

OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY

of 15 April 2020

on the proposed emergency measure by Comision Nacional del Mercado de Valores under Section 1 of Chapter V of Regulation (EU) No 236/2012

In accordance with Article 44(1) of Regulation (EU) No 1095/2010, the **Board of Supervisors** has adopted the following opinion:

I. Legal basis

1. In accordance with Article 27(2) of 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 swaps¹ (the Regulation), the European Securities and Markets Authority (ESMA) shall within 24 hours of the notification made by a competent authority under Article 26 of that Regulation, issue an opinion on whether it considers the measure or proposed measure necessary to address the exceptional circumstances as further specified in Article 24 of Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012.

II. Background

The measure adopted by CNMV on 17 March 2020

2. On 17 March 2020 ESMA issued an opinion on a proposed emergency measure introduced by the Spanish Comisión Nacional del Mercado de Valores (CNMV), under Articles 20(2)(a) and (b) of Regulation (EU) No 236/2012 (ESMA70-155-9556).
3. The measure entered into force on 17 March 2020 before the start of the trading session and should expire after the close of the trading session on 17 April 2020.

¹ OJ L 86, 24.3.2012, p. 1–24.

4. The CNMV considered that the proposed measure was justified by the existence of extreme adverse circumstances that constitute a serious threat to market confidence and may result as a consequence in a threat to the financial stability not only for Spain but in all EU Member States.
5. The CNMV considered that as the COVID-19 pandemic spreads across populations and countries, the sharp price declines observed due to its outbreak might continue and its final impact on markets was unforeseeable. They also noted that some European countries such as Spain have been more seriously hit by the virus and have shown the steepest curves of mortality in this pandemic.

The proposed measure notified on 15 April 2020

6. On 15 April 2020, pursuant to Article 26 of Regulation (EU) No 236/2012, the CNMV notified ESMA of its intention to renew the temporary preventive measure imposed on 17 March 2020, under Article 20(2)(a) and (b) of Regulation (EU) 236/2012 with minor amendments.
7. In particular, the concerned measure bans any legal or natural person from entering into short selling and transactions which might constitute or increase net short positions on stocks admitted to trading on Spanish trading venues (BOLSA DE MADRID, S.A., BOLSA DE BARCELONA, S.A., BOLSA DE VALENCIA, S.A., BOLSA DE BILBAO, S.A. and Mercado Alternativo Bursátil, S.A.) where the CNMV is the competent authority in accordance with article 2.1.j of Regulation 236/2012 and provided that the principal venue for the trading of the shares is located within the EU, as well as to all related instruments relevant for the calculation of the net short position as determined in Annex I, part 1, Articles 5 and 6 of Commission Delegated Regulation (EU) No 918/2012. The ban applies to transactions executed both on a trading venue and over the counter.
8. The measure applies to any natural or legal person domiciled or established within the Union or in a third country.
9. The measure does not apply to:
 - a. market making activities, as defined in Article 2(1)(k) and pursuant to Article 17 of Regulation (EU) No 236/2012.
 - b. the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component.
 - c. the creation of, or increase in, net short positions through weighted index-related instruments or baskets of financial instruments, where the weight of the

Spanish constituents subject to the ban does not reach more than 50% of the total index or basket.

