trading venues cannot be considered as sufficient since some internal rules are less stringent than those included in paragraph 48.a of the Guidelines in relation to minimum continuous presence criterion (70% versus 80% under the Guidelines). Also, evidence was found of rules of one of the UK trading venues which did not require, as a minimum, presence requirements at least equal to those set out in the Guidelines. However for NCAs which do not comply with the membership requirement and haven’t put in place or presented specific checks but largely rely on the monitoring of the TV, compliance cannot be presumed. In the United Kingdom, firms who made notification in respect of ‘on market’ market-making activities without having contract or programme with the trading venue or issuer are not being monitored for presence size and spread by the

trading venue and no substitute approach was set out at the time of the visit. Since then, the FCA requires entities to generate internal reports on a periodic basis and supply these to the FCA.

132. As regards activities performed under Article 2(1)(k)(ii), conditions set out in paragraph 55 of the Guidelines also apply are not assessed since in practice NCAs approaches in most cases are not to review notifications instrument by instrument, with the exception of Consob. In general, NCAs approaches are to look for consistency of the information provided rather than to perform an active assessment of the notifications against the criteria set out in the Guidelines especially when it comes to the scale of activity in comparison to overall proprietary trading of the entity.

4.6 Observations

133. Two out of five NCAs have a very detailed internal procedure on how to deal with notifications and even if it is not as such a requirement of the Guidelines, it is a useful tool to ensure consistency of the process overtime.
134. Although the notification for exemption process is not an authorisation process, most of the NCAs send to the entity notifying an exemption, a 'do not object' letter to inform the notifier of the decision which is also considered as a good practice.
135. It also appeared during the peer review that in some Member States, market makers are clearly tasked to provide liquidity to the market by posting firm, simultaneous two way quotes of comparable size and at competitive prices, whereas in other Member States market makers activities are mainly driven by clients request (FI). These differences in terms of culture and types of business cannot be ignored as the requirements to be met to perform market making under the first limb are much more demanding than where a firm is fulfilling clients' orders on request (the second limb).
136. Close collaboration with other institutions involved in the supervision of market making activities and with trading venues when it comes to measuring performances of the market makers is one of the key features of the exemption process that allow competent authority to properly investigate suspicious transactions.
137. Fostering the level of internal cooperation is also very important to make the best use of information available within the competent authority that could be of relevance for the handling of notification as well as for the identification of suspicious transaction and of potential breach of the SSR. To that aim, interactions between staff handling notifications and teams in charge of monitoring the market and dealing with compliance with Market Abuse and Transparency Directive should be enhanced.

5 Compliance following the notification process

5.1 Main features

138. Before the exemption can apply, a competent authority must be satisfied that the applicant firm meets the conditions set out in the SSR and in the Guidelines for making use of the exemption. Paragraph 43 of the Guidelines sets out the standards that must be taken into account by competent authorities when assessing whether an entity notifying an exemption is entitled to benefit from it.
139. Under the final indent of paragraph 43, entities that notify of an intention to undertake market making activities must also be able to demonstrate at any time to a competent authority that its market making activities comply with the principles and criteria of the Guidelines.
140. Competent authorities generally emphasised that the process is not an authorisation process (as made specific in paragraph 58 of the Guidelines) and it is the responsibility of the person making use of the exemption to ensure that all the principles and criteria are met before submitting any notification to the relevant competent authority and to continually satisfy the conditions of the exemption.
141. Paragraph 68 of the Guidelines places an obligation on exempted market makers to notify the relevant competent authority where there are any changes affecting that person's eligibility to use the exemption; and under paragraph 58 of the Guidelines, the notified competent authority may prohibit the use of the exemption already granted, if it considers that subsequent to the granting of the exemption the conditions of the exemption are no longer fulfilled.
142. Also, paragraph 69 of the Guidelines suggests that competent authorities might on their own initiative carry out thematic reviews to verify at any time whether activities of notified exempt market makers satisfy the conditions of the exemption. This paragraph does not oblige competent authorities to carry out such reviews.
143. However, the Guidelines do suggest that competent authorities should undertake some continuous monitoring, and there is nonetheless an expectation that NCA would make sure that compliance with the Guidelines continues to occur after the notification. Paragraph 43 of the Guidelines requires that an entity availing of the exemption must be able to demonstrate *at any time* to the competent authority that its market making activity meets the principles and criteria in the Guidelines.
144. During the Peer Review, the Assessment Group identified numerous good practices of the reviewed competent authorities (see e.g. paragraphs 60, 110, 111, 153).

5.2 Contact with supervisory authorities

145. All of the EU-based notifying entities are regulated entities authorised and supervised by the relevant prudential competent authorities. This arises due to the description of the activities of market making and the fact that the activities would be regarded as investment service activities under MiFID.
146. This is an important feature from a supervisory point of view as, if the competent authority has concerns regarding the activities conducted by the notifying entity, the teams in charge of handling notifications within competent authorities can escalate or discuss their concerns with the supervisory teams or with the supervisory teams of the national prudential supervisors.
147. There were varying degrees of interaction between NCAs under the SSR and the prudential supervisors under MiFID, graduating from being heavily reliant on regulation under MiFID to this feature being only one of many inputs into the surveillance of the market.
148. A consequence of reliance on the presence of another division supervising for compliance with MiFID is that when a regulated entity has made a notification already in respect of one financial instrument, and has been permitted to use the exemption, then subsequent notifications are handled by competent authorities in a manner that does not seek to re-assess the relevant criteria set out in the Guidelines. This is a feature of the notification process and reflects the fact that all authorities implement an assessment of the entity once-off, rather than an assessment of the entity separately each time a notification is made for a separate financial instrument. See also paragraph 79.

