European Securities and Markets Authority

Consultation paper

ESMA's draft technical advice on possible Delegated Acts concerning the regulation on short selling and certain aspects of credit default swaps ((EC) No XX/2012)

15 February 2012 | ESMA/2012/98

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- indicate the specific question to which the comment relates and respond to the question stated;
- contain a clear rationale, clearly stating the costs and benefits; and
- describe any alternatives ESMA should consider.

Comments should reach us by **9 March 2012**. Any delay in the response would jeopardise the possibility to consider your comments.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Legal notice'.

Who should read this paper

This paper may be specifically of interest to investors that take short positions, hedge funds, investment firms whose clients hold short positions or engage in CDS activity, securities lending firms, hedge funds, prime brokers, custodians, settlement systems, national debt management agencies and issuers.

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Acronyms used

CDS	Credit Default Swap
DA	Delegated Act
EFSF	European Financial Stability Facility
EIB	European Investment Bank
ESM	European Stability Mechanism
ESMA	European Securities Market Authority
ETF	Exchange Traded Funds
MiFID	Market in financial instruments Directive (Directive 2004/39/EC of the European Parliament and of the Council of April 2004)
NAV	Net asset value
OTC	Over-the-Counter
RTS	Regulatory technical standard
UCITS	Undertakings for Collective Investment in Transferable Securities

Executive Summary

Background

In November 2011 the Council and the Parliament voted on a Regulation on short selling and certain aspects of credit default swaps (the Regulation)[1]. This is about to be published and should be applicable from 1 November 2012.

Beyond the technical standards ESMA has to submit to the Commission by 31 March 2012 according to the Regulation, ESMA received a letter from the Commission on 24 November 2011 requesting it to also provide an advice on all the delegated acts contained in the Regulation by the same deadline – 31 March 2012.

Taking into account the amount of work, complexity of the issues and the very tight deadlines, the process of preparing technical standards and elaborating the advice on all delegated acts is being significantly compressed compared to normal ESMA practice. The most important differences compared to normal practice will be the absence of a previous call for evidence (used normally to gather early views to help shape the legal proposals), the length of the consultation period (reduced to 3 weeks) and the absence of a cost-benefit analysis incorporated in the consultation of the technical standards. Nevertheless, it was possible to organise a roundtable with European and international associations representing the various stakeholders at the beginning of December in order to collect views on the approach to be taken in the main technical standards and delegated acts foreseen in the Regulation

On 24 January, ESMA published a consultation paper on draft technical standards (ESMA/2012/30).

Reasons for publication

The purpose of this consultation is to seek comments on the technical advice that ESMA proposes to give to the European Commission on a number of possible delegated acts concerning the Regulation as listed in the Commission request for advice. These delegated acts should then be adopted in accordance with Article 290 of the Treaty of the Functioning of the European Union (TFEU).

Besides, as previously announced when ESMA started the consultation on draft technical standards, this consultation paper also contains the consultation on one regulatory technical standard (RTS) on the method of calculation of the fall in value of a financial instrument, since it is dependent on the provisions of future Commission's Delegated Act on the definition of what is a significant fall in value of financial instruments other than liquid shares.

The Regulation (EU) No 1095/2010 establishing the European Supervisory Authority (ESMA Regulation), empowered ESMA to develop draft regulatory technical standards where the European Parliament and the Council delegate power to the Commission to adopt regulatory standards by means of delegated acts under Article 290 TFEU. Articles 10(1) and 15(1) of ESMA Regulation state that before submitting draft technical standards to the Commission, ESMA shall conduct open public consultations on draft regulatory technical standards and analyse the potential related costs and benefits, unless such consultations and analyses are

[1] http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0486&language=EN#BKMD-12

disproportionate in relation to the scope and impact of the draft technical standards concerned or in relation to the particular urgency of the matter.

Contents

In each of the following sections, the ESMA proposal of advice to the Commission is presented supplemented by its explanatory text. Section I specifies the definition of when a natural or legal person is considered to own a financial instrument for the purposes of the definition of short sale (Article 2(2)).

Section II relates to the net position in shares or sovereign debt covering the concept of holding a position, the case when a person has a net short position and the method of calculation of such a position including when different entities in a group have long or short positions or for fund management activities related to separate funds (Article 3(7)).

Section III sets out the advice on the cases in which a credit default swap (CDS) transaction is considered to be hedging against a default risk or the risk of a decline of the value of the sovereign debt and the method of calculation of an uncovered position in a CDS (Article 4(2)).

Section IV defines the initial and incremental levels of the notification thresholds to apply for the reporting of net short positions in sovereign debt (Article 7(3)).

Section V specifies the parameters and methods for calculating the threshold of liquidity on sovereign debt for suspending restrictions on short sales of sovereign debt (Article 13(4)).

Section VI sets out ESMA's proposal of advice on what constitutes a significant fall in value for various financial instruments and also specifies, in the form of a draft RTS, the method of calculation of such falls (Article 23(7) and (8)). The full text of the draft RTS is presented in Annex IV.

Section VI specifies the criteria and factors to be taken into account by competent authorities and ESMA in determining when adverse events or developments arise (Article 30).

Next steps

ESMA will consider the feedback it receives to this consultation and to the open hearing to be held on 29 February 2012 in March 2012 and expects to publish a final report and submission of the draft advice on Delegated Acts to the European Commission by mid-April 2012.

I. Specification of the definitions laid down in the Regulation and in particular of when a natural or legal person is considered to own a financial instrument for the purposes of the definition of short sale (Article 2(2))

Extract from the Commission's request

ESMA is invited to provide its technical advice on specifying the definitions laid down in the Regulation, in particular specifying when a natural or legal person is considered to own a financial instrument for the purposes of the definition of short sale.

Box 1

Draft advice on "owning" a financial instrument for the purpose of the definition of short sale

1. Ownership of shares and debt instruments due to article 2(1)(r) of the Regulation means legal or beneficial ownership according to the respective civil law or securities law applicable for the relevant sale. A share or debt instrument is considered to be owned by the ultimate beneficial owner, including in cases where it is held by a nominee.

2. Without prejudice to the applicable civil law or securities law and in order to specify the definition of a short sale and the cases mentioned in article 2(1)(r)(i) to (iii) of the Regulation, the definition of a short sale does not include:

a. the selling of financial instruments transferred under a securities lending or repo agreement, if the transferor recalls the securities so that settlement can be effected when it is due;

b. the selling of financial instruments by a person who has purchased them prior to the sale but has not yet taken delivery of them at the time of the sale.

Explanatory text

1. The aim of the Delegated Act is to specify when a natural or a legal person is considered to own a financial instrument for the purposes of the definition of short sale set out in article 2(1)(r) of the Regulation.

2. According to Article 2(1)(r) a "short sale" in relation to a share or debt instrument means any sale of the share or debt instrument which the seller does not own at the time of entering into the agreement to sell including such a sale where at the time of entering into the agreement to sell the seller has borrowed or agreed to borrow the share or debt instrument for delivery at settlement.

3. This definition does not include:

(i) a sale by either party under a repurchase agreement where one party has agreed to sell the other a security at a specified price with a commitment from the other party to sell the security back at a later date at another specified price;

(ii) a transfer of securities under a securities lending agreement; or

(iii) entering into a futures contract or other derivative contract where it is agreed to sell securities at a specified price at a future date.

4. The concept of ownership in the Member States concerning securities is not harmonized. This issue may be considered by the Commission in its future proposal on the Securities Law Directive . This Delegated Act should not anticipate this proposal. For the meantime, it seems appropriate to define legal and beneficial ownership according to the respective civil law or securities law applicable for the relevant sale. In cases of beneficial ownership the relevant financial instrument is considered to be owned by the beneficial owner, even if the legal ownership under the applicable law rests with the nominee. Instead of attempting to provide a specific though harmonised definition of ownership for the sole purposes of the Regulation ESMA has identified additional cases, like the ones mentioned in Article 2(1)(r) where some Member States might have some problems in aligning their civil law or securities law concepts of ownership with the definition of a short sale.

5. One additional example not already mentioned in Article 2(1)(r) of the Regulation might be the sale of financial instruments transferred under a securities lending or repo agreement, if the transferor recalls and receives the financial instrument within the standard settlement period of that sale. The seller may not own the shares or debt instruments from a civil law or securities law point of view, but does so from an economic one. If in addition he recalls the securities so that settlement can be effected when it is due, the exclusion of such cases from the definition of a short sale also involves no risks as regards the timely settlement of the transaction in the concerned financial instruments.

6. A further example should also be included. Under the civil law or securities law of some Member States, the ownership of a financial instrument is not transferred immediately after the sale of that financial instrument. The buyer receives ownership only when the settlement has taken place and the financial instrument is booked to his account. During that time (usually 2 or 3 days) the purchaser has the “economical ownership”. During this period, he is able to sell the securities in all Member States. In some Member States, the purchaser is legally considered to sell his “entitlement” to the financial instrument. It is a common market practice to be able to sell securities that one has purchased without having yet received delivery of those securities. Without the ability to do so, financial markets would not work properly, because it would be impossible to buy and sell securities within a short timeframe. Therefore the possibility to sell financial instruments before the settlement has taken place, without the transaction being considered to be a short sale, must be maintained. This should include cases when emergency measures set out in Chapter V of the Regulation are implemented.

7. In addition, the Delegated Act gives the Commission the possibility to specify any of the other definitions laid down in Article 2(1) of the Regulation if needed. ESMA considers that at the moment there is only a need to specify the definition of a short sale. However, depending on the outcome of this consultation and the experiences of the competent authorities, additional specifications might be added.

Q1: Do you agree with the proposal concerning Article 2(1)(r) of the Regulation?

Q2: Are there other cases which need to be excluded from the definition of a short sale?

Q3: Are there other definitions in Article 2(1), which need further clarification? Please explain which one(s) and why further clarification is required.

II. Specification of the cases in which a natural or legal person is considered to hold a share or debt instrument for the purposes of Article 3(2), cases in which a natural or legal person has a net short position for the purposes of Article 3(4) and (5) and the method of calculation of such position, the method of calculating positions for the purposes of Article 3(4), (5) and (6) when different entities in a group have long or short positions or for fund management activities related to separate funds (Article 3(7))

II.I. Introduction

Extract from the Commission's request

ESMA is invited to provide its technical advice on specifying the cases in which a natural or legal person is considered to hold a share or debt instrument, cases in which a natural or legal person has a net short position and the method of calculation of such position, the method of calculating positions when different entities in a group have long or short positions or for fund management activities related to separate funds. The method of calculation should take into account, in particular, whether different investment strategies are pursued in relation to a particular issuer through more than one separate fund managed by the same fund manager, whether the same investment strategy is pursued in relation to a particular issuer through more than one fund, and whether more than one portfolio within the same entity is managed on a discretionary basis pursuing the same investment strategy in relation to a particular issuer.

8. Investors (natural or legal persons) are required to report net short positions which they hold in relation to the issued share capital of a company to the relevant competent authority (i.e. notification under Article 5 of the Regulation) and to the public (i.e. public disclosure under Article 6) as well as in relation to sovereign debt and uncovered CDS referenced to sovereign debt, to the relevant competent authority (i.e. notifications under Article 7 and 8), when their position equals or crosses up or down specified thresholds.

9. To comply with the transparency duty in relation to the positions held, investors must calculate their net short positions. This has to be done by netting short positions and long positions. Therefore it is a precondition to

    a. define short positions and long positions, taking into account that a long position (Article 3(2)(a) of the Regulation) is composed of holding a share or a sovereign debt instrument and entering into a transaction in instruments whose value depends on the value to the share or sovereign debt (Article 3(2)(b)); and

    b. to determine the method of calculation of these positions, in particular when different entities in a group have long or short positions or for fund management activities related to separate funds.

II.II. Cases in which a natural or legal person is considered to hold a share or debt instrument for the purposes of Article 3(2) (Article 3(7)(a))

Extract from the Commission's request

ESMA is invited to provide its technical advice on specifying the cases in which a natural or legal person is considered to hold a share or debt instrument.

ESMA should take into account that while article 2 refers to the "owning" of a financial instrument, article 3 refers to "holding" a financial instrument. The term "holding" is also the wording used in the Transparency Directive, which requires notification of major holdings. Adopting a similar approach to calculating positions under both the Transparency Directive and this Regulation may minimise the administrative burden on shareholders. However, both the scope and the purpose of the notifications under both pieces of legislation are different. Differences therefore appear to be necessary, notably with regards to financial instruments which are held in the trading book, but also with regard to the contracts which are to be included, and the way in which they are accounted for.

Box 2

Draft advice on "holding" a share or sovereign debt for the purpose of determining a long position

Holding a share issued by a company and holding a debt instrument issued by the sovereign issuer for the purposes of Article 3(2)(a) of the Regulation means:

1. ownership of the instrument as defined in the Delegated Act regarding Article 2(2)of this Regulation; and

2. without having ownership, having a legally enforceable claim to be transferred ownership in cases not mentioned in Article 3(2)(b) of the Regulation according to the respective civil law or securities law applicable for the relevant sale.

Explanatory text

10. This Delegated Act should specify cases in which a natural or legal person is considered to hold a share or debt instrument for the purposes of Article 3(2)(a) of the Regulation.