- d. the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights.
10. The CNMV will re-evaluate these exemptions depending on market circumstances and could amend the decision accordingly if the need arises.
11. The proposed measure is expected to enter into force on 18 April 2020 at 00:00 CEST and to expire on 18 May 2020 at 23:59 CEST. The proposed measure may be lifted before the deadline if the risks of a loss of market confidence are reduced, or may be further extended after the deadline taking into account market conditions. The CNMV indicated that it intends to keep the measure for an as short as possible time period, and only while the risks to market confidence and financial stability are still significant.
12. The CNMV considers that the measure is justified by the existence of extreme adverse circumstances that constitute a serious threat to market confidence and may result as a consequence in a threat to the financial stability not only for Spain but in all EU Member States. For CNMV the threat continues to be, primarily, a threat to market confidence. As a second round effect, should prices of financial instruments and assets in general experience falls and volatility as observed in the second half of March, there could be also risks to financial stability.
13. The CNMV's notification refers to the existence of similar factual circumstances which backed the adoption of its measure on 17 March 2020, and to a similar state of uncertainty as regards future perspectives.
14. The CNMV reports that the pandemic caused by COVID-19 continues hitting European countries and in most cases there is not even a timetable for the gradual lifting of the confinement measures. This is hitting the economies of EU Member States in an unprecedented way, with GDP falls that could amount, according to many forecasts, to more than 2% per each month of lock-down. The CNMV also reports the extension of the state of emergency (*Estado de alarma*) declared by the Spanish Government on 14 March until 26 April. The CNMV reports the extraordinary restrictions on free movement of people, business activities, administrative powers and measures to align all the resources of the Spanish economy that the state of emergency implies.
15. CNMV reports that staff of the three critical infrastructures (trading venues, central counterparties and central securities depositaries) have been divided in three contingents, with one third working remotely from home, one third in the main site and one third in an alternative back-up site.

16. In light of the above situation, CNMV confirms that there are three different threats to market confidence.
17. First, CNMV considers that, as opposed to a deterioration affecting just one issuer based on fundamentals, investors do not have accurate and public information on the impact of the public health crisis on each listed company, since events develop quickly and restrictions adopted by the Government might come with little or no advance notice. Hence, price formation may take place in an environment of partial information.
18. Second, CNMV reports about observed examples of disinformation, rumours and false news in media and social networks regarding activities that could be affected by decisions of the government or by the evolution of the crisis. Those rumours may affect listed companies and may damage the confidence of investors in an efficient market, one where prices are formed on the basis of public, reliable information.
19. Third, CNMV reiterates that, although Regulations 236/2012 and 918/2012 (Article 24) were drafted without a pandemic in mind, when identifying situations that could be considered a threat to market confidence, they refer to “natural disasters” that may damage financial institutions, market infrastructures, clearing and settlement systems and supervisors. The effect of the restrictions as part of the state of emergency on the availability of resources (including human and IT) could be similar to some natural disasters. For CNMV, the restrictions to the movement of workers and the fact that key personnel of infrastructures and supervisors may be affected and unable to continue working, puts both infrastructures and the supervisor at enormous strain to monitor, supervise and manage markets. CNMV notes that the stock market is especially sensitive to this situation and the one more prone to panic, as observed in some recent trading sessions. Additionally, CNMV reports having observed impacts affecting clearing and settlement systems. CNMV considers that in such context, short sales could further affect on-time settlement.
20. In this context, CNMV considers that the growth of short positions betting on negative news (be them real or ill-based) affecting Spanish and EU companies could destabilize markets in a way that could be self-reinforcing, with downward price spirals of the type observed in the session of March 12.
21. The CNMV also considers that, as a consequence of the above, a negative effect on the financial stability of the system cannot be discarded. According to the CNMV, prices of Spanish credit institutions’ stocks are rapidly falling, and the risk of weaker confidence of the public in financial stability based on false rumours cannot be dismissed. While CNMV notes that they have not observed signs of these effects on financial stability since the outbreak of the COVID-19 pandemic, these scenarios could develop quickly if selling panic as in the week from the 9 to 13 March 2020 happens again.

III. Opinion

22. ESMA considered the information provided by CNMV and is adopting the following opinion on the notified measure, on the basis of Article 27(2) of Regulation (EU) No 236/2012:

On the adverse events or developments

23. The proposed measure by the CNMV extends for a further month the one taken on 17 March 2020, with some minor adjustments as regards the instruments subject to the ban, particularly concerning the exemptions.
24. ESMA agrees that the outbreak of the COVID-19 pandemic continues to have serious adverse effects on the real economy and on the financial markets of the Union, and that stock markets in the Union continue to be impacted by it. The effect of the outbreak of COVID-19 on the real economy was previously assessed by ESMA in March in ESMA Decision ESMA70-155-9546 and in the ESMA Opinions ESMA70-155-9556, ESMA70-155-9565, ESMA70-155-9851, ESMA70-155-9587, ESMA70-155-9590 and ESMA70-155-9604 respectively on emergency measures by the Comisión Nacional del Mercado de Valores (CNMV), the Commissione Nazionale per le Società e la Borsa (CONSOB), the Autorité des marchés financiers (AMF), the Hellenic Capital Markets Commission (HCMC), the Financial Securities and Markets Authority (FSMA) and the Austrian Finanzmarktaufsicht (FMA) under Section 1 of Chapter V of Regulation (EU) No 236/2012.
25. ESMA considers that the adverse situation, linked to the COVID-19 pandemic, has greatly increased the vulnerability of EU financial markets. This is partly due to the adoption by EU Member States of restrictive measures which aim at containing the contagion and which impact all economic sectors. In this respect, since the start of 2020, ESMA has observed steep downward trends in European stocks, with a relative improvement after mid-March, which has not however restored the extremely large losses incurred by EU financial markets. As a matter of fact, the Eurostoxx50 index, which was at 3,577.68 on 26 February 2020, reached its lowest point at 2,385.82 on 18 March 2020 and subsequently recovered only partially to 2,892.79 on 9 April 2020 (see the Annex).
26. The pandemic contributed also to extremely high volatility levels. As of January 1st, 2020, the volatility level for the Eurostoxx50 index (VSTOXX) was at 13.95. It reached its highest level on 16 March with the value of 85.62 (+514%) and slowly decreased (-45%) in the following days, reaching 43.03 on 6 April 2020 (see the Annex). The data show that volatility at European level, even though decreasing if compared to the levels reached in mid-March, is still extremely high compared to the pre-COVID-19 situation and is a relevant sign of the instability and vulnerability that keeps affecting European financial markets.

27. ESMA believes that downward pressure and high volatility may continue in the coming weeks, since the COVID-19 pandemic continues spreading across Europe and there is uncertainty as to when the restrictive measures might be, albeit partially, lifted.
28. Pursuant to Article 20(1)(a), the measure under Article 20(2) of Regulation (EU) No 236/2012 requires the presence of adverse events or developments which constitute a serious threat to financial stability or to market confidence in the Member State concerned as also further specified in Article 24 of Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012.
29. The CNMV considers in its notification that the measure is justified by the adverse circumstances which constitute serious threats to market confidence, and potentially to financial stability, in Spain. Namely, in line with the assessment performed for the measure issued on 17 March 2020, the CNMV considers that the current context is not compatible with the availability of accurate information, with the consequence that price formation may take place in an environment of partial information. Rumours of false news linked to the pandemic may have the effect of impacting listed companies and damage the confidence of investors in the markets. A third source of threat to market confidence is that the COVID-19 pandemic is at the origin of restrictions on the availability of human resources at issuers and financial market participants.
30. ESMA notes that, following the ban imposed by the CNMV on 17 March 2020, the data concerning the main Spanish financial indices shows that, even though an improvement may be observed, there are still risks of downward price pressures.
31. In particular, the Spanish main index (the IBEX 35) decreased by 30.25% between 26 February and 17 March 2020. It then recovered approximately 8.8% between 17 March and 9 April 2020. Nevertheless, observing the values of the IBEX 35 since the start of the year, it fell by 27.04% from 2 January to 9 April 2020. Similar or greater decreases can be observed in other main Spanish indices (see the Annex), amounting in one case to a drop of approximately 27.86% for the Bolsa de Madrid General Index (IGBM)(comparing its values on 2 January 2020 to those of 9 April 2020). As regards financial issuers, the Bolsa de Madrid Financial Index dropped approximately 43.68% from 2 January to 17 March 2020, and subsequently recovered by approximately 2.31% until 9 April 2020. The drop from 2 January to 9 April 2020 for this index was approximately 42.38%. It should be noted that the Ibex 35 and the Bolsa de Madrid Financial Index include relevant financial issuers and insurance companies, and in that sense the circumstances described in Article 24(1)(c) of Commission Delegated Regulation (EU) No 918/2012 are met.
32. In addition, ESMA believes that the observed trends may continue in Spain, like for Europe as a whole, as long as the ongoing contagion does not allow to limit the restrictive measures adopted by relevant authorities.

