

## FORMAL REQUEST TO ESMA FOR TECHNICAL ADVICE ON THE EVALUATION OF REGULATION (EU) N° 236/2012 ON SHORT SELLING AND CERTAIN ASPECTS OF CREDIT DEFAULT SWAPS

With this formal mandate to ESMA, the Commission seeks ESMA's technical advice on the evaluation of the Regulation (EU) No 236/2012 on Short Selling and certain aspects of Credit Default Swaps (the "Regulation")<sup>1</sup>.

The Commission reserves the right to revise and/or supplement this formal mandate. The technical advice received on the basis of this mandate should not prejudice the Commission's final policy decision.

This request for technical advice will be made available on DG FISMA's website once it has been sent to ESMA.

The formal mandate focuses on technical issues stemming from the Regulation.

The Commission was originally under the obligation to report to the European Parliament and the Council in 2013 on a number of issues pertaining to the functioning of the Regulation, in accordance with Article 45 of the Regulation. In particular, the Commission assessed the appropriateness of the notification and disclosure thresholds, the operation of the restrictions and requirements relating to the transparency of net short positions and to uncovered short sales, and whether any other restrictions or conditions on short selling or credit default swaps were appropriate.

In December 2013 the Commission published an evaluation on the functioning of the Regulation<sup>2</sup>. This report was based on ESMA's technical advice published in May 2013<sup>3</sup>.

Overall, the Commission could not draw robust conclusions on the overall impact of the framework put in place by the Regulation. This was largely due to the fact that at the time of the assessment the Regulation had been in application for only a few months, thus limiting the set of available data for the evaluation. The Commission concluded that it could not identify evidence suggesting that a revision of the Regulation was warranted at that stage.

The Commission also indicated that a new evaluation of the appropriateness and impact of the Regulation, similar in scope to that specified in Article 45 of the Regulation, could be carried out based on more empirical data and evidence and once the competent authorities have accumulated sufficient regulatory experience of applying the Regulation. The Commission stated that the input of ESMA would then be sought again, as well as the feedback of competent authorities and market participants.

More recently, in its Communication on the Call for evidence, published on 23 November 2016, the Commission announced its intention to assess the definition of the exemption for 'market making activities' and the possibility of introducing a single reporting platform for net short positions and to examine ways to reduce burdens on the reporting of net short positions.

The European Parliament and the Council have been duly informed about this mandate.

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<sup>1</sup> 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 (OJ L 86, 24.3.2012, p. 1), as amended.

<sup>2</sup> COM(2013) 885 final.

<sup>3</sup> ESMA/2013/614.

## 1. Context

### 1.1 Scope

Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps (the "Regulation") lays down a common regulatory framework with regard to the requirements and powers relating to short selling and credit default swaps (CDS) and seeks to ensure greater coordination and consistency between Member States. It pursues the following objectives:

- to increase the transparency of short positions held by investors in certain EU securities (shares and sovereign debts),
- to reduce settlement risks and other risks linked with uncovered or naked short selling of shares and sovereign debts,
- to reduce risks to the stability of sovereign debt markets posed by uncovered sovereign CDS positions, and
- to ensure that Member States have clear powers to intervene in exceptional situations to reduce systemic risks and risks to financial stability and market confidence arising from short selling and credit default swaps, while ensuring co-ordination between Member States and ESMA in such exceptional situations.

In order to address these objectives, the Regulation contains the following measures:

- **Transparency:** Significant net short positions in shares must be reported to the relevant competent authorities when they equal to at least 0.2% of a company's issued share capital and every 0.1% above that. They must be disclosed to the public when they at least equal to 0.5% of a company's issued share capital and every 0.1% above that. Significant net short positions in sovereign debt should be reported to the relevant competent authorities when crossing one of the thresholds published by ESMA for sovereign issuers.
- **Settlement:** Restrictions on naked short selling are introduced through a "locate" rule for short sales. Any person entering into a short sale of shares or sovereign debt securities must be covered by either having borrowed the instruments concerned, having arranged to borrow them, or having an arrangement with a third party (e.g. a prime broker) who has confirmed that the share or the sovereign debt security has been located.
- **A ban on naked sovereign CDS is introduced:** Any person entering into credit default swaps positions related to a sovereign issuer must have an underlying exposure to the risk of default of that sovereign issuer or of a decline in the value of the sovereign debt of that issuer. Regulators may however suspend the ban if the liquidity of their sovereign debt market falls significantly.
- **Intervention powers:** The Regulation gives national regulators and ESMA the power to adopt measures in exceptional situations to mitigate threats to financial stability.