5.3 Market monitoring

149. The Assessment Group reviewed the market monitoring activities of each competent authority. The market monitoring activities are for the purposes of, *inter alia*, supervising compliance with all of the provisions of SSR.
150. While short selling activity by persons availing of the exemption under the SSR for market making will be captured, there is no specific supervision of compliance with the exemption (except where the trading venues themselves monitor compliance by their contracted market makers with certain minimum service delivery standards required by the trading venue).
151. All of the competent authorities relied, to a greater or lesser degree, on supervision by the trading venue of minimum standards for contracted market makers in cases where the person notifying the exemption was undertaking market making activities under a contract with the relevant trading venue.
152. While emphasis was placed on the proxy provided in paragraph 51 of the Guidelines, this proxy does not cover the entire population of notified exempt market makers.

Other persons notifying competent authorities of their intention to make use of the exemption include those persons intending to perform market making activities under the second limb of the definition in Article 2(1)(k) of the SSR (see above). Also, there are entities notifying of their intention to perform market making activities under the first limb of the market making definition but who do not do so under a contractual capacity with the trading venue. In respect of the population of notified market makers whose activities are not being monitored by the trading venue, there is generally little specific supervision of the trading activities of those persons.

153. One example of a good practice identified by the Assessment Group was the level of monitoring by Italian trading venues and their interaction with Consob. Each regulated Italian trading venue uses a form of compliance indicator, a tool for measurement of the performance of market makers vis-à-vis the Guidelines (its components reflect the obligations described in the Guidelines). Consob has also the power to require changes to the rules of the market, including to the methodologies used in the calculation of the compliance indicator. In the case of Borsa Italiana, the compliance indicator, called ‘Epsilon’, is an integrated element of Consob’s monitoring activity. In particular, each day the Markets Supervision department of Borsa Italiana calculates the Epsilon indicator defined as follows:

$$\text{Epsilon (\%)} = 0,4 * P_ratio + 0,4 * S_ratio + 0,2 * Q_ratio$$

Where:

P_ratio is calculated on the basis of the number of minutes of compliance with the continuous quotation obligations (and is related to para. 48(a), for liquid shares under MiFID, and 49(a), for other shares and equity derivatives, of the Guidelines and, more generally, to the reference to “regular and ongoing basis” included in the market making definition of SSR Article 2(1)(k)(i))

S_ratio is calculated on the basis of the number of minutes of compliance with the spread obligations (and is related to para. 48(b), for liquid shares under MiFID, and 49(b), for other shares and equity derivatives, of the Guidelines and, more generally, to the reference to “competitive prices” included in the market making definition of SSR Article 2(1)(k)(i))

Q_ratio is calculated on the basis of the number of minutes of compliance with the minimum quantity obligations (and is related to para. 48(c), for liquid shares under MiFID, and 49(c), for other shares and equity derivatives, of the Guidelines and, more generally, to the reference to “comparable size” included in the market making definition of SSR Article 2(1)(k)(i)).

154. Monthly, the average daily Epsilon indicator for each recognised market maker on shares, equities derivatives and sovereign bonds is received and examined by Consob staff, and a formal letter with the performance of the indicator is sent to each market maker by Borsa Italiana.
155. In cases where poor compliance is suspected (for example on the basis of an investor complaint to Consob), Consob would contact Borsa Italiana asking for

additional information and clarifications, and, usually as a second step, the market maker. Borsa Italiana would independently contact the market maker if the performance of the indicator is not satisfactory.

156. Consob receives similar information from Eurotlx regarding market making activities carried out on financial instruments (corporate bonds and sovereign bonds) traded on that MTF. Similarly to the Epsilon indicator, the “performance index” is built to verify observance with Eurotlx’s own requirements on liquidity provision, minimum quote size, and bid-ask spread. These requirements match or exceed the criteria set out in the Guidelines.

5.4 Analysis of trades and settlement data

157. BaFin also has access to transaction data and has put in place tools (notably IT tools like Business Object) to analyse this data.
158. If a suspicious transaction is identified, BaFin requests additional data from the Trading Surveillance Office (TSO) of the relevant trading venue, and from the market maker (order books, order data, trading books). Data from TSO are compared to the data provided by the market maker from its order book.
159. All authorities also have access to settlement data but make more or less use of these. Settlement data is actually looked at regularly by Consob, MNB and by FI as a good indicator of possible short sells. BaFin, MNB and FCA also indicated that settlement data – in itself - would not be sufficient to identify a short sale since it is very difficult to trace back the initial isolated trade following netting of positions (see observation below). BaFin had analysed settlement data in the past and identified a variety of reasons for the settlement failures but in the final analysis no uncovered short sales could be identified.
160. In the context of capital increases by listed companies, BaFin has spotted various potential cases of breaches:
161. In one case BaFin has commenced an investigation into uncovered short sales of shares of a particular issuer. BaFin examined the activities of one market maker more precisely because there had been indications that proprietary trading activities were not properly kept separate. The market maker has argued that the transactions were in the context of its market making activity in accordance with Article 2(1)(k)(ii) of the SSR as a Specialist (Skontroführer) in accordance with the German Stock Exchange Act (Börsengesetz – BörsG) and provided data where the transactions are marked as “SF” (meaning Skontroführer).
162. Data from the respective Trading Surveillance Office show that on the one hand the market maker acted as Skontroführer as it calculated fair prices by taking into account all orders that had been entered before the time of the price calculation. On the other hand the data also show that a dealer of the company had acted on its own account

by making sell-orders from time to time. It has been argued by the Skontroführer that those sell-orders were also part of the market making activity.