33. For the purpose of assessing whether serious threats to market confidence or financial stability are currently present in Spain, ESMA is mainly considering the developments of prices and volatility of Spanish stocks. ESMA notes that the pattern of the net short positions, which would typically provide a meaningful source of observable market trends, was impacted by the ban imposed by the CNMV on 17 March 2020. In fact, ESMA notes that, since the ban became applicable, a decrease of net short positions in Spain can be observed.
34. ESMA agrees with the CNMV that the severe losses observed, the uncertainty as regards the spreading of the COVID-19 pandemic and the possible consequent further volatility and downward price pressure still constitute risks to market confidence. In this regard, ESMA is of the view that the circumstances underpinning the proposed measure by the CNMV are generally consistent with those observed in March 2020, which justified the adoption of a positive opinion by ESMA.
35. ESMA also considers that, since the decrease in net short positions is mainly linked to the application of the ban, should the latter be lifted, it is likely that such net short positions would increase again. ESMA agrees that such building up of net short positions in a volatile environment and in the potential absence of accurate and reliable information to support the price formation mechanism could exacerbate any downward price spirals, further weakening market confidence in Spain.
36. Furthermore, taking also into account the losses observed in the main Spanish indices, ESMA agrees that such circumstances impact market confidence, in general, with consequences for all listed issuers.
37. ESMA agrees with the CNMV's assessment that the impact of COVID-19 and the extraordinary market conditions caused by it qualify as "adverse events or developments" under Article 24(1)(c) of Commission Delegated Regulation (EU) No 918/2012 and agrees that there are serious threats to market confidence.
38. With reference to the broader EU-markets scenario, ESMA has assessed that there are threats to market integrity, orderly functioning of markets and to financial stability. On that basis, on 16 March 2020 ESMA has adopted a decision to temporarily lower the notification thresholds of net short positions to national competent authorities in accordance with point (a) of Article 28(1) of Regulation (EU) No 236/2012 (ESMA70-155-9546). ESMA considers that its decision has enabled national competent authorities to better monitor the existing threats.
39. At the same time, ESMA considers that the circumstances described above are adverse events or developments which constitute a serious threat to market confidence in Spain as described under Article 20(1) of Regulation (EU) No 236/2012.

On the appropriateness and proportionality of the measure

40. In order to assess whether the renewal of the measure would be appropriate and proportionate in relation to the threat, ESMA has analysed how and the degree to which sharp price declines pose a risk to the orderly functioning, integrity and stability of the Spanish market as a whole, looking not only at the range of shares affected by the latest market developments but also at the build-up of net short positions in the shares in scope before the measure now being renewed was adopted.
41. From the analysis of the shares impacted by these sharp price declines before the entry into application of the restrictive measure, it is evident that the downward spiral spread across the Spanish markets and across different sectors, including systemically important institutions. Such widespread impact is consistent with the nature of the outbreak of a global pandemic (COVID-19), as announced by the World Health Organisation², that has proven to be particularly serious in Spain.
42. From that perspective, ESMA still considers that limiting the scope of its measure to one or several sectors or to a subset of the issuers may not achieve the desired outcome. Without the broad scope applied by this measure the CNMV may have to adopt additional restrictive measures in the near future at a time when their effectiveness may be limited.
43. As also indicated by the CNMV, the latest developments in relation to COVID-19 have put an extremely wide range of Spanish shares in a situation of vulnerability. Without the proposed extension to the restrictive measure, short-selling strategies could start targeting those shares, the prices may start dropping further, potentially triggering other downward spirals and further 'runs' on the market.
44. ESMA considers that suspending the capacity of market participants in the Spanish market to enter into short sales or into transactions with equivalent effect in relation to shares admitted to trading on regulated markets would not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to its benefits. ESMA rather deems this measure appropriate to provide a uniform level of protection to all Spanish issuers and investors and the wider Spanish market as a whole.
45. ESMA considers that the measure is less stringent than other more intrusive measures that could adequately address the threat to confidence in the Spanish market. On the other end, a simple short term restriction on short selling according to Article 23 of the Regulation (EU) No 236/2012 would not address the threat to market confidence as it would remain applicable for a few days only and would be limited to short selling without covering any opening or increasing of net short positions through derivatives.