Exemptions are available for market making activities and operations by authorised primary dealers.

## **1.2 Principles that ESMA should take into account**

On the working approach, ESMA is invited to take account of the following principles:

- The proper functioning of the internal market and to improve the conditions of its functioning, in particular with regard to the financial markets, which are among the objectives of this Regulation.
- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objectives of the Regulation. It should be simple and avoid creating divergent practices by national competent authorities in the application of the Regulation.
- ESMA should respond efficiently by providing comprehensive advice on all subject matters covered by the mandate.
- While preparing its advice, ESMA should seek coherence within the regulatory framework of the Union.
- In accordance with the ESMA Regulation, ESMA should not feel confined in its reflection to elements that it considers should be addressed, if it finds it appropriate, it may indicate guidelines and recommendations.
- ESMA will determine its own working methods, including the roles of ESMA staff or internal committees. Nevertheless, horizontal questions should be dealt with in such a way as to ensure coherence between different works being carried out by ESMA.
- In accordance with the ESMA Regulation, ESMA is invited to widely consult market participants and stakeholders in an open and transparent manner. In doing so, ESMA's advice should take account of different opinions expressed by the market participants and stakeholders during their consultation.
- The technical advice carried out should contain sufficient and detailed explanations for the assessment done, and be presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level.
- ESMA is invited to provide sufficient empirical evidence and factual data backing the analyses and gathered during its assessment. To meet the objectives of this mandate, it is important that the presentation of the advice produced by ESMA makes maximum use of the data gathered.
- ESMA should provide comprehensive technical analysis on the subject matters described below covered by the relevant Commission's request included in this mandate.

## **2. Areas on which ESMA's technical advice is sought**

ESMA should focus its analysis on the three following topics relating to the Regulation, with the overarching objective to evaluate to what extent the corresponding provisions of the Regulation have achieved their original objectives in terms of relevance, effectiveness, coherence, efficiency and EU added value.

- i. ESMA is asked to analyse whether the exemption for market making activities and the definition of market making activities is adequately clear, in view of current practices and as evidenced in previous reviews undertaken by ESMA in relation to its guidelines on that topic, whether the scope of such exemption is appropriate in view of its objective to safeguard the positive role of market making activities with respect to market liquidity and efficiency, and whether the notification procedure of Article 17(5) is adequate, effective and efficient.

In particular, ESMA is asked to assess the impact of the membership requirement featured in the definition of Article 2(1)(k) on those entities making markets on financial instruments which are only traded OTC, and to assess the consequences, if any, of the absence of alignment between the definition of 'market making activities' in Article 2(1)(k) of the Regulation and that of 'market maker' in Article 4(1)(7) of Directive 2014/65/EU.

- ii. ESMA is asked to analyse whether the procedure for imposing short term restrictions on short selling in case of a significant decline in price is efficient, effective and relevant and fosters consistent approaches across the Union, and whether and how it could be simplified.
- iii. ESMA is asked to analyse whether the method of notification and disclosure of net short positions is appropriate, effective and efficient, whether it could be made less burdensome and costly for notifying entities while still providing competent authorities with the information needed for proper supervision, whether further harmonisation of the notification process is needed, and whether public disclosure of net short positions in shares are efficient, effective and relevant in view of their effects on trading behaviours, market efficiency and volatility.

In carrying out its analysis of the issues covered by the mandate, ESMA is encouraged to use and rely upon empirical evidence and quantitative data which it deems relevant, and to seek the views of competent authorities and market participants, including as regards the following questions:

- i. whether the exemption for market making activities allows for liquidity provision without undue circumvention,
- ii. whether the thresholds set to identify a significant drop in the price of financial instruments are appropriate for all instruments,
- iii. whether reporting mechanisms are operating efficiently.

### **3. Indicative timetable**

ESMA is requested to deliver the technical advice by **31 July 2017**.