11. The meaning of holding a position under the Regulation differs from the approach taken under the Transparency directive considering that both the objectives of the two legislative texts and the scope of the financial instruments covered are different and that the method of calculation under the Regulation follows the netting approach.

12. A long position (Article 3(2)(a) of the Regulation) is composed of holding a share or a sovereign debt instrument and entering into a transaction in instruments whose value increases with the price of the share or sovereign debt (Article 3(2)(b)).

Q4: Do you agree with the above proposal? If not, please give reasons.

Q5: Do you have any suggestions on possible further criteria to describe the holding of a share or sovereign debt?

II.III. Concept of having a net short position and method of calculation (Article 3(7)(b))

Extract from the Commission's request

ESMA is invited to provide its technical advice on specifying cases in which a natural or legal person has a net short position and the method of calculation of such position.

1) **Cases in which a natural or legal person has a net short position for the purposes of Article 3 (4) and (5)**

Box 3

Draft advice on cases in which a natural or legal person has a net short position in shares or sovereign debt

Net short position in shares

i) Long positions

1) The Delegated Act on Article 3(7)(a) defines holding of an instrument regarding Article 3 (2) (a). A holding of a share via a long position in a basket of shares should in relation to this special share also be taken into account to the extent that the share in question is represented in the basket.

2) Any exposure through an instrument other than the share which confers a financial advantage in the event of an increase in the price of the share as set out in Article 3(2)(b) means in particular any exposure through any one or more of the following non-exhaustive list of instruments, on the condition that their value depends on the value of the share in respect to which a net short position has to be calculated, and which confer a financial advantage in the event of an increase in the price or value of the share:

- options
- covered warrants
- futures
- index related instruments
- contracts for difference
- shares/units of exchange traded funds
- swaps
- spread bets

- packaged retail or professional investment products
- complex derivatives
- certificates linked to shares
- global depositary receipts

In this context it is irrelevant whether a cash settlement or physical delivery of underlying assets has been agreed.

3) Instruments that give a claim to shares not in issue should not be taken into account as long positions when calculating a net short position. In particular subscription rights, convertible bonds and other comparable instruments are not long positions within the meaning of Article 3(2)(b).

ii) Short Positions

4) A short sale is defined in article 2(1)(r) of the Regulation and in the Delegated Act on Article 2(2). A short sale via a short sale of a basket of shares should, in relation to this special share, also be taken into account to the extent that the share in question is represented in the basket.
5) In relation to the short position set out in Articles 3(1)(a) and 3(3) of the Regulation where a position in an instrument such as those listed in subparagraph 2 above confers a financial advantage in the event of a decrease in the price or value of the share, this position should be taken into account in calculating the short position.
6) It is irrelevant whether a cash settlement or physical delivery of underlying assets has been agreed.

Net short position in sovereign debt

i) Long Positions

7) The Delegated Act on Article 3(7)(a) of the Regulation defines holding of an instrument regarding Article 3(2)(a).

8) Any exposure through an instrument other than the sovereign debt which confers a financial advantage in the event of an increase in the price of the sovereign bond regarding Article 3(2)(b) of the Regulation means in particular any exposure through any one or more of the following non-exhaustive list of instruments, on the condition that their value depends on the value of the sovereign debt in respect to which a net short position has to be calculated, and which confers a financial advantage in the event of an increase in the price or value of the sovereign debt:

- options
- futures
- index related instruments
- contracts for difference

- swaps, especially sovereign credit default swaps
- spread bets
- complex derivatives
- certificates linked to sovereign debt

9) In this context it is irrelevant whether a cash settlement or physical delivery of underlying assets has been agreed.

10) Under the assumption that a high correlation exists, all net holdings of sovereign debt of the correlated sovereign issuer as set out in Article 2(1)(i) of the Regulation should be included. Debt instruments from issuers outside the union should not be included.

11) For assets with a liquid market price a high correlation between the pricing of a debt instrument of another sovereign issuer and the pricing of the given sovereign debt should be measured on a historical basis using data for the 24 month period before the position in the sovereign debt is taken out. For assets for which there is not a liquid market price or where there is not a sufficiently long price history, a good proxy should be used.

12) High correlation is assumed when the correlation coefficient between the price of the debt instrument of another sovereign issuer and the price of the given sovereign debt is at least [90%].

13) If the position subsequently ceases to meet the test of high correlation based on the 24 month timeframe, then the sovereign debt of the previously highly correlated sovereign issuer can no longer be taken into account in calculating a long position.

ii) Short positions

14) A short sale is defined in article 2(1)(r) of the Regulation and in the proposed advice on the Delegated Act on Article 2(2). A short sale via sale of a basket of sovereign debt instruments of different sovereign issuers should in relation to this special share also be taken into account to the extent that the sovereign debt in question is represented in the basket.

15) In relation to the short position set out in Articles 3(1)(a) and 3(3) of the Regulation where a position in an instrument such as those listed in subparagraph 8 above confers a financial advantage in the event of a decrease in the price or value of the sovereign debt, this position should be taken into account in calculating the short position.

16) It is irrelevant whether a cash settlement or physical delivery of underlying assets has been agreed.

17) CDS referenced to the sovereign issuer have to be included in calculating net short positions in sovereign debt. Sales of CDS (i.e. exposures to the credit of a sovereign issuer) should be counted as long positions while purchases of CDS should be counted as short positions.

18) If a sovereign CDS position is hedging a risk other than the referenced sovereign debt, the value of the hedged risk cannot be treated as a long position for the purposes of calculating whether a

person has a net short position in the issued sovereign debt of a sovereign issuer.

Explanatory text

Introduction

13. This Delegated Act should define cases in which a natural or legal person has a net short position due to Article 3(7)(b) of the Regulation.

14. A precondition for netting off short positions and long positions for the purpose of calculating net short positions is to define short positions and long positions.

Calculating Long Positions

15. ESMA considers that, as recommended in paragraph 8 of CESR's Model for a Pan-European Short Selling Disclosure Regime of March 2010 (CESR/10-088), instruments that give a claim to shares not in issue (i.e. subscription rights, convertible bonds) should not be taken into account in calculating a net short position.

16. A long position is composed of a) positions obtained by holding the instrument itself (Article 3(2)(a) of the Regulation) and b) positions obtained by entering into a transaction in instruments whose value depends on the value of the share or sovereign debt in respect to which a net short position has to be calculated, and which confer a financial advantage in the event of an increase in the price or value of the share or sovereign debt (Article 3(2)(b) of the Regulation).

17. A long position in a sovereign debt instrument shall be calculated by including any long position in relation to the issued sovereign debt of a sovereign issuer and any net long position in debt instruments of a sovereign issuer the pricing of which is highly correlated to the pricing of the given sovereign debt (Article 3(5) of the Regulation). In relation to highly correlated sovereign debt, the interpretation of the Regulation has been taken that only net long position rather than gross long position had to be taken into account.

18. ESMA has considered how 'highly correlated' should be defined for these purposes. The choice was between setting a specific percentage measure of correlation which must be reached or using instead a qualitative measure.

19. As the test is one of high correlation, it may be feasible to set a percentage threshold rather than simply relying on a purely qualitative definition. ESMA is aware that there is currently no definition of the term 'highly correlated' elsewhere in EU legislation which could be used as a benchmark in this Delegated Act and recognises that there currently may not be a commonly agreed standard for the level of statistical correlation required. However, setting a quantitative threshold would provide a clear, objective and measurable standard against which regulators and market participants could judge whether the condition of highly correlated set in the Regulation is or is not met. It is also relevant that the comparison is one between financial instruments of the same class for which pricing data is generally available. On balance therefore ESMA is minded to propose using a quantitative definition and considers that a percentage of 80% or 90% would seem to be appropriate for the purposes of calculating a net short position in sovereign debt. However, this is an issue on which ESMA would particularly welcome the views of market participants and oth-

ers both as regards whether a quantitative standard is the better one in this case and, if so, what correlation co-efficient is the most suitable.

20. In ESMA's view the calculation of correlation for assets with a liquid market price should be carried out on a historical basis using data for the 24 month period before the position in the sovereign debt is taken out. However, ESMA recognizes that new sovereign debt instruments are regularly issued and will not have a 24 month trading history. There are also some sovereign debt instruments in which there is little trading as they are mostly 'buy and hold' assets. For debt instruments for which there is not a liquid market price or where there is not a sufficiently long price history, a good proxy debt instrument of that sovereign issuer should be used in undertaking the measurement of correlation. Such a good proxy could be another debt instrument, whose remaining maturity is similar to the one to calculate.

21. If the position subsequently no longer meets the test of high correlation based on the 24 month timeframe then the sovereign debt of the previously highly correlated sovereign issuer can no longer be taken into account in calculating a long position. Assuming that a quantitative measure for assessing high correlation is set, ESMA considers that provision would need to be made for periods when there might be temporary fluctuations in the level of correlation between the price of the sovereign debt of different sovereign issuers. To cater for such situations ESMA envisages that there could be a temporary buffer period during which a lower level of correlation would be acceptable. So, for example, if the level of correlation was set at 90% or 80%, it could be acceptable for a period of three months that a level of at least, respectively, 75% or 70% was met. Clearly, if the level of correlation fell below the prescribed measure for more than this buffer period or if the level of correlation fell below the lower reference level, the test of highly correlated would no longer be met.

22. Under the assumption that a high correlation exists, all net long positions in debt instruments of a sovereign issuer in the sense of Article 2(1)(i) of the Regulation should be included. There is no restriction that only debt instruments issued by the sovereign issuer, for which the net short position has to be calculated, can be used.

23. So for example, in calculating whether a net short position exists in relation to the sovereign debt instruments of Germany and assuming that a high correlation exists, a net long position in the debt instruments issued by Bavaria can be included, because Germany is a federal state. According to Article 2(1)(i) of the Regulation debts issued by one of the members making up the federation are defined as sovereign debts. Similarly, if an investor holds net long positions in the sovereign debt of country X and assuming that the pricing of this debt is highly correlated to that of the sovereign debt of country Y, the investor can take account of his net holdings in sovereign debt of country X in calculating whether he has a net short position in sovereign debt of country Y.

Calculating Short positions

24. A short position is composed of a) positions obtained by a short sale of an instrument (Article 3(1)(a) of the Regulation) and b) positions developed by entering into a transaction in instruments, whose value depends on the value of the share or sovereign debt, in respect to which a net short position has to be calculated, and which confer a financial advantage in the event of a decrease in the price or value of the share or sovereign debt (Article 3(1)(b) of the Regulation).

25. The holding of special "short instruments", e.g. shares in reverse ETFs, which create a short position in the referenced share(s) or debt should also be taken into account when calculating a short position.

Q6: Do you agree with the above proposal? If not, please give reasons.

Q7: Do you agree with setting a quantitative threshold for high correlation? If so, what would be the best correlation co-efficient to use for this purpose ?

Q8: Do you think it is practicable to measure correlation for sovereign debt with a liquid market price and a long price history on a historical basis using data for the 24 month period before the position in the sovereign debt is taken out? Do you consider that a 24 month reference period is the most appropriate one?

Q9: Do you think it is practicable to measure correlation for assets with no liquid market price or with no sufficiently long price history by using a proxy? What could be a good proxy? What criteria do you think are necessary?

Q10: Do you consider that this Delegated Act needs to provide further specifications on the calculation of whether the high correlation test is met? Do you have any suggestions on what they may contain (e.g. use of a maturity bucket)?

Q11: Do you think that there is a need for a buffer period addressing the issue of temporary fluctuations in the correlation of the sovereign debt (e.g. period of 3 months during which the correlation is less than the standard level (e.g. 90% or 80%) but at least met a prescribed lower threshold (e.g. 75% or 70%)?

2) **Method of calculation of net short positions**

26. According to article 3(4) of the Regulation, "*the position remaining after deducting any long position that a natural or legal person holds in relation to the issued share capital of a company from any short position that that natural or legal person holds in relation to that capital shall be considered a net short position in relation to the issued share capital of that company*".

27. According to article 3(5) of the Regulation, "*the position remaining after deducting any long position that a natural or legal person holds in relation to the issued sovereign debt of a sovereign issuer and any long position in debt instruments of a sovereign issuer the pricing of which is highly correlated to the pricing of the given sovereign debt from any short position that natural or legal person holds in relation to the same sovereign debt shall be considered a net short position in relation to the issued sovereign debt of that sovereign issuer*".

28. There might be several possible methods of calculation. The Regulation does not specify the models or methods to be chosen. The following Box sets out ESMA's draft advice on the method of calculation of the position in relation to the issued share capital of a company and to the issued debt of a sovereign issuer.

Box 4

Draft advice on the method of calculation of net short position

In relation to shares

1. There are several possible methods of calculation. ESMA recommends a delta adjusted model for shares as proposed by ESMA/CESR in May 2010 in the document "Technical details of the pan-European short selling regime" (CESR/10-453). This model has been already implemented by some jurisdictions and it is operating satisfactorily.

2. Calculations of a long and short position in relation to shares should be done using the same methods.

3. Positions shall be calculated by taking into account transactions in all financial instruments (inside or outside a trading venue) that confer a financial advantage in the event of a change in price or value of the share.

4. Any derivative and cash position would be accounted for on a delta adjusted basis (cash position having delta 1). Delta indicates how much a financial instrument's theoretical value would move in case of an underlying instrument's price variation. In order to calculate the delta of a derivative, investors shall take into account the current implied volatility of the derivative and the closing price (or last price) of the underlying instrument. Therefore, in order to determine a position having equity or cash investments and derivatives at the same time, investors shall calculate the individual delta adjusted position of every derivative that is held in the portfolio, plus or minus all cash positions.