163. For the same capital increase, BaFin examined more precisely the activities of another market maker to assess whether certain short sales were part of its market making activity. The requested data showed some short hedging activity and the market maker explained the correlation between the hedging and the relevant market making transactions in detail. The market maker demonstrated that the short sales were made in anticipation of clients' requests to trade due to the expected capital increase of an issuer. The short sales were necessary as anticipated hedging for the performance of its actual market making activities and were not carried out for speculative purposes. The data showed clients' requests in a temporal context, meaning that the market maker was not short more than two days.
164. In yet another capital increase case, BaFin identify a designated sponsor that was not posting two way quotes simultaneously. As a consequence, more than 100 breaches of the German ban for uncovered short sales were found and the market maker may be liable to pay a fine of €100,000. The designated sponsor no longer performs as market maker.
165. This data analysis to identify suspicious transactions, also carried out to a lesser extent by MNB and FI, can reveal weaknesses in the activities of market participants and is something to be encouraged. Consob also looks at stock lending data.

5.5 Inspections

166. The main opportunity for competent authorities to review compliance with the conditions for use of the exemption is by individual inspection. These inspections can arise through:
 - (a) routine supervision by the prudential authority responsible for authorising the market maker,
 - (b) thematic review, or
 - (c) investigation following up some suspicion or complaint.

(a) Routine supervision:

167. BaFin, Consob, MNB, and to a lesser extent FI displayed an ongoing interaction between the markets surveillance team and the team responsible for supervision of the entities that would benefit from the exemption. Thus, having the correct organisational structure and the necessary policies and procedures in place to comply with the criteria of the Guidelines is something that falls within the consideration of supervision teams.
168. In addition, Consob receives periodic and ongoing reporting by regulated firms of quantitative data on both market making activities and other proprietary trading activities (separately). BaFin is provided with extracts of the annual audit report in

which there is a dedicated part related to the requirements of the SSR and receives periodic reporting from the exchanges regarding the cancellation of the agreements with a market maker for specific instruments.

169. Also BaFin uses recurring mistakes and formal deficiencies in notifications received from market makers as triggers to be followed up and potentially crosschecked with other information such as transactions data.
170. The FCA has a practice of following up with entities that have made notifications in respect of the constituents of an index on a particular date, where the constituents of that index subsequently changes but no new notifications are received by the FCA. This is a good practice as firms that do not make new notifications are liable to be in breach of short selling restrictions on certain instruments new to the index if those instruments have not been included in prior notifications.

(b) Thematic review:

171. The Guidelines indicate that thematic reviews are something that might be used by competent authorities on their own initiative (paragraph 69). Reviews were carried out in the autumn of 2014 by the FCA and by the FI.
172. As part of their methodology, an approach used by the FCA was to focus part of the review on 21 entities that had notified of the intention to make use of the exemption in respect of a number of financial instruments in 2012, but which had remained silent since that initial notification. This 'Silent Review' sought to bring out details from these firms of their actual market making activities and to see if these activities tallied with those that they had notified to the FCA.
173. The Assessment Group consider that this was a good approach to identifying entities that might need to be reviewed or inspected. The changing nature of financial markets means that instruments are often delisted, new instruments are coming to the market all the time, and index-related instruments have their component or constituent instruments shuffled and changed from time to time. Silence on the part of market participants that carry out numerous market making lines of business is a key risk indicator that entity may not be complying with the requirements of the SSR sufficient to qualify for the exemption.
174. The results of the FCA 'silent review' showed that five notified market makers were no longer carrying on market making activity, the FCA have updated the ESMA list, and the FCA is getting regular updates from exempted market makers since the review exercise. Following this 'silent review', the FCA started a thematic review targeting a group of 12 firms relying on the exemption with the highest number of instruments notified to the FCA. The purpose of this review is to evaluate how those firms use the exemption and how they respect the provisions set out in the SSR, the Guidelines and the FCA's principles.
175. The FI also conducted a review on stock lending compared with notified exemptions. The FI were able to verify the amount of borrowed stocks and examine discrepancies between notified short positions and the overall stock lending positions. FI also

conducted an in-depth review of six of the entities using the market making exemption. The review checked all relevant requirements of the Guidelines. It was discovered arising out of this review that some market makers had not regularly updated the notifications.

176. BaFin requires its market makers to correct the notification if the market makers notify instruments that are, for example, on the ESMA list of exempted shares, or if a notification relates to issuers that are not “sovereign issuers” within the meaning of Article 2(1)(d) of the SSR. In spring 2015 BaFin started a thematic review regarding delisted instruments where it requires its market makers to notify of any change regarding notified instruments that were delisted without undue delay.

(c) Ad hoc investigation:

177. All competent authorities visited confirmed that this was a possibility. Some NCAs Consob and BaFin referred to, and gave details of, actual investigations that were ongoing into whether a firm was making use of a notified exemption for market making appropriately.
178. No investigation has concluded with publicly announced sanctions.
179. BaFin receives suspicious transactions reports from market makers (voluntary self-declarations) according to section 10 of the German Securities Trading Act (WpHG) which can trigger *ad hoc* investigations.