² https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200310-sitrep-50-covid-19.pdf?sfvrsn=55e904fb_2

46. Additionally, ESMA notes that the proposed renewed measure introduces a slightly amended exemption now referring to weighted index-related instruments or baskets of financial instruments, where the weight of the Spanish constituents subject to the ban does not reach more than 50% of the total index or basket. The exemptions for net short positions acquired through a convertible bond leading to a delta-neutral position, net short positions in shares hedged by a purchase that is equivalent in terms of proportion on subscription rights and for market making activities are maintained.
47. This is done with a view to limit the measure to the strictly necessary scope and not to be overly restrictive to trading strategies of market participants, with particular reference to those ones that provide an important service in terms of increasing liquidity and reducing volatility, which is particularly relevant in the current situation. ESMA also welcomes that the exemption for index- and basket related instruments has been aligned with exemptions provided in measures adopted by other national competent authorities. ESMA considers that this alignment provides for a more consistent approach across the Union and facilitates the compliance with the different national bans for market participants.
48. For the above reasons, ESMA considers that the renewal of the emergency measure proposed by the CNMV under Article 20(2)(a) and (b) of Regulation (EU) No 236/2012 as further specified by Article 24(1)(c) of Commission Delegated Regulation (EU) No 918/2012 in relation to the shares in scope of the measure is appropriate and proportionate to address the existing threat to market confidence in the Spanish market.

On the duration of the measure

49. In terms of duration of the measure, ESMA considers that maintaining the prohibition for one month is justified considering the information publicly available at the moment. While the CNMV expressed its intention to lift the ban as soon as the evolution of the situation allows, it does not discard the possibility of extending the measure if the situation so requires.

Conclusion: on the necessity of the measure

50. Having considered the adverse situation linked to the COVID-19, the appropriateness, proportionality and justified duration, ESMA considers the renewed emergency measure proposed by the CNMV as necessary under Article 20(2)(a) and (b) of Regulation (EU) No 236/2012 and Article 24(1)(c) of Commission Delegated Regulation (EU) No 918/2012 in relation to Spanish shares.

This opinion will be published on ESMA's website.