5. Investors should be aware that a nominal cash short position might not be offset in some cases by an equivalent nominal long position taken in derivatives. Delta-adjusted long positions in derivatives may not compensate identical nominal short positions taken in other financial instruments due to the delta adjustment. Persons entering into derivatives contracts giving rise to potentially reportable short positions should calculate net position changes in their portfolio arising from changes in the delta.

7. Any transaction that confers a financial advantage in the event of a change in price or value of the share held as part of a basket, index or exchange traded fund (ETF) shall be included when calculating the position in each individual share. Positions on these financial instruments shall be calculated taking into account the weight of that share in the underlying basket, index or fund. Investors shall perform calculations in these financial instruments following the principles set out in article 3(3) of the Regulation: the principle of acting reasonably having regard to publicly available information as to the composition of the relevant index, basket of securities or interests held in a ETF and the principle that stipulates that no person shall be required to obtain any real-time information as to such composition from any person.

8. Net short position is calculated then by netting long and short delta adjusted positions in a given issuer.

9. As for the issued share capital of the company, it is defined in article 2(1)(h) of the Regulation and means the total of ordinary and any preference shares issued by the company but does not include convertible debt securities. ESMA thinks that when issuers have several share classes it would be necessary to take into account the total number of shares issued in each class and to add them up.

10. Calculation of positions needs to take into account changes in the share capital of the issuer (like capital raising, bond conversion, capital amortisation etc.) that can trigger or eliminate notification obligations.

Persons entering into short positions should be able to calculate net position changes arising from any change in the issued share capital of the company.

11. New shares issued from a capital increase shall be accounted for the calculation of the total issued share capital from to the day they are admitted to trading on a trading venue.

12. The net short position expressed as a percentage of the company issued share capital is then obtained by dividing the net short position in equivalent shares by the total issued share capital of the company.

In relation to the issued sovereign debt of a sovereign issuer

13. Positions shall be calculated by taking into account transactions in all financial instruments that confer a financial advantage in the event of a change in price or value of the issued sovereign debt of a sovereign issuer.

14. Cash positions and positions in derivatives (bond futures, options on bond futures, other derivatives, etc.) shall be taken into account using their nominal amount. Options and other derivative instruments shall be then adjusted by their delta. For delta calculations of derivatives please refer to paragraph 4. Therefore, in order to determine a position having cash investments and derivatives at the same time, investors shall calculate the individual delta adjusted position of every derivative that is held in the portfolio, plus or minus all cash positions (cash position having delta 1).

15. Nominal positions in bonds issued in other currencies than the Euro shall be converted to Euros using "bona fide" practice taking the last reliable updated spot currency price available. The same principle applies to other financial instruments.

16. Other derivatives, in particular forward bonds, shall be also adjusted using the same principles.

17. Any economic interest or position that creates a financial advantage to the issued sovereign debt of a sovereign issuer held as part of a basket, index or exchange traded fund (ETF) shall be included when calculating the position in each individual debt of a sovereign issuer. Positions on these financial instruments shall be calculated taking into account the weight of that "sovereign exposure" in the underlying basket, index or fund. Investors shall perform calculations in these financial instruments following the principles set out in article 3(3) of the Regulation: the principle of acting reasonably having regard to publicly available information as to the composition of the relevant index, basket of securities or interests held in a ETF and the principle that stipulates that no person shall be required to obtain any real-time information as to such composition from any person.

18. Calculations for sovereign debt instruments with high correlation follow the same methods of calculation of long positions in debt instruments of a sovereign issuer. Long positions in debt instruments of a sovereign issuer the pricing of which are highly correlated to the pricing of the given sovereign debt can be taken into account for calculation purposes. When these positions no longer meet the test of high correlation then they shall not be taken into account to offset short positions.

19. Nominal long positions of CDS shall be included in the calculation as short positions. In calculating an investor sovereign CDS position its net positions should be used (i.e. sales of CDS in the referenced sovereign counted as long positions). Positions intended to be covered or hedged through the purchase of a CDS that are not sovereign bonds (like any other assets, liabilities or any other kind of counterparty default risk) will not be taken into account as long positions. CDS are considered to have delta 1.

20. The net short position is calculated then by netting nominal delta adjusted equivalent long and short positions in the issued sovereign debt of a Member State.

21. As for the issued sovereign debt of a sovereign issuer it is defined in article 2(1)(i) of the Regulation and means the total of sovereign debt issued by a sovereign issuer that has not been redeemed.

22. The net short position expressed as a percentage of the total issued sovereign debt of a sovereign issuer is then obtained by dividing the nominal net short position by the total issued sovereign debt of a sovereign issuer.

23. Calculation of positions needs to take into account changes in correlations and in the total sovereign debt of a sovereign issuer. Persons entering into short positions should be able to calculate net position changes arising from any changes in correlations and total sovereign debt of a sovereign issuer.

24. Only long positions in debt instruments of a sovereign issuer of an EU Member State the pricing of which is highly correlated to the pricing of sovereign debt of an EU sovereign issuer shall be taken into account to offset short positions in highly correlated issued sovereign debt. A given long position of a highly correlated debt can only be used once to offset a short position in cases where the investor maintains several short positions of different sovereign issuers (the same amount of the long position cannot be applied several times to net off different short positions taken in highly correlated sovereign debt).

25. Investors with multiple allocations of long positions of highly correlated debt across several different sovereign issuers should be in a position to have records that show their allocation methods.

26. Article 3(6) of the Regulation states that "the calculation under paragraphs 1 to 5 for sovereign debt shall be for each single sovereign issuer even if separate entities issue sovereign debt on behalf of the sovereign issuer". Positions shall be then calculated for every sovereign issuer of the EU in which an investor (market participant) holds a short position.

Explanatory text

29. Recital 10 of the Regulation states that "*in order to ensure a comprehensive and effective transparency it is important that the notification requirements cover not only short positions created by trading shares or sovereign debt on trading venues but also short positions created by trading outside trading venues and economic net short positions created by the use of derivatives, such as options, futures, index-related instruments, contracts for differences and spread bets relating to shares or sovereign debt*".

30. Recital 12 of the Regulation states that "*the calculation of short positions or long positions should take into account any form of economic interest which a natural or legal person has in relation to the issued share capital of a company or to issued sovereign debt of a Member State or of the Union. In particular, it should take into account such an economic interest obtained directly or indirectly through the use of derivatives such as options, futures, contracts for differences and spread bets relating to shares or sovereign debt, and indices, baskets of securities and exchange traded funds. In the case of positions relating to sovereign debt it should also take into account credit default swaps relating to sovereign debt issuers*".

31. Article 5(2) of the Regulation states that "*a relevant notification threshold is a percentage that equals 0,2% of the issued share capital of the company concerned and each 0,1% above that*". The Regulation is thus requesting the notified net short position to be at least expressed as a percentage of the company`s issued share capital. Calculation and notification in percentage of issued share capital allows market participants and competent authorities a quick and accurate assessment of the significance of the short position.

32. ESMA understands that for notification purposes a figure expressing the percentage of the net short position in relation to the total outstanding sovereign debt of a sovereign issuer is necessary, although according with Article 7(2) of the Regulation the relevant notification thresholds will be set up in nominal terms (See Chapter IV below).

33. Article 9(2) of the Regulation states that "*the relevant time for calculation of a net short position shall be midnight at the end of the trading day on which the natural or legal person has the relevant position. It shall apply to all transactions executed through either manual or automated trading, and irrespective of whether the transactions have taken place during normal trading hours*".

34. ESMA recognises that there might be several appropriate methods of calculation of net short positions in relation to the issued sovereign debt of a sovereign issuer. However, the choice essentially comes down to whether to adopt a nominal model, as with shares, or a sensitivity adjusted method to take into account the fact that different issues of sovereign debt have different maturities. The two respective methods are set out below but it should be emphasised that neither method is intended to offer any guidance or basis for portfolio or bond valuation at all. The choice of the methods should be determined by whichever better meets the goal of the Regulation that notification of significant short positions shall provide important information to assist regulators in monitoring whether such positions are creating systemic risk or being used for abusive purposes. A further determining criterion is that the method selected should be straightforward and easy to apply for all market participants.

Sensitivity adjusted method (Value of a basis point, Duration or Modified Duration)

35. The following paragraphs set out the main lines of a "sensitivity adjusted" method of calculation of the position in relation to the issued sovereign debt of a Member State or of the Union. Any "sensitivity adjusted method" (value of a basis point, duration or modified duration) offers a comparison between relative or absolute price changes in a debt instrument and relative or absolute yield changes. This method would basically share many of the main features and calculation rules of the "nominal" method proposed by ESMA. ESMA assumes that the value of basis point (PVBP or PV01) is the method most often used for market participants to assess interest rate risk. However, duration or modified duration methods could equally be used as are very closely related.

36. Positions should be calculated by taking into account transactions in all financial instruments that confer a financial advantage to the issued sovereign debt of a sovereign debt issuer.

37. Bond positions should be adjusted (multiplied) by their PV01, modified duration or duration figure. To calculate a portfolio's PV01, modified duration or duration, the same principle applies.

38. Bond futures positions should first be converted to an equivalent cash position and then adjusted (multiplied) by the PV01 (modified duration or duration) of the cheapest to deliver bond.

39. Options on bond futures should be converted to an equivalent cash position by their delta and then adjusted by the PV01 (modified duration or duration) of the underlying future.

40. Other derivatives, in particular forward bonds, should be calculated using the same principles.

41. Nominal values in bonds issued in other currencies than euro should be first converted to Euros using bona fide practice taking the last reliable updated price available.

42. The net short position is then calculated by netting long and short PV01 adjusted positions (modified duration or duration adjusted) in a given sovereign issuer.

43. Accordingly, the total sovereign debt issued by a sovereign issuer that has not been redeemed would be adjusted (multiplied) by their PV01, modified duration or duration figure.

44. The net short position expressed as a percentage of the total PV01 adjusted (modified duration or duration adjusted) issued sovereign debt of a sovereign issuer is then obtained by dividing the nominal net short PV01-adjusted position (modified duration or duration adjusted position) by the total issued PV01-adjusted position (modified duration or duration adjusted) of the sovereign debt of a sovereign issuer.

45. The advantages of using a sensitivity adjusted method are that it better reflects the fact that taking short positions in issues of different duration will have different market impacts – a short position in Treasury Bills will have less impact than an equivalent position in for example, 10 year bonds. Adjusting positions by "sensitivity" captures adequately the level of risk to changes in yields and the associate interest rate exposure in such circumstances. However, a sensitivity adjusted method is less useful than the nominal method in times of market stress and would inevitably entail more complexity in terms of calculation of positions

Nominal model and general considerations

46. In contrast the nominal model offers great simplicity for calculation and might prove very useful when the market in debt instruments is mostly led by events other than interest rate risk (credit risk or distress situation). These are also the kind of situations when the knowledge of short positions becomes more important for regulators. ESMA acknowledges that in normal market conditions the usefulness of the nominal information for supervisors is less relevant since it is difficult to grasp the kind of strategy that a market participant is carrying out without a measure of the impact on its position of a yield curve movement. ESMA is also aware that the nominal approach may have the disadvantage of not always accurately reflecting the nature of a position, in particular when it results from the aggregation of debt instruments of different maturities (e.g.: simultaneous sale of a 10 year maturity bond and purchase of a short term debt instrument).

47. Both methods therefore have their advantages and disadvantages and neither is perfect. The ideal solution might be to be able to apply the method which best suits the prevailing market conditions but ESMA recognises that such a pick and mix approach may be difficult to reconcile with setting one standard around which market participants can design their reporting systems. Taking into account that the purpose of Regulation is to assess the market impact that a net short position is able to produce as well as to obtain complete and accurate information about a person's position, ESMA considers that, on balance, concerning debt instruments, calculating and reporting net short positions in nominal terms better accomplishes both goals. In this respect positions taken in one part of the yield curve should not be given a greater weight than another. However, this is an-

other topic on which ESMA would particularly welcome the views of market participants and others before taking a final decision on the draft advice to be provided to the Commission.

Q12: Do you think it is appropriate the "delta adjusted method" for the calculation of short position for shares?

Q13: Is there any comment you would like to make in relation to the calculation of the position in shares set out in Box 4?

Q14: Is there any additional method of calculation for shares that you would suggest ESMA to consider?

Q15 Which in your view is the most appropriate method for the calculation of short position for debt instruments of a sovereign issuer? Are there methods other than the nominal or sensitivity adjusted ones outlined above which you think ESMA should consider?

Q16: Is there any comment you would like to make in relation to the calculation of the position in sovereign debt of a sovereign issuer set out in Box 4?

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II.IV. Method of calculating positions when different entities in a group have long or short positions or for fund management activities related to separate funds

Introduction

48. The aim of the Delegated Act is to specify the method of calculating long, short and net positions relating to the issued share capital of a company or the issued sovereign debt of a sovereign issuer when different entities in a group have long or short positions or for fund management activities related to separate funds.