5.6 Assessment

180. The Assessment Group assessed whether there were arrangements in place that could provide assurance that notified market makers would or could at some stage be scrutinised for their compliance with the ongoing obligations of the Guidelines, because the Assessment Group believes that there is an expectation that NCA would make sure that compliance with the Guidelines continues to occur after the notification, and the Guidelines themselves specifically require firms to be able *at any time* to demonstrate to the competent authority that its market making activity meets the principles and criteria in the Guidelines.
181. Where a market maker that notifies of the use of the exemption is carrying out those market making activities under a market making agreement with the trading venue, or under a liquidity provision agreement with an issuer (in accordance with the internal rules of the trading venues), then the ongoing assessment carried out by the trading venue is a sufficient substitute for supervision by the NCA of some of the conditions that must be met to justify entitlement to the exemption. The rules of the trading venue which contain the minimum criteria are scrutinised and approved by the NCA under MiFID, as trading venues will be regulated entities. Trading venues are, however, only concerned with their own rules and would not concern themselves with other, more general criteria, such as for example the requirement to separate proprietary trading from market making activities (paragraph 43 of the Guidelines).

182. There are two other types of market making that will not be scrutinised or checked on an ongoing basis by the trading venues: these are
- (a) the activity of quoting to clients on request (Article 2(1)(k)(ii) of the SSR)¹⁹; and
 - (b) those firms who notify their competent authority of the intention to avail of the exemptions under the SSR when they post simultaneous two-way quotes on the market (Article 2(1)(k)(i)) but which firms do not enter into arrangements with the trading venue (or issuer) to provide that service.
183. In respect of (b), during the onsite visit in the UK, the Assessment Group prompted the FCA to identify a reasonably large number of notified financial instruments falling within this category. The FCA carried out a review of such activity subsequent to the onsite visit. The result of the FCA's work on this was that the FCA identifying many errors in notifications made by firms, but also resulted in the FCA imposing regular reporting requirements on firms falling into this category..
184. The Guidelines and the SSR do not preclude the activity described in (b). Some NCAs acknowledged during the Peer Review that it is likely that there are some firms that have notified of the use of the exemption under 2(1)(k)(i) but which are not supervised by the trading venues for compliance with the requirements in paras. 44 to 49 of the Guidelines.
185. The Guidelines do not expect that competent authorities should identify and execute some way of continuous monitoring of the firms falling into category (b), but would expect that those firms are subject to a much larger degree of scrutiny when making notifications under Article 17.
186. Generally, ongoing supervision of compliance with the general criteria set out in paragraph 43 of the Guidelines is done with varying degrees of organisation and resource allocation, from little resource until a new team was set up in SE in 2015, to NCAs that have and use dedicated supervision tools (CONSOB, BaFin).The regulated status of market makers is a reassurance that there is the possibility that entities may be asked during routine inspection, or during thematic inspections, to provide evidence of ongoing compliance with the SSR and the Guidelines.
187. All NCAs have some connection to the prudential supervisor which is important and necessary.
188. There are no obligations under the Guidelines to scrutinise post- trading data, but it was noted that some NCAs (Consob, BaFin, and FI) are using these sources to identify possible problems or cause for investigation.

¹⁹ In Germany, some market making activity in respect of (a) takes place on the trading venues as part of a liquidity provider contract and therefore are also monitored by the trading venues.

5.7 Observations

189. Some NCAs expressed the view that settlements data are not considered as a good way to identify a short sale since it is very difficult to trace back the initial isolated trade following netting of liabilities, and previous investigations based on that basis have not led to concrete results. It was noted during the Review that there was a high degree of interoperability between trading venues throughout Europe, and a high degree of common reliance on centralised counterparties and clearing. As a result, the delivery of daily net, or aggregated, positions for settlement to investment firms and credit institutions would obscure many unsettled transactions that may occur through uncovered short positions. So, absent inspection of a firm's trading records, it may prove difficult to identify when a firm has entered into uncovered short positions.

6 State of play on reported non-compliance

6.1 Description

190. In June 2013 ESMA published a “Guidelines compliance table”²⁰ in respect of the exemption for market making activities based on the information supplied by all competent authorities. Italy and Hungary declared compliance (or intention to comply) with the Guidelines, while Germany, Sweden and the UK reported non-compliance with the following specific provisions of the Guidelines:
191. The three non-compliant Member States reported non-compliance with the “trading venue membership” requirement. According to the explanations provided, they consider that the Guidelines go beyond the definition of market making activities of Level 1 (Article 2(1)(k) of the SSR) by making it a condition for the exemption that the market maker must be member of a trading venue where the financial instrument notified is admitted to trading or is traded and in which it conducts a market making activity in that instrument.
192. The authorities argued that the requirement to be a member of a trading venue within the definition in Article 2(1)(k) of the SSR is related only to the first limb of the definition, i.e. the type of firm that can be carrying out the market making activities, and not to the types of activities carried out, which are specified in the second limb. This requirement, as mentioned in paragraph 22 of the Guidelines, implies that market making activities for instruments that are not admitted to trading or traded on a trading venue could not qualify for the exemption under Article 17(1) of SSR. In response to this, the three competent authorities also highlighted that the SSR envisages an exemption of sovereign CDS market making activities in article 17(1) (by virtue of referring to article 14) and that this is meaningless when the definition of

²⁰ http://www.esma.europa.eu/system/files/2013-765_guidelines_compliance_table_-_market_making_guidelines.pdf

market making activities is read in such a way as to exclude sovereign CDS activities, given that these instruments are traded OTC.