Done at Paris, 15 April 2020



For the Board of Supervisors

Steven Maijor

Chair

ANNEX

FIGURE 1 – MAIN SPANISH INDICES

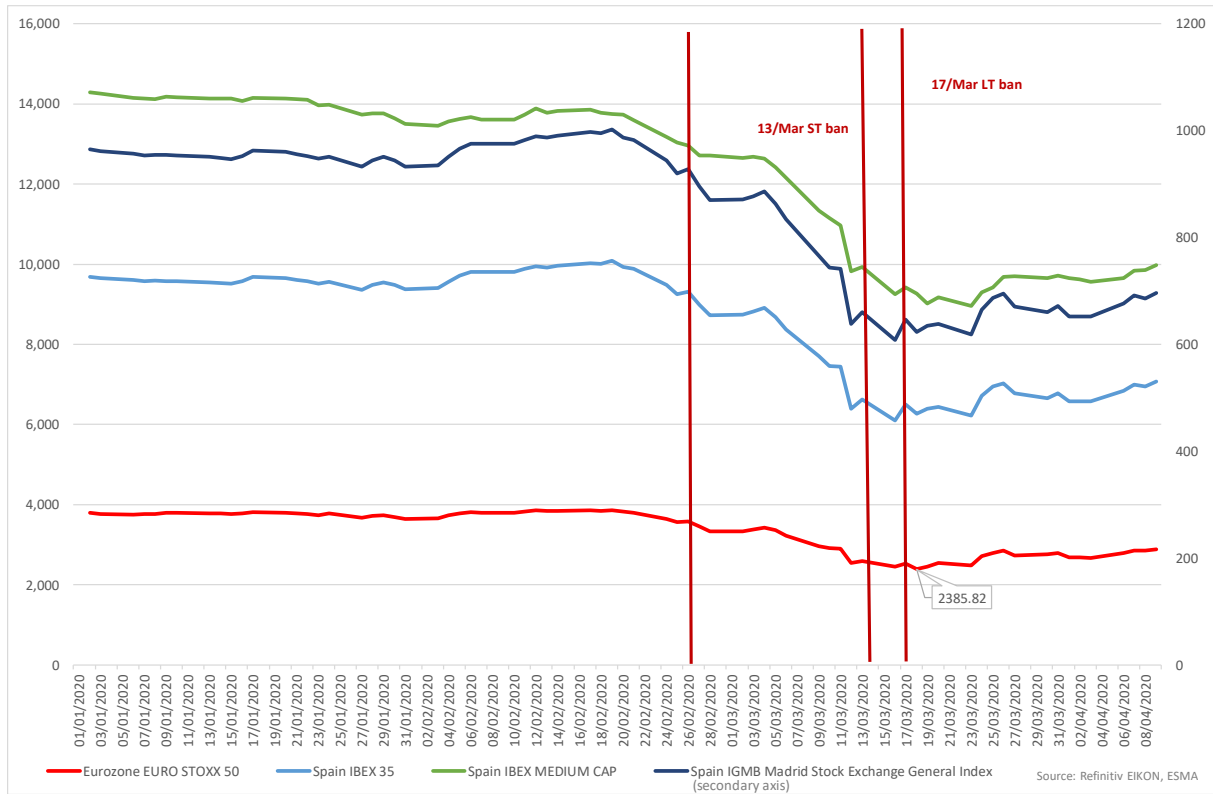


FIGURE 2 – SECTORIAL SPANISH INDICES

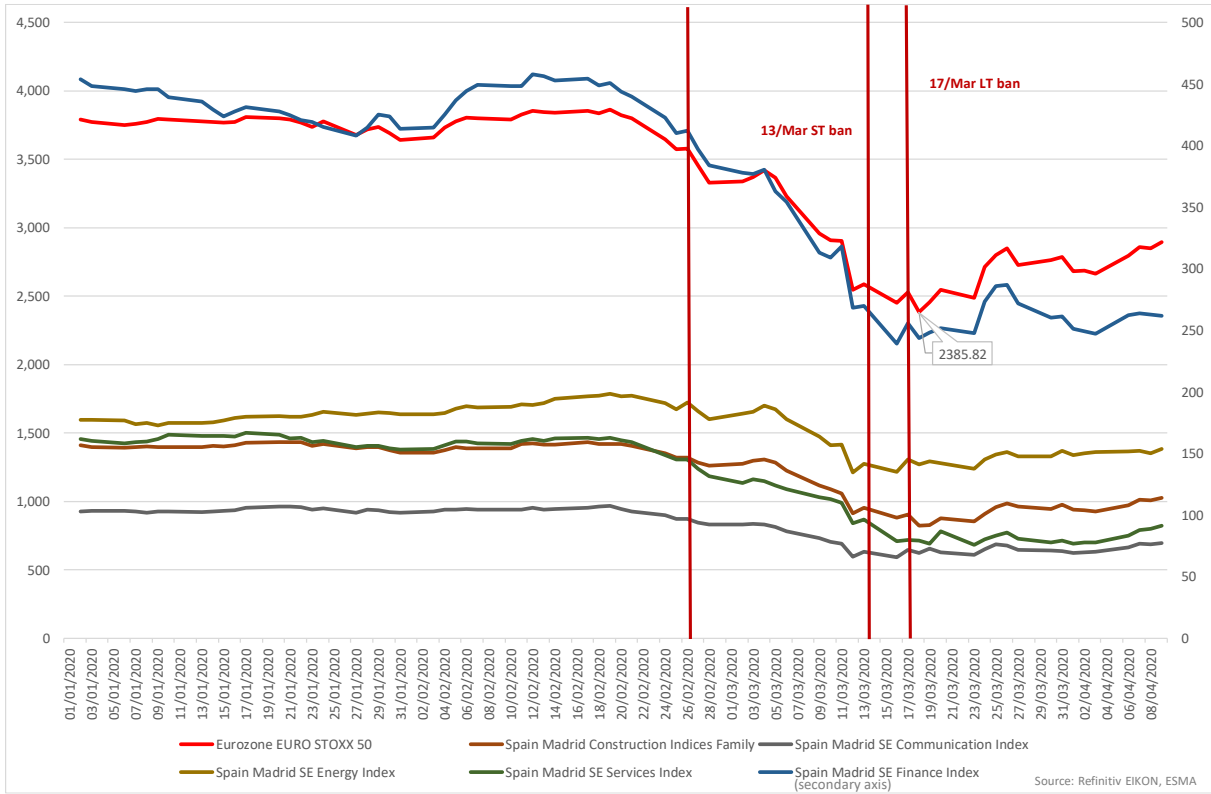
