EUROPEAN
PRINCIPAL TRADERS
ASSOCIATION

04 September 2017

Response to ESMA consultation on the evaluation of the Short-selling Regulation

1. Introductory remarks

FIA EPTA is comprised of 28 principal trading firms (**PTFs**) which deal on own account in a wide range of financial instruments traded on trading venues across Europe. PTFs play a key role in the modern financial ecosystem, bridging gaps in supply and demand between market participants and facilitating price discovery, especially at times when markets are volatile. FIA EPTA members engage in manual, automated and hybrid methods of trading. Collectively, FIA EPTA members are an important source of liquidity for trading venues and end-investors, allowing those who use the capital markets (whether to invest or to manage their business risks), to buy or sell financial instruments efficiently and at low cost. FIA EPTA's mission is to support transparent, robust and safe markets with a level playing field for all market participants. We strongly believe access to markets should be open to all and non-discriminatory in order to minimise barriers to entry and increase competition and efficiency.

We welcome the opportunity to contribute to the evaluation of Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps ("Short Selling Regulation" or **SSR**) and in particular the market making activities (**MMA**) exemption provided for in Article 17(1) SSR. At present, FIA EPTA members are of the view that the SSR definition of "market making activities" in Article 2(1)(k) inappropriately limits the scope of the Article 17(1) exemption. The purpose of the exemption is to ensure that activities, which are crucial to providing liquidity to the markets, are not inhibited from doing so. However, the current definition fails to recognise that there are various models for providing liquidity to the market.

Liquidity providers have evolved in a variant of ways and as a result their business models can be passive or active and holding periods can vary from seconds to weeks. Moreover, the strategies they deploy span a broad spectrum, for example: correlation trades that rely on a consistent relationship between the prices of different assets; spread trading where market participants take both long and short positions in related contracts; active strategies that attempt to predict future market movements; and, the more traditional concept of market making providing two-sided quotes. Despite the variation, all of these strategies contribute to market liquidity, which can be quantified in a manner that can be monitored for the purposes of relying on this exemption. Therefore, the Article 2(1)(k) definition should not define "liquidity provider" too narrowly in order to avoid impractical or convoluted obligations and to ensure that it is fit for future developments in the market structure.

FIA EPTA members look forward to engaging throughout this evaluation process and remain at your disposal to discuss any of the elements our response or provide additional input as required.

2. Exemption for market making activities

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

We believe that the Article 2(1)(k) definition of "market making activities" (**MMA**) inappropriately limits the scope of the Article 17 SSR exemption or other exceptions to restrictions made by competent authorities. Specifically, the wording of Article 2(1)(k) excludes from engaging in MMA for the Article 17 exemption and any national measures based on the MMA definition:

- Persons making markets on a bilateral (or "over-the-counter" [**OTC**]) basis;
- Persons providing liquidity without posting two-way quotes;
- Persons using direct electronic access (**DEA**) arrangements to submit orders to a trading venue; and
- Persons transacting in financial instruments admitted to trading on a third country market.

We do not believe that simply replacing the MMA definition with the Article 4(1)(7) MiFID II definition will fix deficiencies given the "holding out" requirement of the latter provision. We are also concerned that simply replacing the MMA definition with the Article 4(1)(7) MiFID II definition would effectively exclude systematic internalisers from the Article 17 SSR exemption and any national measures based on the MMA definition given the Article 4(1)(7) MiFID II reference to "on the financial markets".

We strongly believe that the scope of Article 2(1)(k) SSR should be broadened to take account of the diverse range of strategies, including those listed above, which market makers deploy to provide liquidity to the market. We appreciate there will be a need for further articulation of the parameters by which to quantify and monitor liquidity provision, and FIA EPTA members remain at your disposal to provide further input if and when required. Additionally, given the continuous evolution of the market structure, we believe that the the broadening of the scope of the MMA definition is essential to ensuring that it can withstand future developments.

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

In line with our answer to Question 1 above, we do not consider the membership of a trading venue to be a necessary requirement to avail of the market making activities exemption, regardless of whether conducted OTC or on-exchange. The purpose of the MMA exemption, set out in Recital 26 SSR, can be fulfilled equally by MMA in exchange-traded instruments as those carried out OTC.

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

See our answers to Questions 1 and 2 above.

It should be borne in mind that the applicability of MiFIR as of the 03 January 2018 will increase the transparency of trading activities carried out OTC, therefore they should not be considered detrimental to the interest of investors or consumers.

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

See our answers to Questions 1 and 2 above.

Q5 Do you have proposals in relation to the improvement of the transparency of market making activities conducted OTC and exempted under the SSR? Do you think that requiring a firm willing to benefit from the exemption for its market making activities conducted OTC to qualify as systematic

internaliser is a viable option that would improve the transparency of their activity? Please provide justifications.

ESMA's proposal to require firms to become a systematic internaliser (**SI**) is not reasonable and does not take into account the significant operational burden of registering as such (the technology requirements, the reporting requirements, the publication of quotes and extensive quarterly 'quality of execution' statistics etc.). The SI regime permits firms to opt-in should they wish, and requires them to register as an SI once certain thresholds are met. We see no need to add an additional requirement to register if below these thresholds, but wishing to make use of an SSR exemption.

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

FIA EPTA members support ESMA's suggestions to enlarge the set of financial instruments eligible for the MMA exemption. In addition we would suggest adding ETFs to the list for sovereign issuers.