193. Germany and the UK also declared non-compliance with the “product scope” of the Guidelines. The Guidelines, paragraphs 30-32, limits the scope of the exemption to shares, sovereign debt instruments and instruments which must be taken into account when calculating a net short position in shares or sovereign debts as they are listed in Part 1 and 2 of Annex of the Commission Delegated Regulation (EU) No 918/2012. When declaring non-compliance, and during the Peer Review, BaFin and the FCA mentioned corporate bonds and subscription rights as financial instruments that they think should be covered by the scope of the exemption. They both justified this stance stating that it is a common strategy for market makers in corporate bonds (and an accepted market practice) to hedge their market making risks by trading in the relevant sovereign debt, and without the exemption, the market maker would need to meet all the conditions for undertaking a short sale in sovereign debt and, in turn, this would impair its activities. The two competent authorities also suggested that, in terms of scope, the Guidelines should refer to the definition of financial instrument for the purpose of the SSR, i.e. those financial instruments listed in Section C of Annex I to MiFID - as suggested in the first draft of the ESMA Guidelines- , and not just financial instruments that create long or short positions in shares or sovereign debt, i.e. the instruments included in Part 1 and 2 of Annex I of Commission Delegated Regulation (EU) No 918/2012
194. Finally, Sweden declared not compliance with paragraph 75 of the Guidelines. According to this paragraph the competent authorities had to review and assess notifications that were approved before the Guidelines entered into force. In its declaration of non-compliance, FI explained that articles 17(6) and 17(7) of the SSR state that a competent authority only may prohibit a notifying party from using the exemption within a 30 day period from the date the notification was received by the competent authority or if the competent authority becomes aware that there have been changes in the circumstances of the natural or legal person so that it no longer satisfies the requirements for an exemption. FI considers that it would violate Article 17(6) and 17(7) of the Regulation to reassess a previously approved notification if the only reason for such reassessment is the entry into force of the Guidelines. Furthermore, it was explained that Swedish law prohibits FI from conducting a reassessment of a previously approved notification under the circumstances stated in paragraph 75 of the guidelines.

6.2 Assessment

195. Following the onsite visit, the Assessment Group understood that the extent of non-compliance of the three Member States in relation to “trading venue membership” is mainly limited to market making activity in OTC financial instruments, for which this criterion could not be met by definition. In the case of listed financial instruments, such as shares traded on regulated markets or MTFs, the trading venue membership

is almost always met by the market makers who notified BaFin, the FCA and the FI. In fact, in most of the cases, these entities are members of the trading venue where the listed financial instrument is traded, and in addition they also have in place a contract with such trading venue that qualify them as an “official” market maker recognised by the trading venue. In other words, the trading venue membership criteria is met in almost all cases where it can be met (listed financial instruments), and is not met for only a fraction of the notified financial instruments (including CDS), for which it cannot be met by definition (OTC financial instruments).

196. In relation to the scope of permissible exemptions for market making activities, as some NCAs have stated that they will be non-compliant with regards the membership requirement of the Guidelines i.e. all that they will require is that a notifier be a member of at least one EU trading venue, these NCAs permit notifications to them of market-making activities in relation to OTC derivatives (BaFin, FCA and FI), whereas other NCAs strictly prohibit them (Consob, MNB). This has led to inconsistent practices across EU.
197. Finally, in relation to the non-compliance by Sweden of the obligation to review notifications received before the entry into force of the Guidelines, no such review was undertaken by the FI as national Swedish law would impede a revision of a decision taken before just because of the entry into force of the Guidelines.

6.3 Observations

198. In the context of the trading venue membership, it should be noted that in June 2013 ESMA issued a technical advice on the evaluation of the SSR21, stating that “*the market making exemption is particularly important in sovereign CDS, given the prohibition on undertaking uncovered sovereign CDS transactions. In the absence of the exemption, this prohibition would effectively mean that market makers in sovereign CDS would be unable to make two way markets*”, and concluding that “*the requirement in the Regulation for the market maker to be a member of a trading venue on which the product in which it is market making is admitted to trading should be reconsidered in Article 2(1)(k) of the Regulation – at least in respect of financial instruments not admitted to any EU trading venue*” (see pages 36/7).
199. In relation to the non-compliance with the product scope, it should be noted that ESMA’s letter of 23 October 2013 (Ref. ESMA/2013-1395) to the European Commission containing a description of identified issues when preparing the Final Report on technical advice on the SSR highlighted that there are divergent views among the regulators regarding the common understanding of the term “debt instruments of an issuer”. The European Commission suggested ESMA could solve

²¹ Available at this link: http://www.esma.europa.eu/system/files/2013-614_final_report_on_ssr_evaluation.pdf

the matter via Q&As (EC letter of 25 September 2014, Ref. MARKT/G3MN/or/Ares(2014) 3371115) but for this has not yet been done..