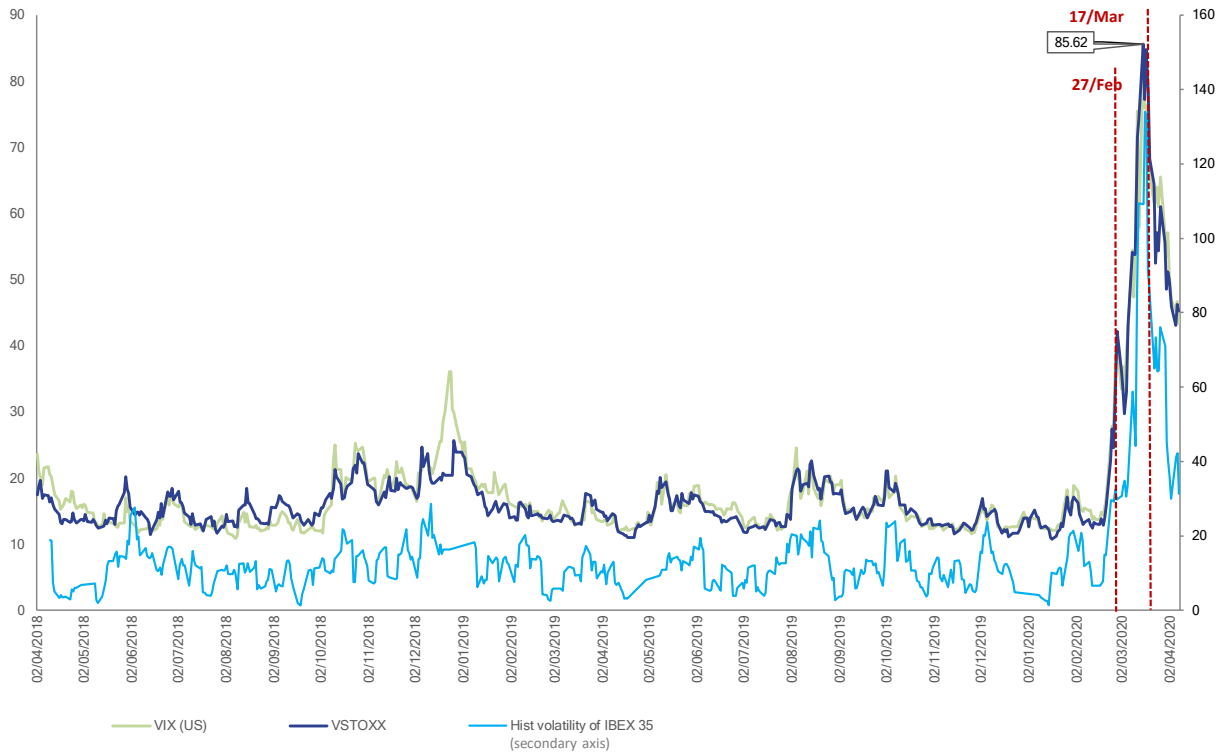


FIGURE 3 – VOLATILITY: EU - US – IBEX 35



Note: Implied volatility of EURO STOXX 50 (VSTOXX), S&P 500 (VIX), Historical volatility of the national index in %.
Sources: Refinitiv Datastream, Refinitiv EIKON, ESMA.