Extract from the Commission's request

ESMA is invited to provide its technical advice on specifying [...] the method of calculation of such position [net short position], *the method of calculating positions when different entities in a group have long or short positions or for fund management activities related to separate funds. The method of calculation should take into account, in particular, whether different investment strategies are pursued in relation to a particular issuer through more than one separate fund managed by the same fund manager, whether the same investment strategy is pursued in relation to a particular issuer through more than one fund, and whether more than one portfolio within the same entity is managed on a discretionary basis pursuing the same investment strategy in relation to a particular issuer.*

Box 5

Draft Advice on the method of calculating positions when different entities in a group have long or short positions or for fund management activities related to separate fundsH

1) Definitions

   a. Decision Maker means a single natural person or several natural persons, a body within a legal entity or a legal entity within a group pursuing the same investment strategy in relation to a particular issuer through one sub entity or different sub entities within the same legal entity or within a group .

   b. Investment Strategy means the strategy that is pursued by an investor, regarding a particular issuer, to have either a net short or a net long position taken through transactions in various financial instruments issued by this particular issuer or that relate to that issuer.

2) Group: a legal entity constituted of several legal entities.

3) 2. For fund management activities related to several funds,

   a. the calculation of the net short position in a particular issuer shall be made in accordance with the advice on Delegated Act relating to article 3(7)(a) and (b) for each individual fund, irrespective of its legal form.

   b. the net positions of the funds managed by the same decision maker and for which the same investment strategy is pursued in relation to a particular issuer shall be aggregated.

   c. the net short and long positions of all the funds under the responsibility of a management

company shall be aggregated and netted.

4) The fund management company shall report, or disclose where relevant, the net short position that results from 2(a), 2(b) or 2(c) above when it reaches or exceeds a relevant notification or disclosure thresholds, or, the highest of the net short positions determined under 2(a), 2(b) and 2(c) above when more than one of them reaches or crosses such thresholds.

5) When the management of funds has been delegated by one or more management companies to an external party, that party shall be considered as the decision maker for the purpose of article 3(7)(c) of the Regulation. It shall aggregate the position of all the funds under its management having net short position in relation to a particular issuer and where relevant proceed with the net short position notification or disclosure. The management companies delegating the fund management still aggregate and net the positions of the respective funds according to paragraph 2c.

6) When the management of a single fund has been delegated to more than one external party by a fund management company, there should be an arrangement in place to ensure that either these parties, independent from each other, report the relevant information to the fund management company to calculate the net short position and where relevant notify or disclose it or that one of these parties is entrusted by the fund management company to conduct the calculation and notify or report a net short position, provided that party receives the relevant information from the other party(ies).

7) When different legal entities within a group have long or short positions in relation to a particular issuer,

   a. the calculation of the net short position shall be made in accordance with the advice on Delegated Act relating to article 3(7)(a) and (b) for each legal entity constituting the group;

   b. the net positions of these legal entities that are managed by the same decision maker and for which the same investment strategy is pursued in relation to a particular issuer shall be aggregated;

   c. the net short and long positions of all the legal entities constituting the group shall be aggregated and netted.

8) The group shall report, or disclose where relevant, the net short position that results from 7(a), 7(b) or 7(c) above when it reaches or exceeds a relevant notification or disclosure thresholds, or the highest of the net short positions determined under 7(a), 7(b) and 7(c) above when more than one of them reaches or crosses such thresholds.

9) Where two or more portfolios are managed on a discretionary basis by the same decision maker pursuing the same investment strategy in relation to a particular issuer, the positions of all the managed portfolios having a net short position should be aggregated and notified or disclosed where relevant by the firm in charge of the management of these managed portfolio when a notification or disclosure threshold is reached or exceeded.

10) In relation to a legal entity constituted of several different non-legal entities with different activi-

ties,

a. the calculation of the net short position shall be made in accordance with the advice on Delegated Act relating to article 3(7)(a) and (b) at the level of each of the decision makers to be considered as the separate business lines (which normally will be separated from the other businesses at least by information barriers)

b. The net short and long positions of all the decision makers within this legal entity shall be aggregated and netted.

11) The legal entity shall report, or disclose where relevant, the net short position that results from 10(a), or 10(b) above when it reaches or exceeds a relevant notification or disclosure thresholds, or, the highest of the net short positions determined under 10(a), or 10(b) above when both reach or cross such thresholds.

Explanatory text

49. Although under the Regulation the notification or disclosure requirements fall on the legal entity in relation to net short positions on the issued share capital of a company or the issued sovereign debt of a sovereign issuer, Article 3(7)(c) requires that the method of calculating the positions should be specified under a Delegated Act in two specific instances:

a. when different entities in a group have long or short positions;

b. for fund management activities related to separate funds.

50. The most relevant recital for the aim of the Delegated Act is recital 11 of the Regulation: ¨*To be useful to regulators and markets, any transparency regime should provide complete and accurate information about a natural or legal person's positions. In particular, information provided to the regulator or the market should take into account both short and long positions so as to provide valuable information about the natural or legal person's net short position in shares, sovereign debt and credit default swaps.*¨

51. Therefore, in line with the CESR report "Technical details of the pan-European short selling disclosure regime" (10-453; May 2010), ESMA considers that the objectives are to achieve a maximum transparency and avoid non-compliance with notification and disclosure requirements through:

a. concealing an otherwise notifiable or discloseable net short position by using a group structure; and/or

b. diluting an otherwise notifiable or discloseable net short position by allocating such a position through different entities within an organization or to different funds all of which are managed by the person which took the position.

52. In this respect and for the purpose of article 3(7)(c), ESMA considers that it is necessary in certain cases to require the aggregation of positions above legal entity level or require the reporting of positions held at a level below legal entity in order to ensure that competent authorities obtain notifi-

cations of reportable positions taken by the person who is deciding on the investment and that the public access meaningful disclosures when relevant. For this purpose, an additional level needs to be considered in the method of calculation of the positions i.e. the level of decision maker. Depending on the circumstances, it should be introduced below or above the legal entity level.

53. A decision maker is a person pursuing the same investment strategy in relation to a particular issuer through (one sub entity or) different sub entities within the same legal entity or within a group (See appendix). A decision maker can be a single natural person (e.g. fund manager managing the portfolios of separate legal entities, a portfolio manager) or several natural persons (e.g. two or more fund managers following the same investment strategy for the funds they manage individually), a body within a legal entity (e.g. investment committee of a fund management company) or a legal entity within a group.

54. The concept of investment strategy is foreseen in the Regulation under Article 3(7)(c) in order to cater for the specific cases to be considered in the method of calculation. An investment strategy that is pursued by an investor, regarding a particular issuer, is implemented by taking positions through transactions in various financial instruments issued by this particular issuer or that relates to that issuer. Ultimately, an investment strategy is either being long or short on a particular issuer.

55. The determination of a net short position and the method of calculating a net short position as described in the advice on article 3(7)(b) remains relevant for the purpose of article 3(7)(c). However, for the specific cases envisaged under that article 3(7)(c), ESMA considers that it should also determine at which level the calculation of the net short position should take place and how the positions of the sub entities have to be netted and/or aggregated in relation to a particular issuer.

For fund management activities

56. For the purpose of Article 3(7)(c) ESMA considers that the calculation of the net short position in a particular issuer, in accordance with the advice on Delegated Act relating to article 3(7)(a) and (b) should be conducted at the level of each individual fund holding such a net short position, though ESMA is aware that in some jurisdictions, funds may not be a legal person (they can have a corporate or contractual form). This will allow to the competent authority determine the investment strategy of that entity that is the fund.

57. When the same investment strategy is pursued in relation to a particular issuer through more than one fund and these funds are managed by the same decision maker i.e. the fund manager, the positions of all the funds having a net short position should be aggregated. With such an approach, the market impact of building a net short position can be assessed.

58. Besides, it enables the avoidance of loopholes in the regime in case of delegation of the management of funds. Several management companies may individually decide to delegate the management of some or of all the funds under their responsibilities to the same fund manager, a legal entity independent from them. When using the decision maker approach, the net short positions in a particular issuer of all the funds managed by this fund manager would have to be aggregated in order to determine the overall net short position decided by this fund manager.

59. There may be cases when the management of a single fund has been delegated by a fund management company to two different and independent fund managers. In such situations, ESMA consid-

ers that there should be an arrangement in place to ensure that either these two independent parties report the relevant information to the fund management company to conduct the proper calculation or one of these parties is entrusted by the fund management company to conduct the calculation provided that party receives the relevant information from the other party.

60. Finally, to cover the situation described in the Regulation whereby a fund manager is pursuing different strategies through more than one managed fund, ESMA considers that a fund management company, which is a legal entity, should conduct an aggregation and netting of the net positions (net short or net long) of all the funds under its management. The objective is to come up with a single figure of the overall net (short) position held in relation to that issuer by the fund management company (regardless of any delegation of the effective management of some or all of the funds).

For a group and the legal entities constituting it

61. With respect to a group constituted of several legal entities, the same approach as for fund management activities should apply: net short positions are calculated by each individual entity constituting the group, aggregation of the net short positions of the legal entities takes place at decision maker level and the whole group conducts an aggregation and netting of the net positions (net short or net long) of all the legal entities constituting the group. Two alternatives arise when defining group.

62. **Alternative 1**:

- group: legal entity that incorporates in its balance sheet the gains and losses of one or more single legal entities that belong to it;

- legal entity belonging to a group: single legal entity which gains and losses are incorporated to the balance sheet of the group that belongs

Alternative 2 A group is a legal entity constituted of several legal entities it controls as defined under article 2(1)(f) of the Transparency directive[2].

A controlled undertaking' means any undertaking:

(i) in which a natural person or legal entity has a majority of the voting rights; or

(ii) of which a natural person or legal entity has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in, or member of, the undertaking in question; or

(iii) of which a natural person or legal entity is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights, respectively, pursuant to an agreement entered into with other shareholders or members of the undertaking in question; or

[2] Directive 2004/19/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

(iv) over which a natural person or legal entity has the power to exercise, or actually exercises, dominant influence or control.

For managed portfolios

63. In order to ensure that the market impact of building a net short position can be assessed, where two or more portfolios managed on a discretionary basis by the same manager (the decision maker) follow the same investment strategy in relation to a particular issuer, the positions of all the managed portfolios having a net short position should be aggregated.

For a legal entity constituted of several different non-legal entities with different activities

64. This situation would for instance cover the case of credit institutions or investment firms performing, within a single legal structure, several types of different activities, such as proprietary trading and individual portfolio management on a discretionary basis.

65. In this case, the concept of "decision maker" should apply within the concerned legal entity in relation to the various sub entities that the legal entity is composed of.

66. However, as a proxy to the concept of decision maker and in line with the CESR advice of 2010 (Technical details of the pan-European short selling disclosure regime¨ (CESR/10-453; May 2010)), ESMA considers that net short position calculation and the netting should take place at the level of separate business lines (which normally will be separated from the other businesses at least by information barriers).

67. An alternative would be to leave it to the legal entity to conduct a proper mapping of who/what are the decision makers within their organization. Though this would provide a flexible approach to cater for the various practical situations, ESMA does not back this as the proposed approach since it may result in a high level of complexity and unstable situations resulting in on-going and frequent changes in the organisation of such legal entities.

68. In any case and in order to fulfil the objective of avoiding non-compliance with the notification and disclosure requirements, ESMA considers that at legal entity level, an overall netting of the short positions with long positions held by all the sub entities/decision makers (e.g. business lines) should also take place.

Reducing duplicative reporting of short positions

69. As a result of the methods suggested above for each specific case, the same net short position can be considered more than once in the calculation within a fund management company, a group or a single legal entity. Therefore, ESMA considers that clarification should be provided as to notification and/or disclosure process, taking into account at which specific level or levels a notification/disclosure threshold has been crossed further to the calculation method applied, in order to limit non-compliance with the requirement and provide, to the extent possible, meaningful information to be reported to regulators or disclosed to the public.

70. There are two main situations to consider. On the one hand, a notification threshold is reached or crossed only at one of the levels identified previously (e.g. for fund management activities: at fund level or at decision maker level or at fund management company level) and then only one net short

position is expected to be reported or disclosed. On the other hand, relevant thresholds are simultaneously crossed at two or more levels to consider in the calculation method. This would mean that the same net short position could be reported more than once to the regulator, either individually or as part of an aggregated, a netted position or both. This would cause problems for the regulator to properly distinguish between them (accuracy issue and complexity in managing the notifications received). Similarly, the same net position could be published more than once, which would give misleading information to the market.

71. To strike the right balance between the accuracy of the information notified to regulators or disclosed to the public and the complexity of reporting (avoiding repetition and duplication), ESMA considers that within a fund management company or a group or within a single legal entity composed of sub-entities, the highest of the net short positions on a specific issuer should be reported at whatever level this position lies (e.g. fund, decision maker or fund management company/group/legal entity).

72. Therefore, in relation to fund management activities and groups constituted of several legal entities, ESMA suggests that:

a. When an individual fund or a legal entity crosses a threshold, the reporting should be done by the fund management company or the group on behalf of the concerned fund or legal entity;

b. When a threshold is crossed at decision maker level, the fund management company or the group reports on its behalf, except:

i. When the decision maker is independent from, is not part of or does not belong to the fund management company and manages several funds from several management companies, in which case that decision maker shall report the aggregated net short position of these funds.

ii. When the management of a single fund is delegated to more than one fund manager, independent from each other, where there should be an arrangement in place to ensure that either these independent parties report the relevant information to the fund management company to allow the reporting the relevant net short position on behalf of the fund or one of these parties is entrusted by the fund management company to report on behalf of the fund provided it receives the relevant information from the other parties.

c. When a threshold is crossed at fund management company level, the fund management company reports the position.

d. When a threshold is crossed at fund, decision maker (exception mentioned above excluded) and fund management company levels, the latter reports only the highest of the three positions.