200. Article 13 of SSR, paragraph 2, states that: “The restrictions in paragraph 1 [*on uncovered short sales of sovereign debt*] do not apply if the transaction serves to hedge a long position in debt instruments of an issuer, the pricing of which has a high correlation with the pricing of the given sovereign debt”. According to this paragraph, in the case of corporate bonds with a high correlation to a sovereign debt, the restriction on uncovered short sales in sovereign debt does not apply, and therefore there is no need to use the exemption of Article 17, as far as the exemption concerns restrictions on uncovered short sales in sovereign debt. At the same time it should be noted that Article 13(2) does not discharge the obligation of notification to competent authorities of significant net short positions in sovereign debt as per Article 7 of SSR.
201. In other words, uncovered short sales in sovereign debt as a hedge for corporate bonds highly correlated with them could be considered as permitted by the SSR, while at the same time net short positions above the threshold would still have to be notified to the competent authority. The FCA staff replied to this explaining that, according to the European Commission, the word “issuer” in Article 13(2) of the SSR should be interpreted as “sovereign issuer” only, and that the specific paragraph refers to the situation where, for example, market makers in Danish sovereign bonds were hedging their positions using German sovereign bonds.
202. It should be noted that the criterion of “high correlation” is not defined in the SSR framework. Even without a formal definition, it is evident that not all corporate bonds have a high correlation with the sovereign debt of their domestic countries, but Article 13(2) of SSR would be applicable in a variety of cases. At the same time, it is also evident that proper hedging of a corporate bond using a sovereign bond can be achieved only when the two are highly correlated.
203. Against this background, the instance of corporate bonds as a situation of non-compliance should therefore be limited to the cases of threshold notifications, which in practical terms is limited, the thresholds²² for notification being relatively high and rarely breached, and to situations in which corporate bonds are hedged with sovereign bonds which are not highly correlated.

²² The thresholds could be found at this link: <http://www.esma.europa.eu/page/Net-short-position-notification-thresholds-sovereign-issuers>

Annex 1

Mandate for a Peer Review on the compliance with the SSR as regards Market Making activities

Background

1. The Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps (the Guidelines or the SSR), was published in the Official Journal of the European Union on 24 March 2012, and is applicable from 1 November 2012.
2. Article 17 of the Regulation provides for exemption for market making activities and primary market operations. Provisions of the Regulation prescribe the notification of intent to make use of the exemption to be made to the competent authority as determined by Article 17(5) (the home Member State for the market making exemption) and 17(6) (the relevant competent authority of the concerned sovereign debt for authorised primary dealer exemption), while the exempted activities might also take place in other jurisdictions outside the supervisory remit of that authority.
3. For the purpose of ensuring a level playing field, consistency of market practices and convergence of supervisory practices across the EEA, ESMA has issued guidelines on market making activities as defined in Article 2(1) of the Regulation and on a common approach to the application of the exemptions under Article 17. The guidelines were published on 2 April 2013. Competent Authorities had to notify to ESMA within two months if they complied or intended to comply with the Guidelines. The Guidelines compliance table dated 19 June 2013 indicates that all Competent Authorities but five declared their compliance or intention to comply. The authorities from Denmark, France, Germany, Sweden and the United Kingdom reported that they did not comply nor intended to comply with the Guidelines, and provided explanations which have been published in the compliance table.
4. ESMA received in July 2013 a letter from the EC's DG MARKT with the subject "Instances of inconsistent application of the SSR (SSR)". In relation to the market making guidelines issued by ESMA, the Commission noted that several Member States have explained their non-compliance with the Guidelines. The Commission said that its preliminary assessment was that the explanations given by Competent Authorities for their partial non-compliance raise questions about their compliance with the requirements of the SSR on market making.
5. The ESMA Board of Supervisors decided in its meeting on 24 September 2013 that ESMA should undertake a review regarding the use of exemptions for market making. The agreed proposal included a "*review of application of the general principles and qualifying criteria of eligibility for the exemption specified in Section VIII of the Guidelines. In this context and due to the fact that these general principles and qualifying criteria of eligibility apply regardless of the notifying entity's membership status or the scope of instruments it intends to use the*

exemption for, Competent Authorities shall take them into account when assessing whether the entity notifying an exemption under Article 17(5) of the SSR is entitled to benefit from it. The outcome of the proposed review would allow identifying possible cases of non-compliance with the essential provisions of the Guidelines aimed at ensuring a harmonised application of the SSR. The proposed review could take the form of a limited and targeted exercise primarily focused on those Member States with more entities benefiting from the market making exemption and the highest number of financial instruments notified by exempted entities”.

Legal basis

6. This Peer Review will be conducted in accordance with Article 30 of Regulation N. 1095/2010 of the European Parliament and of the Council (ESMA Regulation) and the revised Review Panel Methodology (ESMA/2013/1709).

Purpose

7. The purpose of the Peer Review will be to gain a thorough understanding of how Competent Authorities apply the exemption foreseen in Article 17 SSR and whether they are assessing the general principles and criteria of eligibility for the exemption in compliance with section VIII of the Guidelines, which details if an entity is entitled to benefit from an exemption, when an entity notifies to a Competent Authority that it intends to do so under Article 17(5) SSR.
8. The outcome of the Peer Review will allow to: a) Assess whether the handling of notifications is being done in a consistent manner; b) Identify possible cases of non-compliance with the provisions of the Guidelines in the scope of this review and/or underlying provisions of the SSR Regulation. The Peer Review will also aim at identifying good practices and at informing future discussions on the evaluation of the SSR to be concluded by the European Commission by 2016.

Scope

9. The Peer Review shall assess the effectiveness of supervisory practices put in place in order to comply with the provisions of Article 17 SSR, in the light of section VIII (General principles and qualifying criteria of eligibility for the exemption), and section IX (Exemption process²³) and X (Transitory measures) of the Guidelines. Where competent authorities have reported non-compliance with certain provisions of sections VIII, IX and X of the Guidelines, the Peer Review will analyse the corresponding applicable provisions if any, assess the materiality of any level playing field issues caused by the non-compliance, and seek updates on possible steps taken towards compliance.
10. The Peer Review will focus on those markets with the highest number of Market Makers benefiting from the exemption and the markets in which Market Makers have notified the highest number of instruments. For practical and resource reasons, it is also proposed to limit

²³ The paragraphs in section IX related to Specific situation of emergency measures and to Cooperation between competent authorities will be left out as they don't relate specifically to the application of the principles of section VIII.

the review to 5 countries. Based on information currently available at ESMA²⁴, the review will therefore be limited to the following countries: DE, IT, HU, SE and UK, which together represent 69% of the Market makers benefitting from an exemption.