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

In line with ESMA's thinking in paragraph 46 of the consultation paper, and evidenced by the peer review, the current instrument-by-instrument approach to the exemption is complex and burdensome for market participants and regulators alike. Thus FIA EPTA members are of the view that notifying exemptions by index would be operationally much easier for firms and regulators to administer. These exemptions should be for as long as that index exists (i.e. no need to re-notify the regulator as and when components are added or removed, or ISIN of a component changes, as is current practice), and as long as firms perform one of the market making activities as defined in article 2(1)(k) SSR in relation to the index components.

We would challenge ESMA's assertion that market makers shall only be permitted to use an index when it undertakes MMA in each of the components; this would run contrary to the objective to simplify the notification procedure. We nevertheless understand ESMA's and the national competent authorities' (**NCAs**) desire to have an overview of the exact instruments for which the exemption is permitted thus would suggest that market makers notify by index and maintain an internal record of each of the instruments for which they avail of the exemption. ESMA and/or NCAs may then request to consult this list at any time.

Additionally, we are of the view that the notification requirement should extend only to the liquidity providing instruments and not the underlyings as these may vary depending on market circumstances. Moreover, under MIFID II, NCAs will already receive information on the underlyings and so the notification procedure should be limited to avoid duplication and increase efficiency.

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

See answer to Question 9 below.

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

With regard to the notification period, we would advocate for the replacement of the current 30-day period, provided for in Article 17(5) SSR, with a post-facto notification process. Similarly to the SI regime in MIFID II, market makers should be able to assess whether they meet the conditions of Article 2(1)(k) SRR and consequently benefit from the MMA exemption in Article 17(1). As detailed above under Question 7, firms would notify relevant NCAs by index and would maintain a list of instruments for which they avail of the exemption but would be able to proceed with MMA on the basis of the exemption without being obliged to wait for NCA confirmation. Market makers would be subject to periodic reporting of the exempt market making activities and the necessary safeguards would be in place to allow NCAs to immediately prohibit the use of the exemption if the market maker no longer satisfies the conditions of Article 2(1)(k) SSR.

In line with ESMA's thinking in Q5, we are of the view that systematic internalisers should automatically benefit from the MMA exemption.

3. Short term restrictions on short selling in case of a significant decline in prices

Q10 What are your views on the proposal to change the procedure to adopt short term bans under Article 23 of the SSR? Please elaborate.

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Q11 What are your views on the proposal to change the scope of short term bans under Article 23 of the SSR? Please elaborate.

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4. Transparency of net short positions and reporting requirements

Q12 Do you see any reasons to change the current levels of the thresholds regarding the notification to competent authorities and the public disclosure of significant net short positions in shares? Please elaborate.

It should be borne in mind that short sell or position reporting is of less relevance if a position is incurred as a result of liquidity providing activities as it does not indicate that a speculating position is being built up which could affect issuers or consumers. Rather, the position is there for reasons of having inventory or resulting from regular trading behaviour and is a "snap shot". Nevertheless, in some instances the notification to NCAs and the disclosure of this information can be meaningful to the regulator and useful to the market. Consequently, FIA EPTA members would support retaining the 0.2% and 0.5% thresholds. However, we question the value of the incremental 0.1% thresholds for notification/disclosure when the position holder exceeds or falls below. Removing this requirement would ease the operational and administrative burden on both the regulators and position holders.

Q13 Do you see benefits in the introduction of a new requirement to publish anonymised aggregated net short positions by issuer on a regular basis? Can you provide a quantification of the benefit of such new requirement to your activity? Please elaborate.

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Q14 Do you agree that the notification time should be kept at no later than 15:30 on the following trading day? If not, please explain.

We believe that extra time for notifying firms to submit their notifications to their competent authority would be useful in the event that they incur an issue with their notification process that requires investigation. As such we would welcome an extension of the notification deadline to 17.30pm on the following trading day.

Q15 Do you agree that the publication time should be changed at no later than 17:30 on the following trading day? Please elaborate.

Yes, see answer to Q14 above.

Q16 What are your views on a centralised notification and publication system at Union level? Can you provide a quantification of the benefit of such centralised notification to your activity? What are your views on levying a fee on position holders to have access to and report through such a centralised system? Please elaborate.

FIA EPTA members would welcome the establishment of a centralised notification and publication system at Union level. At present, members submit multiple notifications per day across many jurisdictions which is both time consuming and inefficient. The introduction of a centralised system, would improve members' straight through processing thus reducing the administrative burden and the risk of errors.

A nominal fee for access to such a system would be acceptable, however, any fee will obviously reduce the cost benefit of making it available.

Q17 Which other amendments, if any, would you suggest to make the notification less burdensome?

FIA EPTA members are of the view that the establishment of a centralised source of total issued share capital for all issuers whose main shares market is within the Union would ease the notification burden. Alternatively, issuers within the European Union should be required to publish and maintain this information in an easily accessible and uniform manner.

Additionally, we would suggest the establishment of a centralised register of all in-scope issuers. Currently, there is no such reference data, only a list of exempted issuers whose main shares market is outside of the Union.

Q18 Do you agree that the identification code of the position holder should be the LEI and that such code should be mandatory for legal entities? Please elaborate.

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Q.19 What are your views on the method that should be favoured, the nominal method or the duration-adjusted method as described above? In the latter case, do you think that the thresholds should be changed? Please elaborate.

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