73. In relation to managed portfolios, ESMA suggests that when a threshold is crossed at decision maker level, if the decision maker is, belongs to or is part of the portfolio management company, the latter reports on its behalf.

74. In relation to a legal entity (a "group") constituted of several different non-legal entities with different activities, ESMA suggests that:

a. when a net short position of either a decision maker or the legal entity equals or exceeds a relevant notification or disclosure threshold, the legal entity reports the net short position

b. when a threshold is reached or crossed by both a decision maker and the legal entity, the latter reports only the highest of the two positions.

75. ESMA acknowledges the complexity of the proposed method of calculation not only in terms of implementation but also for supervision purposes. The objective pursued remains however to find a balanced approach between comprehensiveness in reporting and avoiding multiple reporting and thus potentially duplication while still obtaining meaningful information. Therefore, this is another topic on which ESMA would particularly welcome the views of market participants and others before taking a final decision on the draft advice to be provided to the Commission.

Q17: Do you agree with the approaches described above to cater for specific situations when different entities in a group have long or short positions or for fund management activities related to separate funds? If not, can you state your reasons and provide alternative method(s) of calculation?

Q18: Which do you consider the better definition of a group for the purpose of this Regulation?

Q19: Are there other situations that should be taken into account?

III. Specification of the cases in which a credit default swap transaction is considered to be hedging against a default risk and the method of calculation of an uncovered position in a credit default swap and the method of calculating positions where different entities in a group have long or short positions or for fund management activities related to separate funds (Article 4(2))

Extract from the Commission's request

ESMA is invited to provide its technical advice on cases in which a credit default swap transaction is considered to be hedging against a default risk and the method of calculation of an uncovered position in a credit default swap, the method of calculating positions where different entities in a group have long or short positions or for fund management activities related to separate funds.

Introduction

76. The aim of this Delegated Act is to set out for the purpose of Article 4(1) of the Regulation:

a. cases in which a sovereign CDS transaction is considered to be hedging against a default risk or the risk of a decline of the value of the sovereign debt and the method of calculation of an uncovered position in a sovereign CDS;

b. the method for calculating positions where different entities in a group have long or short positions or for fund management activities relating to separate funds.

This chapter sets out ESMA's draft advice on when a CDS position should be considered to be a covered one and on the method for calculating whether a position is covered on uncovered. The issue of determining the positions of groups and funds is dealt with under our general advice on this topic in chapter II-IV of this Consultation Paper.

III.I. Cases in which a CDS transaction is considered to be hedging against a default risk or the risk of a decline of the value of the sovereign debt.

Box 6

Draft Advice on cases in which a sovereign CDS transaction is considered to be hedging against a default risk or a risk in the decline of the value of assets or liabilities correlated with the value of the referenced sovereign debt

General Conditions

1. In order not to qualify as an uncovered position, a sovereign credit default swap (CDS) position must meet the following conditions:

a) it must serve to hedge against either or both of the circumstances set out in Article 4(1) of the Regulation

b) In relation to hedges for the purpose of Article 4(1)(b), the CDS position must serve to hedge against the risk of decline of the value of assets/liabilities correlated with the risk of the decline of the value of the sovereign debt which the CDS references. There must there-

fore be a consistent significant positive correlation between the value of the asset/liability being hedged and the value of the referenced sovereign debt.

c) A sovereign CDS position referencing a Member State (including any ministry, agency or special purpose vehicle of the Member State, or in the case of a Member State that is a federal state, one of the members making up the federation) may be used to hedge any assets or liabilities meeting the correlation test provided that the obligor of (or counterparty to) such asset/liability is located in the same Member State as the reference sovereign for the CDS. However, where the counterparty is a supra-national European body (e.g. a special purpose vehicle for a number of Member States or the European Investment Bank) it would be permissible to hedge the counterparty risk with an appropriately chosen – as based on the correlation test- basket of sovereign CDS referencing that entity's guarantors or shareholders.

d) For hedges against risk of default of the sovereign issuer and hedges against the risks of the decline in the value of assets/ liabilities correlated to the value of the referenced sovereign debt, the CDS position must be proportionate to the risks it is hedging.

Those entering into a sovereign CDS position should, on request of the competent authority, be able to justify to that competent authority that at the time of the position was entered into it met the above conditions.

Demonstrating Correlation

2. For assets with a liquid market price, correlation should be measured on a historical basis using data for the 12 months of trading days period before the CDS position is taken out. This would require data both for the prices of the asset and for the relevant reference price for the sovereign debt.

3. For assets for which there is not a liquid market price or where there is not a sufficiently long price history, a good proxy should be used. In certain cases such a proxy may be based on economic fundamentals (e.g. the size of the exposure of the company to the sovereign issuer of the reference obligation of the CDS is so large that the company's would be seriously affected if the sovereign's propensity to default increased); in other cases a certain level of similarity between the hedged assets/liabilities to another asset may be sufficient.

Proportionality

4. In determining whether the size of the CDS position is proportionate to the size of the assets/liabilities it is hedging, where a perfect hedge is not be possible, an exact match is not required and limited overprovision would be permissible.

5. Where justified by the nature of the assets/ liabilities being hedged and their relationship to the value of the sovereign debt referenced in the CDS, a greater value of sovereign CDS can be held to hedge a given value of assets/liabilities. However, this should only permissible where it can be clearly demonstrated that a larger value of sovereign CDS is necessary to match a relevant measure of risk associated with the reference portfolio, taking into account such factors as the size of the nominal position, the sensitivity ratio of the asset/liability to the referenced sovereign debt and whether the hedging strategy involved is dynamic or static.

6. It is the responsibility of the position holder to ensure that their CDS position remains covered at all times and the duration of the CDS position should be aligned as closely as possible with the duration of the assets/liabilities being hedged. If assets or liabilities being hedged by the CDS position are liquidated or redeemed, they must either be replaced by equivalents or the CDS position must be accordingly reduced. However, provided that a sovereign CDS position was covered at the time it was entered into, it should not be treated as becoming uncovered if the sole reason for this is a fluctuation in the value of the hedged assets/liabilities or the value of the CDS.

7. Where parties accept a sovereign CDS position as a consequence of their obligations as members of a central counterparty which clears sovereign CDS transactions and as a result of the operation of the rules of that CCP, such a position will be treated as an involuntary one rather than one the party has entered into and so would not fall to be considered as uncovered.

Illustrative cases of assets/liabilities which could be hedged through a sovereign CDS position provided the general conditions are met

(i) A long position in the sovereign debt of the relevant issuer;

(ii) Any position or portfolio used in the context of hedging exposures to a sovereign referenced in the CDS;

(iii) Any assets or liabilities which refer to public sector entities in the Member State whose sovereign debt is referenced in the CDS. This includes exposures to central, regional and local administration, public sector entities or any exposure guaranteed by the referred entity. The assets and liabilities include but are not limited to financial contracts, a portfolio of assets or financial obligations, interest rate or currency swap transactions where the sovereign CDS is used as a counterparty risk management tool for hedging exposure on financial or foreign trade contracts;

(iv) Exposures to private sector entities established in the Member State which is referenced in the CDS. The exposures in question include but are not limited to loans, counterparty credit risk (including potential exposure when regulatory capital is required for such exposure), receivables and guarantees. The assets and liabilities include but are not limited to financial contracts, a portfolio of assets or financial obligations, interest rate or currency swap transactions where the sovereign CDS is used as a counterparty risk management tool for hedging exposure on financial or foreign trade contracts;

(v) Any indirect exposures to any of the above entities obtained through exposure to indices, funds or special purpose vehicles.

Explanatory text

77. Article 4(1) of the Regulation states that "...an uncovered position in a sovereign credit default swap [is] when the sovereign credit default swap does not serve to hedge against:

    a. the risk of default of the issuer where the natural or legal person has a long position in the sovereign debt of that issuer to which the sovereign credit default swap relates, or

b. the risk of a decline of the value of the sovereign debt where the natural or legal person holds assets or is subject to liabilities, including but not limited to financial contracts, a portfolio of assets or financial obligations the value of which is correlated to the sovereign debt."

78. In drafting the advice on this Delegated Act it is important to reflect the scope of the circumstances in which sovereign CDS can be used for hedging as envisaged under Article 4(1) of the Regulation. While the CDS obviously provide protection in the case of a default by the referenced sovereign itself (the case cited by Article 4(1)(a)), they can also play an important role as a hedging tool against a wider range of exposures as set out in Article 4(1)(b). In this latter case their utility to the position holder will not necessarily depend on there being an actual default by the referenced sovereign issuer or other credit event which triggers a payment on the CDS. Instead their use as a hedging tool may result from an increase in value of the CDS, due to a change in credit spreads. Nor under Article 4(1) (b) is it a pre-condition that the CDS must specifically be hedging against credit risk, although in practice this will often be the case. The Delegated Act therefore needs to cover both the situations set out in Article 4(1) but clearly it is the second scenario (Article 4(1)(b)) where greater elaboration is required. The advice therefore focuses more on this aspect.

79. Both the text of the Regulation and the relevant Recital (21) make clear that it is envisaged that a very wide range of risks could potentially be eligible for hedging through a sovereign CDS position. ESMA therefore considers that seeking to set out an exhaustive list of particular cases where risks could legitimately be hedged via sovereign CDS would not be a sensible approach. Such a list would be highly unlikely to cover all such cases and would not be able to take account of future developments. Hedging strategies which met the criteria set out in the Regulation itself might therefore be unreasonably excluded.

80. ESMA therefore considers a better approach is to set out the conditions which need to be met in order for a sovereign CDS position to be a valid hedge for a given risk and thus to be treated as a covered position under the terms of the Regulation. However, these conditions should be supplemented by as many illustrative examples as possible of cases which would be treated as eligible for hedging. This would provide the most useful information to market participants as to what would or would not fall into the category of covered CDS positions.

Scope

81. Recital 21 sets out a wide range of risks, assets and liabilities which could be hedged through a CDS position and these obviously need to be included in the list of illustrative cases. However, from the language of the Recital it is clear that this is certainly not intended to be a comprehensive list. The key tests for the purposes of Article 4(1)(b) are that the sovereign CDS position should serve a hedge for a risk and that the value of the asset or liabilities being hedged should be correlated to the value of the sovereign debt referenced by the CDS. Hence ESMA considers that there should not be any restrictions as regards the scope of the assets/liabilities which can be hedged provided that they meet the conditions of correlation and proportionality.

82. The one exception to this is that the location of the obligor or counterparty referenced in the asset or liability being hedged by the sovereign CDS should be in the same Member State whose sovereign debt is referenced in the CDS. Although there could be risks in one Member State which are correlated with the value of the sovereign debt of another Member State, it was the intention of the co-legislators that the geographical scope of the provision should not be drawn too widely.

However, ESMA considers that provision does need to be made for cases where the counterparty is a supra-national European body (e.g. a special purpose vehicle for a number of Member States or the European Investment Bank). In such cases, the relevant sovereign risks will be those of the entity's guarantors and not the sovereign where it is physically located. Accordingly, it should be permissible to hedge the counterparty risk with an appropriately chosen basket of sovereign CDS.

Level of Correlation

83. As noted above, correlation is a key condition as regards eligibility. To what extent does the value of a non-sovereign debt asset/liability need to be correlated with the sovereign debt referenced in the CDS for the sovereign CDS to be treated as hedging a risk or a decline in value? ESMA has considered whether to recommend specifying a correlation in statistical terms – which was one of the options the Commission mentioned in its request for advice on this topic. This would have the benefit of setting out a clear measure against which to judge whether the correlation test had been met.

84. However, it should be noted that the test set out in Article 4(1) of the Regulation is a general one – simple correlation. The Regulation does not prescribe any particular degree of correlation (unlike in Articles 3(5) and 13(2) dealing respectively with calculations of net short positions in sovereign debt and uncovered short sales in sovereign debt where in both cases a test of high correlation is set.) In addition, whereas Articles 3(5) and 13(2) cover a relatively narrow group of assets – sovereign debt instruments themselves – for which in general there should be price data available to undertake a quantitative measurement of correlation, this is not the case with regards to the assets and liabilities encompassed by Article 4(1). As noted above, a very wide range of assets and liabilities can potentially be considered as being eligible for hedging by a sovereign CDS and the correlation test will have to be applied in cases where there may not be a sufficient run of data. Finally, it is also clearly relevant that, whereas Articles 3(5) and 13(2) of the Regulation are drafted in terms of the pricing of the respective sovereign debt being highly correlated, Article 4(1) specifies correlation in terms of value. For these reasons ESMA therefore considers that as regards the Delegated Act relating to Article 4 it is better not to produce a very precise quantitative definition as to the extent of the correlation required. There must be a clear positive directional dimension to the correlation[3] but a general qualitative statement should be sufficient and would not risk setting an overly precise boundary.