11. Out of the 167 market makers concerned in these five countries, the review should assess a sample of those, being 10 % of the Market Makers active in that jurisdiction, with a minimum of three market makers per jurisdiction, hence eight files for the UK, and four for Germany and three each for the other countries. The sampling of the files will be made by the Assessment team.
12. The Peer Review shall cover topics such as:
 - Supervisory practices in relation to compliance with the principles for application of the SSR exemptions;
 - The degree of convergence among Competent Authorities as regards the supervisory practices for the purpose of application of the SSR exemptions;
 - Existing best practices identified in Competent Authorities which may be of benefit for other Competent Authorities to adopt;
 - Organisational set-up of Competent Authorities to deal with exemptions, including the review of exemptions granted before the Guidelines became applicable;
 - The detailed procedures and requirements applied in Competent Authorities with regard to notifications of exemptions, including detailed examples of concrete applications of the notification requirements;
 - The statistical use of notifications.
13. The Peer Review shall result in a detailed descriptive review against the criteria as expressed in the Guidelines. The report shall include relevant information, such as supervisory (best) practices established in a Competent Authority that others can learn from, that can contribute to enhance supervisory and enforcement convergence in this field.

Review approach

14. In accordance with the Review Panel Methodology, the peer review will be carried out by an Assessment Group. The Assessment Group will be composed of the following persons, with extensive knowledge and experience in the supervision of Market Integrity legislation, including Short Selling and MiFID, as well as in the conduct of reviews:

²⁴ The countries with the highest number of Market Makers benefitting from the exemption are the following: UK (81), DE (44), IT (17) HU (15). The market in which Market Makers have notified the highest number of instruments is by far the Swedish market, which also reported a significant number of exemptions (10).

- José Manuel Portero (CNMV)
 - Michael Hennigan (Central Bank of Ireland)
 - Michele Mazzoni (ESMA staff)
 - Anne-Laurence Semik (ESMA staff)
15. The Assessment Group shall be co-ordinated by Sophie Vuarlot-Dignac, Head of the Legal, Cooperation and Convergence Unit. Anne-Laurence Semik will act as Rapporteur of the Assessment Group.
16. In line with the Review Panel methodology the Assessment Group will report its findings to the Board of Supervisors, for its approval, after consultation of the Review Panel.

Review Period

17. The period under review spans from 3 June 2013 to 30 November 2014 included, and shall cover all new notifications and updates (of previous notifications) received during this period, as well as reviews (performed during this period) of notifications relating to exemptions granted after the SSR became applicable and before the Guidelines became applicable

Methodology

18. Some of the tools that can be used include, but are not limited to, interviews with Competent Authorities' staff, the demonstration of the work carried out, and access to supervisory files for granting exemptions. If the Competent Authorities so requires, such supervisory files are anonymised.
19. The obligations on professional secrecy as stipulated by Article 70 of the ESMA Regulation and subsequently by the ESMA Management Board Decision on Professional Secrecy and Confidentiality apply to all members of the Assessment Group, including non ESMA staff through their explicit consent to comply with those obligations. A confidentiality agreement signed by all members of the Assessment Group will be communicated to the Competent Authorities concerned.
20. The Peer Review shall result in a written report. The report will rely on the responses to a self-assessment questionnaire to be addressed to the Competent Authorities subject to the review, supplemented by the results of the on-site visits and the evidence provided. Following an assessment of the replies to the questionnaire, visits will be arranged to the Competent Authorities in question in order to complement the findings from the questionnaire with the detailed information that will be needed to gain a thorough understanding of the supervisory practices applied, and for Competent Authorities to demonstrate their compliance. Meetings will be arranged between the Assessment Group members and the national experts in the field, including their management. Each visit shall last for one to two days.

21. As a matter of principle, all Assessment Group members should commit to actively participate to the review, including through the on-site visits.

Evidence

22. Competent Authorities will be asked to support their replies to the questions (written or oral) with examples from their supervisory actions, practices and procedures, in the form of supervisory files of the Market Makers having used the possibilities for exemptions, and samples and their supervisory handbooks, instruction manuals and similar. The evidence shall demonstrate their supervisory actions in relation to the application of Article 17(5) SSR and of Section VIII and X of the Guidelines. The evidence will have to be provided in English, to the extent possible.

Publication

23. The Report resulting from the work shall be made public, unless the Board of Supervisors decides otherwise at the time of approving the report. The findings of the Assessment Group shall in any case be shared with the Board of Supervisors, after consultation of the Review Panel.

Time-line expected for the work

a) The following timeline is envisaged for the work:

<i>Task/Event</i>	<i>Dates (tentative)</i>
<i>Approval of the mandate by the BoS</i>	<i>End September 2014</i>
<i>Set-up of the Assessment team & Drafting of the questionnaire</i>	<i>October-Nov 2014</i>
<i>Questionnaire to be completed within four weeks (excluding Christmas break)</i>	<i>Dec 2014 -Jan 2015</i>
<i>Analysis of replies, begin drafting of report and preparation of visits 2015</i>	<i>January-February</i>
<i>Visits</i>	<i>March-May 2015</i>
<i>Progress report to the Board of Supervisors</i>	<i>24-25 June 2015</i>
<i>Finalisation of report</i>	<i>June 2015</i>



<i>Accuracy checking with NCAs bilaterally</i>	<i>July-August 2015</i>
<i>Finalisation of report following accuracy checks</i>	<i>September 2015</i>
<i>Consultation of the Report with the Review Panel</i>	<i>October 2015</i>
<i>Submission of Report to the BoS</i>	<i>5 November 2015</i>

Annex 2

Guidelines Compliance Table : 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 on the compliance with the SSR as regards Market Making activities

https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-765_guidelines_compliance_table_-_market_making_guidelines.pdf

Annex 3

Good practices identified in the General Report

Organisation and cooperation with other institutions involved in the implementation of the SSR:

- (a) when responsibilities are shared between different competent authorities in a Member State, having a clearly delimited scope and perimeter, strong coordination and detailed information flows established with an MoU;
- (b) work arrangements in place to facilitate interactions and meetings regularly organized between institutions involved in the process, to inform each other about and to discuss any issues identified or upcoming (BaFin, Consob, MNB);
- (c) interaction between teams involved in the handling of notifications and other teams in charge of monitoring markets, dealing with the SSR, market abuse and transparency directives, or in charge of authorising firms, is a positive feature of the organisation of an NCA's activities, allowing access by the notification team to various data and to the assessments of firms' internal organisation made by other divisions/department
- (d) training sessions organized and knowledge management processes put in place to ensure that decisions made in relation to notifications are consistent over time;

Raising awareness of industry:

- (e) transition measures put in place by NCAs (BaFin, Consob, FCA) leveraging on the draft of the ESMA Guidelines to inform industry and provide them with guidance describing the new process and requirements;
- (f) meetings, seminars, workshops with industry were organized when the SSR entered into force and also in some cases before the application of the Guidelines;
- (g) ongoing interactions with market makers as part of the notifications process and following subsequent notifications submitted, with bilateral meetings arranged when clarifications are needed;
- (h) sending a general reminder to market makers when an issue is identified in a notification and there seems to be a need for clarification e.g. on the scope of the exemption (BaFin);

Notification handling process:

- (i) affirmation letter/email sent to the notifier that the NCA does not object to a notifying entity using the market maker exemption (BaFin, FCA, FI) which also clarifies that the entity is responsible for ensuring that it can use the exemption in respect of individual

trades. In this letter, entities are also reminded that the exemption only covers market making activities as defined in the Regulation and in the ESMA's Guidelines (FCA);

- (j) requiring entities submitting notifications for new financial instruments to provide inventories of all the financial instruments already notified to the NCA and benefiting from the exemption highlighting the new financial instruments added (BaFin);
- (k) for notifications made in relation to indices, the FCA requests the entity to update its submission when an index reshuffles;
- (l) checking the trading venue website to ensure that the membership requirement is met;

Monitoring of the market makers' compliance with the requirements of the Guidelines (GL 43, last indent):

- (m) indicators set out in cooperation with the trading venue to monitor market makers' performances, and analysed on a monthly basis (Consob);
- (n) regular reports sent by the trading venue on market makers' performances analysed by the monitoring team as part of the on-going supervision;
- (o) infringements to the SSR flagged by the trading venue and reported to the NCA when market makers fail to comply with the trading venue rules for a specific period;

Proactive approach to identify breaches of the SSR with:

- (p) Transactions data analysis thanks to IT tools (Business Object) to identify through alerts suspicious trade. Thanks to these triggers, investigation can be initiated and fine imposed if needed (BaFin);
- (q) Settlements data and stock lending data analysis to identify fails and potential uncovered short sales;
- (r) The FCA carried out a 'silent review' requesting targeted firms to provide updated information on their market making activities to verify that they continued to meet the conditions for use of the exemption;
- (s) Several NCAs carried out thematic reviews as set out by paragraph 69 of the Guidelines to verify whether the relevant activities still qualify for the exemption.

Annex 4

Statement from reviewed NCAs on the peer review report on Compliance with SSR as regards Market Making activities

- **Joint statement of BaFin/FCA**

BaFin and the UK FCA would like to note that in their view the General Report does not present an accurate and balanced summary of the findings as discussed during the on-site visits and set out in previous drafts by the Assessment Group.

BaFin and the UK FCA would like to note that, given the exemption for market making activities is not an authorisation or a licensing process, a continuous monitoring of the general principles and criteria contradicts the aim of the exemption. Furthermore, in our view, continuous monitoring is not required neither in the SSR nor in the ESMA Guidelines.

Also an instrument-based assessment would be unlikely to achieve the desired outcome when, as has been the reality, the number of notifications has been very large. In these circumstances, even though the ESMA Guidelines require market makers to notify on an instrument basis only regarding shares (for other instruments an instrument based notification is not demanded), an instrument-based assessment is impractical. Indeed, attempting to employ regarding assessment an instrument by instrument approach would in our view in fact lead to a lower quality of scrutiny and would be significantly detrimental to the outcomes being sought by authorities. We also note, furthermore, that in our view an instrument-based assessment is not required neither in the SSR nor in the ESMA-Guidelines.

We, therefore, consider our current processes are proportionate and adapted to the requirements of the Guidelines that we comply with as indicated in the Guidelines compliance table (dated 19 June 2013 ref. ESMA/2013/765).