Measuring Correlation

85. As regards measuring correlation between the value of an asset/liability and the referenced sovereign debt, ESMA recognises that the method will depend on the nature of the asset or liability in question. Where there is historical data for a sufficiently long period (at least 12 calendar months of trading days), this should be used as providing the best assurance that genuine correlation exists.

86. ESMA recognises, however, that for some risks to be hedged via a sovereign CDS there will not be a liquid market price or a long enough price history. Where this information is not available, a good proxy should be used. In certain cases such a proxy may be based on economic fundamentals

[3] Where the sovereign CDS is hedging a liability as opposed to an asset, the correlation could be a negative one: if the price of the sovereign debt was decreasing,the absolute value of the liabilities which the CDS was hedging could be going up.

(e.g. the size of the exposure of the company to the sovereign issuer of the reference obligation of the CDS is so large that the company's would be seriously affected if the sovereign's propensity to default increased); in other cases a certain level of similarity between the hedged assets/liabilities to another asset may be sufficient. It is also important to note that there will be cases where although the value of an asset/liability does not change in the holder's books, the risk profile of the asset is linked to the risk profile of the sovereign in question. But in all cases the position holder must be able to justify before entering into a sovereign CDS transaction that the values of the hedged risk and the sovereign debt are correlated.

Proportionality

87. A further condition which ESMA sees as essential if a sovereign CDS position is to be treated as a covered one is proportionality. The value of the assets/liabilities hedged by the sovereign CDS should be broadly proportionate to the value of the sovereign debt to which the CDS is referenced at the time the position is entered into. A position holder cannot be considered to have a covered CDS position if the value of the sovereign CDS is disproportionately large in comparison with the size of the risks it is intended to hedge. However, ESMA recognises that obtaining a perfectly hedged position may not be possible. In addition, the Delegated Act should cater for cases where, because of the nature of the asset held, it would be legitimate to hold more sovereign CDS than the notional value of the exposure (e.g. if every 1% change in the value of the referenced sovereign debt was matched by a 2% change in the value of the hedged asset). Where the position holder has a CDS position which is greater than the value of the assets/liabilities being hedged, they would need to be able to demonstrate that this was justified for the purposes of the hedge taking into account such factors as the size of the nominal position, the sensitivity ratio of the asset/liability to the referenced sovereign debt and whether the hedging strategy involved is dynamic or static. This issue is discussed further below in the section dealing with method of calculating positions.

88. The principle that a CDS position should be proportionate to the risks it is hedging should be the case not only at the point at which the CDS transaction was entered into but also for the duration of the position. It would clearly frustrate the purpose of Article 4 if, after the CDS position was taken out, the risks it was hedging were subsequently reduced or removed (e.g. through the liquidation of the hedged assets or liabilities) without any change in the size of the CDS position, thus leaving a wholly or partially uncovered position. ESMA therefore considers that the general principle must be that the position holder is responsible for ensuring that their sovereign CDS position remained covered for the duration of the position. If assets or liabilities being hedged by the CDS position are liquidated, they must either be replaced by equivalents or the CDS position must be accordingly reduced.

89. However, ESMA recognises that there will be cases where, due to fluctuations in the value of the assets or liabilities being hedged and/or the CDS used as the hedge, what was a matched position at the time it was entered into could become unmatched even though there had been no change in the portfolio. The fact that the position had become partially uncovered would not be the result of any actions on the part of the position holder and it would seem unjustified to treat these cases as infringements of the restriction on holding uncovered positions. Hence ESMA considers that, as a derogation from the general principle of the responsibility of the position holder to ensure the position remained covered, the Delegated Act should recognise that changes in market valuations without any active change of position by the CDS purchaser would not affect the covered status of the sovereign CDS position. However, it might be envisaged to set up a time limit to such a situa-

tion of non-proportionality, in order to not have them remaining for an unlimited period and thus conflicting with the intention of the Regulation.

Involuntary uncovered sovereign CDS positions

90. ESMA also considers that the provision needs to be made under the Regulation for parties which are required to accept uncovered sovereign CDS positions on an involuntary basis. The prime example of this would be general clearing members of central counterparties (CCPs) which clear sovereign CDS transactions. Two circumstances in which such a party might find itself with an involuntary sovereign CDS position are daily valuations and crossing.

91. The first results from the fact that CCPs require daily (and sometimes intraday) valuations in order to calculate the variation and initial margin that each member needs to post. It is not always possible to guarantee that real prices for the relevant OTC derivatives such as sovereign CDS can be observed in the market at the precise times required by the CCP. Hence many CCPs have a process by which their members are contractually obliged to provide prices at certain times to the CCP. In order to ensure that the price provided are as "real" as possible, there is a process by which randomly selected crossed pairs of trades may be obliged to actually settle i.e. the member has to enter into the trade at the price provided. This is an extremely effective way of ensuring sufficient attention is expended and avoiding manipulation of the prices provided. For sovereign CDS, however, this crossing process could oblige members to enter into a CDS position which would be uncovered according to the Regulation if they did not have assets/liabilities which were eligible for being hedged by the CDS position.

92. The second circumstance involves the default of a member of the CCP. When this happens, the CCP has a range of tools at its disposal to manage down the market risk that their member has left it exposed to. These include macro hedging and auctioning off the portfolio of the defaulted member. If the auction fails, some CCPs fall back to a process called Forced Allocation where the portfolio of the defaulted member is divided up and given (along with margin) to some or all of the remaining members. This process could result in one or more of the members of the CCP being allocated a sovereign CDS position. Again the member might not own the underlying sovereign debt or an eligible offsetting asset/liability.

93. ESMA does not consider that either of these situations are cases which the restriction on uncovered sovereign CDS positions was intended to address. Any sovereign CDS positions a clearing member of the CCP was obliged to accept would be a by-product of processes designed to ensure the prudent operation and stability of the CCP rather than the result of any party voluntarily entering into a directional position in the CDS. As such, they should not fall to be treated as uncovered CDS. However, any involuntary uncovered sovereign CDS positions which were obtained would be expected to be closed or rendered covered by the holder as soon as possible.

Q20: Do you agree with the general conditions proposed for determining when a sovereign CDS position can be considered covered? Are there any modifications you would propose?

Q21: Do you have any comments or alternative suggestions on the proposed test for correlation? Do you have any estimates of the costs which applying the qualitative test envisaged by ESMA would entail for market participants or the costs which would be associated with the imposition of a quantitative test?

Q22: Do you consider the proposals for demonstrating correlation provide a workable framework for market participants?

Q23: Are any changes required to the proposals for determining whether a sovereign CDS position is proportionate?

Q24: Do you think that a position that had become partially uncovered due to fluctuations in the value of the assets or liabilities being hedged and/or the CDS used as the hedge should be allowed only for a certain period of time? If so, what would be an appropriate time limit?

Q25: Do you agree that sovereign CDS positions which are obtained involuntarily as a result of the operations of a CCP clearing sovereign CDS should not fall to be considered as entering into a CDS transaction for the purposes of the Regulation?

Q26: Do you consider there are any other illustrative cases of a risk which would be eligible to be hedged by a sovereign CDS position which should be included in the indicative list?

III.II. Method of calculating an uncovered Position

Box 7

Draft Advice on method of calculation of an uncovered sovereign CDS position

1. In calculating a party's sovereign CDS position its net position should be used (i.e. deducting any sales of CDS in the referenced sovereign from its CDS purchases).

2. In calculating the value of the eligible risks hedged/to be hedged by a sovereign CDS position a distinction should be drawn between static and dynamic hedging strategies. For static hedging (e.g. direct exposures to sovereign or public sector bodies in the sovereign) the metric used should be the jump to default measure of the loss if the entity to which the position holder is exposed defaults. The resulting value can then be compared against the net notional value of the CDS position.

3. In determining the value of market value adjusted risks (e.g. swaps) for which a dynamic hedging strategy is required, the calculations can be undertaken on a risk-adjusted rather than notional basis, taking into account the extent to which an exposure might increase (or decrease) during its duration and the relative volatilities of the assets/liabilities being hedged and of the referenced sovereign debt. A beta adjustment should be used if the asset/liability for which the CDS position is being used as a hedge is different to the reference asset of the CDS.

4. Indirect exposures to risks (through indices, funds, special purpose vehicles etc) and to CDS positions should be taken into account in proportion to the extent the reference asset/liability/CDS is represented in the index, fund or other mechanism.

5. The value of the eligible portfolio of assets/liabilities to be hedged should then be deducted from the value of the net CDS position held. If the resulting number was positive it would be an uncovered CDS position.

Explanatory text

94. ESMA is requested to provide advice on the method of calculation of an uncovered position in a sovereign CDS. This breaks down into calculating the value of the CDS position itself; the value of the risk assets or liabilities the CDS position is intended to hedge; and how to determine what size of CDS position is required to hedge a given value of risk – as previously explained this will not necessarily be on a one for one basis. This section of the advice also deals with the issue of how indirect exposures (e.g. through indices, funds, etc) should be treated

95. As regards calculating the value of the sovereign CDS position, it is necessary to decide whether the position should be the net one (i.e. deducting any sales by the position holder of the relevant sovereign CDS from the purchased CDS) or the gross. The argument in favour of using the net position is that if a market participant has sold protection via a CDS referencing a sovereign debt issuer, it is exposed to risk related to that sovereign issuer. It is reasonable to hedge its risk by purchasing sovereign CDS and to treat its own purchases as offsetting its sales (in the same way that a short position in shares offsets a long position and should be deducted in calculating the net position). The net approach would be consistent with the objective of the Regulation and the approach taken in relation to short positions in shares and sovereign debt.

96. How is the value of the assets/liabilities which the CDS is intended to hedge to be calculated? ESMA considers that there should be different methods for assessing the size of the risk position depending on the nature of the hedging strategy. For 'static' hedges dealing with default risk (e.g. where the CDS position is hedging against a direct exposure to the sovereign) the notional value of the assets/ liabilities would be a suitable choice as well as being easy to compute. The metric would be the straightforward jump to default measure (i.e. how much you would lose if the entity defaults).

97. However, CDS positions are also used to hedge dynamic risks (e.g. swap positions). Using the notional value of the assets/liabilities is not suitable for assets/liabilities which are explicitly market value adjusted. For these cases, using the notional values alone would not reflect the fact that the exposure of the position holder could increase during the lifetime of the contract (e.g. due to currency fluctuations). In addition, the value of an asset may be more (or less) volatile than the value of the sovereign debt referenced. So it would be reasonable to apply an adjustment factor to take into account the relative volatilities (risk adjusted values). Thus the CDS position could be risk adjusted (e.g. "beta-adjusted") to translate this risk into the same terms as the risk associated with the assets and liabilities which it is intended to hedge. For example, an asset valued at € 10m whose beta with the referenced sovereign debt is 1.2 could be hedged by a €12m CDS position. A sensitivity approach should be used in calculating the effect of the hedge as well as the sensitivity of the asset/liability. This makes calculations more complicated but provides that the value of the CDS position permitted is more closely tied to value of the hedged asset and reflects the purpose of the hedge.

98. How should indirect exposures (e.g. through indices, funds, etc.) be treated? Recital 21 explicitly makes clear that indirect exposures (through indices, funds, special purpose vehicles etc) should be taken into account when considering the assets/liabilities which a sovereign CDS is used to hedge. ESMA considers there is no sensible alternative here to taking those exposures into account in proportion to the extent that the reference asset/liability is represented in the index, fund etc.

99. Having calculated the value of portfolio of assets/ liabilities to be hedged (risk adjusted as appropriate), there would be an uncovered position if the value of the sovereign CDS position being used as the hedge exceeded this value.

100. In determining the size of an uncovered sovereign CDS position in circumstances where a competent authority has temporarily suspended the restriction on holding such positions, the value of the CDS position should be calculated on the same basis as that used for determining whether an investor holds a net short position in relation to the sovereign debt instruments of a sovereign issuer.

Q27: Do you agree that the net CDS position is the correct one to use in the calculations?

Q28: Do you consider that there should be different methods for calculating the value of the positions to be hedged by the sovereign CDS according to whether a static or dynamic hedging strategy is used?

Q29: Are there refinements which can be made to the proposed methodology? Are there any standard calculation formulae which can be used when applying risk adjustments which we should include in the draft advice?

Q30: Do you agree with the proposed method of treating indirect exposures?

IV. Specification of the amounts and incremental levels of notification thresholds referred to in Article 7(2) for net short positions relating to the issued sovereign debt of a sovereign issuer (Article 7(3))

101. Investors (natural or legal persons) are required to report net short positions that they hold in relation to the issued sovereign debt of a sovereign issuer to the relevant competent authority, when those positions equal or cross up or down specified notification thresholds.

Extract from the Commission's request

ESMA is invited to provide its technical advice on amounts and incremental levels of notification thresholds for net short position related to the issued sovereign debt of a sovereign issuer.

Box 8

Draft Advice on the amounts and incremental levels of notification thresholds for net short positions relating to the issued sovereign debt of a sovereign issuer

1. The relevant measure for the threshold that triggers notification to the relevant national authority of net short positions related to the issued sovereign debt of a sovereign issuer is built from a percentage of the total amount of outstanding issued sovereign debt for each sovereign issuer.

2. The reporting threshold corresponds to a monetary amount. This monetary amount is fixed on the basis of the conversion (rounding up to the nearest million Euros) of the percentage threshold applied to the outstanding sovereign debt of the sovereign issuer.

3. The monetary amount implied by the percentage threshold is revised and updated quarterly in order to reflect changes in the total amount of outstanding issued sovereign debt of each sovereign issuer.

4. The monetary amount implied by the percentage threshold and the total amount of outstanding issued sovereign debt are calculated in accordance with the method of calculation for net short positions in sovereign debt.

5. The initial amounts and additional incremental levels for sovereign issuers are set using the following factors:

a) The thresholds will not require notifications of net short positions of minimal value in any sovereign issuers.

b) The total amount of outstanding sovereign debt for sovereign issuers and average size of positions held by market participants relating to the sovereign debt of that sovereign issuer.

c) The liquidity of the sovereign debt market of each sovereign issuer, including, where appropriate, the existence of a liquid futures market for that sovereign debt.

6. Taking into account these factors, the relevant notification thresholds for the initial amount to be considered for each sovereign issuer are a percentage that equals 0.1 %, o,25% and 0,5% of the total amount of outstanding issued sovereign debt. The relevant percentage to be applied for each issuer shall be determined in application of the criteria described in par 5, so that each sovereign is-

suer is assigned one of the three percentage thresholds used to calculate the monetary amounts that will be relevant for notification.

7. The additional incremental levels will be set at 50 % of the initial thresholds. Therefore, the incremental levels will be :

- each 0.05 % above the initial notification threshold of 0,1% (0.15 %, 0.2 %, 0.25 % etc);

- each 0.125 % above the initial threshold of 0,25% (0.375%, 0,5 %, 0.625 % etc).

- each 0.25 % above the initial threshold of 0,5% (0.75 %, 1 %, 1.25 % etc).

8. Where a change in the sovereign debt market of a sovereign issuer (in terms of the factors specified in paragraph 5) warrants this, the sovereign issuer shall move to the appropriate threshold group.

Explanatory text

General approach to setting the thresholds – percentages of total issued sovereign debt and corresponding monetary amounts

102. The Regulation stipulates that the relevant notification thresholds shall consist of an initial amount and then additional incremental levels in relation to each sovereign issuer. Article 7(3) specifies that when devising the relevant notification a number of factors should be taken into account. First, these thresholds should not be set at such levels which would imply that net short positions of minimal value are required to be notified to the relevant competent authority. Second, the proposed thresholds should take into account the total amount of outstanding issued sovereign debt for each sovereign issuer, and the average size of positions held by market participants relating to the sovereign debt of that sovereign issuer. Last, the liquidity of each sovereign bond market is also to be taken into account.

103. In providing its draft advice on this Delegated Act, ESMA has also taken into account Recital 8 of the Regulation. This states that 'Notification to regulators of significant net short positions relating to sovereign debt in the Union should be introduced as it would provide important information to assist regulators in monitoring whether such positions are in fact creating systemic risks or being used for abusive purposes. '

104. ESMA proposes that the relevant measure for the threshold that triggers notification to the relevant national authority should be defined as a percentage of the total amount of outstanding issued sovereign debt for each sovereign issuer. The rationale for this approach is that it is the percentage of the outstanding issued sovereign debt that is relevant in terms of potential volatility. Using a percentage threshold also caters for the differing sizes of issued debt in the various sovereign issuers. Finally, defining the threshold as a percentage would avoid the necessity of adjusting the initial threshold as the outstanding issued sovereign debt levels changes with time. Setting a threshold purely in terms of a monetary amount, unrelated to the outstanding sovereign debt, could mean that the threshold becomes either too high or too low as the case may be in the light of developments in the size of individual sovereign debt markets.

105. However, ESMA also sees the need to take into account the fact that there are frequent new issues of sovereign debt and issues which are maturing. For many sovereign issuers therefore the amount of total issued sovereign debt is frequently changing. To provide some stability and clarity for

market participants ESMA therefore proposes that the percentage thresholds should be converted into monetary amounts (rounded up to the nearest million Euros). This monetary amount would be recalculated on a quarterly basis by competent authorities to take into account changes in the issued sovereign debt over the previous month/quarter. The figures for both the total amount of outstanding issued sovereign debt and the monetary amount implied by the percentage threshold would be published by ESMA based on the data provided by competent authorities. Both these values (the numerator and the denominator in the calculation of the percentage threshold) would be calculated in accordance with the proposed method of calculation for net short positions in sovereign debt [see chapter II.IV 2)]. The figures for the threshold amounts and the total issued debt would then remain valid until the following quarter for the purposes of determining whether a notifiable net short position was held. This approach would be broadly in line with that taken for the reporting of significant long positions under the Transparency Directive.

Q31: Do you agree that the relevant notification threshold should be based on a percentage of the total amount of outstanding issued sovereign debt for each sovereign issuer?

Q32: Do you agree with the proposal to convert these percentages into monetary amounts which would be updated quarterly to reflect changes in the issued sovereign debt? If not, what other arrangement would you suggest?

What thresholds should be set for sovereign issuers?

106. In specifying the notification threshold for significant net short positions in sovereign debt for sovereign issuers ESMA has considered a number of possible alternatives, analysing the advantages and disadvantages of each option.

107. One option would obviously be to set a single percentage to calculate the thresholds for all sovereign debt issuers. This would be in line with the approach taken by the Regulation in relation to shares where there is one uniform percentage trigger applicable to all shares whatever the size of the issued share capital or liquidity or the Member State in which the share is traded. However, ESMA considers that setting a single percentage to define the threshold for all sovereign issuers would not be optimal as it would be difficult to find an appropriate one-size-fits-all threshold valid for all sovereign issuers. It would also appear difficult to reconcile such an approach with the provisions of Article 7(3) of the Regulation. For example, depending on the level of the threshold and the size of the outstanding issued sovereign debt, having only one specified percentage threshold may mean that for some sovereign issuers a large number of net short positions, including those which are of minimal value, are always reported, whereas for other sovereign issuers the same threshold may imply that no reporting at all takes place. Such a result would not be in line with the intention of the Regulation to enable authorities to identify and monitor those net short positions likely to have some impact on the sovereign debt of each sovereign issuer and which might contribute to creating systemic risks or potential market abuse.

108. Another alternative would be to set individual percentages to establish the monetary amount threshold for each sovereign issuer. On the one hand this would provide the possibility to set thresholds precisely tailored to the situation of each individual sovereign issuer, ensuring the notifiable positions best reflect the liquidity and size of the market and maximising the likelihood that the reports generated would be of some value to national authorities.

109. On the other hand, from a practical point of view, it would mean that market participants would have to cope with a great array of percentages, one for each sovereign issuer setting nearly 50 different percentage thresholds would to some extent run counter to the harmonising intent of the Regulation, leaving a fragmented situation of individual requirements for the reporting of net short positions in sovereign debt. So while a one-size-fits-all solution is not recommended by ESMA, neither is setting a multiplicity of divergent percentages in order to establish the monetary thresholds.

110. Instead, ESMA considers that the best approach is a solution which would group sovereign issuers into broad categories according to the factors set out in the Regulation. This would provide a balance between providing meaningful information on short positions to national authorities whilst avoiding a confusing panoply of different percentages used for calculating the monetary thresholds. In determining the categories of thresholds it is necessary to take into account the size of the outstanding issued sovereign debt[4] and the liquidity of the sovereign debt market in absolute terms, i.e. as measured by total turnover. As a starting point, it might be considered that the larger and the more liquid a particular sovereign debt market is, the higher the notification threshold should be set. In some sense these measures would also provide a proxy for the average size of positions of the market participants as this parameter should be positively correlated to the size and absolute liquidity of the sovereign debt market. However, it is important to note that it should by no means be assumed that a small sovereign debt market is necessarily an illiquid one and hence the size of the market should obviously not be the sole determinant.

111. Other factors also need to be taken into account. For example, in determining absolute liquidity, the existence of a liquid futures market for sovereign debt can be very important. A highly liquid market for sovereign bond futures implies a high turnover. Indeed there may be much more trading taking place in the bond futures market than in the actual market for the sovereign debt. In addition, the existence of a bond futures market makes it easier for market participants to take short positions (in fact they may have larger positions in the futures market than the cash market). In such markets a given short position may have less market impact than in those of other sovereign issuers. Correspondingly, requiring reports of such positions may have much less value for the national authorities in terms of checking for systemic risk or potential market abuse. Another factor to consider is the organisation of the secondary market, including market making arrangements, for the sovereign debt in question which may also contribute to the liquidity of the market.

112. Taking into account the criteria outlined above and the information available to it regarding the sovereign debt markets of sovereign issuers ESMA considers that three different categories of threshold can be set as follows:

    a. An initial threshold of 0.1 %

    b. A threshold of 0.25 %

[4] Annex V: table showing the total outstanding sovereign debt at the end of 2010 for the 27 Member States along with a bar chart on these nominal values. The table indicates the implied monetary amount for different alternatives of percentage thresholds. In addition, a table with the total outstanding sovereign debt issued by the 16 German federal states and the monetary amount for different thresholds is also attached, in order to give a picture of the implications for the Member States that are federal states.

c. A threshold of 0.5 %

113. For each category the additional incremental levels are set at 50 percent of the initial threshold. For those sovereign issuers that would apply an initial threshold of 0,1% the incremental levels will thus be 0.15 %, 0.2 %, 0.25 % etc; for those applying the 0,25% threshold the incremental levels will be 0.375%, 0,5 %, 0.625 % etc, and for the 0,5% threshold the incremental levels will be 0.75 %, 1 %, 1.25 %, etc.

114. In all cases, these percentages would be used to calculate the appropriate monetary amount that would be published for each sovereign and that would be the relevant reference to ensure compliance with the disclosure obligations under the Regulation.

115. If there is a significant change in a sovereign issuer's sovereign debt market in terms of the factors listed above which would require a change in its categorisation for the purposes of the reporting thresholds, this would need to be announced to the market a month before the new reporting thresholds came into effect.

116. ESMA believes that this solution will enable and facilitate the reporting and the monitoring of those net short positions which are indeed significant, while at the same time catering for the diversities of the sovereign debt markets in the Union. It also accounts for the size of the issued sovereign debt, thereby most likely also capturing the average size of positions held by market participants, and the liquidity of the sovereign debt markets, taking into account both cash and futures markets. It also has the advantages of simplicity and practical easiness of application. Investors, whether legal or natural, would find it easier when they have to deal with only three thresholds instead of keeping track of all the different thresholds varying by sovereign issuer. Thus, this option facilitates legal certainty while at the same time reducing the administrative burden for market participants.

117. In terms of the need for a review mechanism for the thresholds, Article 45 specifies that the Commission shall, after discussions with the competent authorities and ESMA, report to the European Parliament and the Council on the appropriateness of, among others, the reporting and disclosure thresholds of significant net short positions related to the issued sovereign debt.

Q33: Do you agree with ESMA's proposal to group sovereign issuers into categories for the purposes of setting the notification thresholds or would you prefer an alternative approach (e.g. a single threshold for all sovereign issuers or setting individual thresholds for each sovereign issuer)? Please state your reasons.

Q34: If you support grouping sovereign issuers into categories, do you agree with ESMA's proposal to set the three categories of notification thresholds suggested above? If not, what other grouping would you suggest and why?

Q35: Do you consider the proposed initial amounts and the incremental levels as reasonable and optimal? If not, what amounts and incremental levels do you consider as more appropriate and why?

Q36: If given the thresholds ESMA has proposed above are implemented, how many notifications do you expect to make in a month to each relevant competent authority?

Q37: What level of net short position do you regard as significant for the particular sovereign debt markets?

V. Specification of the parameters and methods for calculating the threshold of liquidity referred to in Article 13(3) in relation to the issued sovereign debt for suspending restrictions on short sales of sovereign debt (Article 13(4))

Extract from the Commission's request

ESMA is invited to provide its technical advice on the parameters and methods for calculating the threshold of liquidity for suspending restrictions on short sales of sovereign debt. The parameters and methods for Member States to calculate the threshold shall be set in such a way that when the threshold is reached, it represents a significant decline relative to the average level of liquidity for the sovereign debt concerned. This threshold shall be defined based on objective criteria specific to the relevant sovereign debt market, including the total amount of outstanding issued sovereign debt for each sovereign issuer.

Box 9

Draft advice on the parameters and methods for calculating the threshold of liquidity of the issued sovereign debt for suspending restrictions on short sales

1) The measure of liquidity of the issued sovereign debt to be used by each competent authority is the turnover, defined as the total nominal value 0f debt instruments traded, in relation to a basket of benchmarks with different maturity buckets.

2) The temporary suspension of restrictions on uncovered short sales in sovereign debt may be triggered when the turnover of a month falls below the 5th percentile of the monthly volume traded in the previous twelve months.

3) To make these calculations each competent authority shall use the representative data readily available, from one or more trading venues, from OTC trading or from both, and inform ESMA of the data used.

4) Before the competent authorities exercise the power to lift the restrictions on short-selling related to sovereign debt, they should ensure that the significant drop in liquidity is not the result of seasonal effects in liquidity.

Explanatory text

118. The Regulation on Short Selling and certain aspects of Credit Default Swaps foresees the circumstances in which a natural or legal person may enter into a short sale of sovereign debt, imposing a 'locate rule', in order to restrict the potential risk of settlement failure and volatility that may stem from uncovered short sales.

119. Market makers as well as primary dealers are exempted from these requirements.

120. The Regulation specifies that where the liquidity of sovereign debt falls below a threshold to be defined by the Commission, the restrictions on entering into a short sale may be temporarily suspended by the relevant competent authority. Before suspending these restrictions, the relevant

competent authority shall notify ESMA and other competent authorities about the proposed suspension.

121. The key issues at stake are (i) calculation data; (ii) measure of liquidity, and (iii) definition of the threshold (and its calculation's time frame).

Calculation data

122. In view of the rationale behind the power conferred to the competent authorities to suspend restrictions on uncovered short sales when there is a significant fall in the average level of liquidity for the sovereign debt, it is considered any lifting of such restrictions should be done for the sovereign debt as a whole rather than particular debt instruments.

123. In this scenario, theoretically, each Member State may calculate one threshold for the whole sovereign debt:

a. proceeding with the calculation of the liquidity for each and every issue;

b. taking a representative sample, such as a basket of benchmark issues with different maturity buckets , or using a single benchmark, for instance the 10 year Bond , as a proxy for the whole sovereign debt.

124. The first option acknowledges that the behaviour in the secondary market for different sovereign debt instruments is not homogeneous. However, on the other hand, it requires gathering data and monitoring of the liquidity in relation to each and every sovereign debt instrument for that issuer.

125. The second option is easier to implement and, in principle, it may be assumed that if the basket is suffering a significant decline in liquidity, then the sovereign's other issues will be suffering too. Equally, it seems unlikely that liquidity in other issues will suffer a significant decline without this also being the case with the basket.

126. ESMA is of the opinion that using the liquidity of a basket of benchmark issues with different maturity buckets as a proxy for the liquidity of the sovereign bond market as a whole would make calculation and monitoring simpler, and does not impair an accurate understanding of the sovereign bond market as a whole.

127. The other issue to be dealt with is the market (in a broad sense) from which the data (transactions, prices and/or offers) will be used.

128. In discussing this issue, one should bear in mind the peculiarities of the sovereign debt markets. In general, in this market most participants (typically primary dealers) take up their positions in auctions and maintain them in secondary markets. In addition, unlike shares, sovereign debt instruments are not always admitted to trading on a trading venue (such as a regulated market or a MTF) and, even when they are, they are regularly traded OTC rather than on the venue itself, which may impair the liquidity of the debt instruments on the trading venue.

129. Besides being negotiated often OTC, the level of concentration/fragmentation of the trading venues in which sovereign debt is traded is not homogeneous. While in one Member State, it may be possible to identify a single representative trading venue, in others the data will need to be collected from a number of trading venues.

130. MIFID requires investment firms to report to the competent authority transactions executed in financial instruments admitted to trading on a regulated market (article 25).

131. In these circumstances, ESMA proposes that each competent authority should use the representative data readily available, from one or more trading venue, from OTC trading or from both.

132. In order to calculate the liquidity, each competent authority will have to decide what trading venues are to be considered and/or if it will use data from OTC trading and inform ESMA accordingly.

133. The competent authorities shall cooperate with each other for the purpose of calculating the liquidity measure of the sovereign debt, as each Member State is not the home Member State of all trading venues and will have to obtain trading data on sovereign debt from each trading venue considered.

Measure of liquidity

134. The definition of a measure of liquidity to be used by each Member State is crucial as it is going to be used for the determination of the thresholds.

135. There are several measures of liquidity which may be grouped in one variable measure or composite measures. The measures that take only one variable into account are, for instance, those based on the trades (turnover, number of trades) or on the orders (spread bid/offer, volume offered, number of bids). A measure that combines properties of different types of measure would be one that combines, for instance, turnover and bid-offer spread.

136. The composite measures have the disadvantage of using as inputs several variables, which makes them more complex and difficult to calculate. This difficulty is made worse if one considers that the data in question may come from different trading venues with different characteristics[5].

137. It is possible to calculate a composite liquidity measure of sovereign debt that combines, for instance, the turnover traded and the spread bid-offer. Such a measure implies determining, first of all, the weighting of each factor (for instance 75% to turnover and 25% to the bid-offer spread) and defining bid-offer spread (e.g. spread at a specific moment/period or the minimum spread of the trading day). In order to compute it, each competent authority will have to store data on all trades and orders for all trading venues to be considered and calculate the bid-offer spread. This would be a significant task.

138. In ESMA's view the measure more appropriate to calculate the liquidity of the sovereign debt should be the turnover: total nominal value 0f bonds traded.

139. This one-variable measure is deemed appropriate for several reasons. It is simple to apply, is used very often and such information is easy to obtain when compared with those required for other

[5] This has certainly be considered, when establishing the criteria for the determination of liquid shares, for MiFID purposes, which takes into account non composite measures (article 22 of MIFID Regulation 1287/2006).

measures, notably those involving orders. It is also worth noting that, in the sovereign debt market, a measure based on bid/offer spread would be affected by the market makers activity.

Definition of the threshold and reference time frame

140. The thresholds can be defined in an absolute or a relative way.

141. An absolute threshold corresponds to the determination of a specific amount of liquidity. For example, when using turnover as the measure of liquidity, a threshold would be "XXX M €." When used in relation to several instruments, the disadvantage of this choice relates to the need to define a different threshold for each financial instrument, since the levels of liquidity can vary from instrument to instrument. So a certain threshold could thus be suitable for a particular instrument, but inappropriate for others. With regard to a basket of benchmarks, the drawback of an absolute threshold is the fact that it may not take into account changes in market conditions.

142. A relative threshold would correspond to the determination of relative values of liquidity. For example, "75% of the average market liquidity in the previous 12 months," or "two standard deviations below the average market liquidity in the previous 12 months ", or "the 5th percentile of the monthly volume traded in the last 12 months "[6].

143. ESMA considers that it is better to adopt a relative threshold which considers the distribution of the liquidity and, therefore, when it is reached it represents a significant decline relative to the average level of liquidity. From the three examples above, one of the most suitable would be "the 5th percentile of the monthly volume traded in the last 12 months." The 5th percentile criterion[7] has the advantage of providing a value for the threshold comprised in the distribution of data considered for liquidity, which does not happen in the other two cases. In theory and assuming a normal distribution of the data, crossing a threshold would happen once in 20 months. Though evidence

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[6] For instance, if the reference time for calculation of the liquidity corresponds to a sample of twelve monthly observations, as foreseen above:
75% of the average market liquidity in the previous year: This measure consists of calculating the average of 12 monthly observations of liquidity (number of bonds traded in terms of nominal value), month to month from -13 to -2. Then the result of such calculation is multiplied by 75% and the end result is compared with the liquidity figure recorded in the last month (-1). If the end result is greater than the value of the liquidity of the month -1, there is a significant decline in liquidity.
Two standard deviations below the average market liquidity in the previous year: This measure consists of calculating the average of twelve monthly observations of liquidity, month to month from -13 to -2. Two standard deviations are then calculated and subtracted from the average. If the end result is greater than the value of the liquidity of the month -1, there is a significant decline in liquidity.
The 5th percentile of the monthly volume traded in the last 12 months: This measure consists in sorting the monthly observations of liquidity in ascending order. The rank of the observation that corresponds to the 5th percentile is then calculated and rounded to the nearest integer. Lastly, one picks out the value that corresponds to the observation rank rounded. If the liquidity of the last month (-1) is lesser than the value of the liquidity of the month with the lowest value of liquidity in the period -13 to -2, there is a significant decline in liquidity. For example, if we wanted to assess the liquidity to January (-1), knowing that the monthly distribution of liquidity over the previous 12 months was as follows:

Month (Obs.)	Jan (-13)	Feb (-12)	Mar (-11	Apr (-10)	May (-9)	Jun (-8)	Jul (-7)	Aug (-6)	Sep (-5)	Oct (-4)	Nov (-3)	Dec (-2)	Jan (-1)
Liquidity	4.1	3.5	6.2	4.6	5.0	3.7	2.4	5.1	3.2	4.4	5.8	3.3	2.2

, then the conclusion would be that we were facing a period of low liquidity, since the value of liquidity in January (-1), which is 2.2, is lower than the minimum value of liquidity over the last 12 months, which is 2.4, corresponding to July(-7)).

[7] According to this criterion, the threshold is triggered when the liquidity of the reference month falls below the lowest monthly liquidity of the previous 12 months.

in one European country shows that over the last 21 years, it would have happened 22 times[8] but it should be noted that the concentration of the contraction of the liquidity has happened in various months of 6 years in that example.

144. The two standard deviation criterion allows a great drop in liquidity if the series includes significant variation among the data (e.g. only the seasonal effect or the lack of homogeneity among the number of trading days per month). A drop of 25% in the volume could trigger the application too late when the situation might have entered into a drying spiral of liquidity.

145. In calculating such thresholds, additional questions would be (i) the period of time for comparison, (ii) the reference time to establish the fall in liquidity, and (iii) the frequency of the analysis of the competent authority.

146. As far as the first question is concerned, in the examples above, the relevant period for comparison data is set at 12 months (365 calendar days). ESMA considers this is the minimum length of time necessary to be considered. A shorter period, for instance 3 or 6 months, runs the risk of basing the decision on a period which may not be properly representative of the usual level of trading in the sovereign debt. Setting a 12 month period as the frame of reference will also help to enable seasonal variations in liquidity (e.g. during the summer holidays or the Christmas/New Year period) to be taken into account. When the CAs exercise the power to lift the restrictions on short-selling related to sovereign debt, they should ensure that the significant drop in liquidity is not the result of any of the above mentioned seasonality effects.

147. However, with regard to the time frame of the input data needed to calculate the fall in liquidity, one month (30 calendar days) would be enough, to ensure prompt action from the competent authority. ESMA considers it reasonable and in line with the intention behind Article 13 that national authorities would want the ability to intervene promptly in the face of a significant decline of liquidity in order to prevent a downward spiral in liquidity developing.

148. Hence, the liquidity of a given month period shall be compared with the market liquidity for the previous 12 month period.

149. Finally, ESMA considers that the decision on how often the competent authority calculates the liquidity in order to decide whether or not to suspend the restrictions on uncovered short sales is to be taken by each competent authority. Thus, competent authorities can, for example, calculate the liquidity of the sovereign debt market on a daily, weekly or monthly basis, but always in relation to the previous 30 calendar days.

150. In this particular issue, it should be recalled that Recital 22 (although not directly applicable as it relates to the parallel issue of suspension of restrictions on uncovered CDS in sovereign debt) mentions that the competent authority should be empowered to suspend such restrictions «at the first initial signals that the sovereign debt market is not functioning properly».

[8] Based on a simulation on sovereign bond of a Member State during the last 21 year on monthly basis
the 2 standard deviation (2 sigma criterion) threshold only triggered twice, the "75% of the average market liquidity" (a drop of 25%) happened 20 times, the 10th percentile occurred 32 times and the 5th percentile 22 times.

Q38: Do you agree with the general proposal suggested by ESMA for setting the parameters and methods for calculating the threshold of liquidity of the issued sovereign debt for suspending restrictions on short sales? If not, please state your reason and explain what could be an appropriate alternative.

Q39: In particular, do you agree that a measure in percentiles of the monthly volume traded in the last twelve months is suitable to define a threshold that represents a significant decline relative to the average level of liquidity for the sovereign debt concerned?

Q40: In light of your response to the question above, do you think that a threshold of a) the 5th percentile, b) 2nd percentile or c) 1st percentile would best represent a significant decline relative to the average level of liquidity for sovereign debt? Please explain why providing data if possible.

VI. Specification of what constitutes a significant fall in value for financial instruments other than liquid shares and draft regulatory standard on the method for calculating the fall (Article 23)

VI.I. Draft advice on the Delegated Act relating the significant falls in value (Article 23(8))

151. Where the price of a financial instrument on a trading venue has significantly fallen during a single trading day in relation to the closing price on that venue on the previous trading day, the competent authority of the home Member State for that venue shall consider whether it is appropriate to prohibit or restrict natural or legal persons from engaging in short selling of the financial instrument on that trading venue or otherwise limit transactions in that financial instrument on that trading venue in order to prevent a disorderly decline in the price of the financial instrument.

152. Any measure taken by the competent authority shall apply for a period not exceeding the end of the trading day following the trading day on which the fall in price occurs. If at the end of that next trading day (the second trading day) there is, despite the measure being imposed, a further significant fall in value of the financial instrument from the closing price of the first trading day, the competent authority may extend the measure for a further period not exceeding two trading days after the end of the second trading day. The further significant fall in value shall be an amount that is half the initial amount specified.

Extract from the Commission's request

ESMA is invited to provide its technical advice on what constitutes a significant fall in value for financial instruments other than liquid shares, taking into account the specificities of each class of financial instrument and the differences of volatility.

Box 10

Draft advice on what constitute a significant fall in value for financial instruments other than liquid shares

For the purpose of Article 23(5) of the Regulation,

1) For an illiquid share, a significant fall in value during a single trading day in relation to the closing price of the previous trading day is:

a) A 10% or more decrease in the price when the share is included in the main index of a trading venue and is the underlying financial instrument for a derivative contract admitted to trading on a trading venue,

b) A 20% or more decrease in the price where the share price is EUR 0.50 or higher (or the equivalent in the local currency), or otherwise a 30% or more decrease in the price.

2) A significant fall in value for a sovereign bond is reflected by an increase of 5% or more in the yield across the yield curve for the relevant sovereign issuer.

3) A significant fall in value for a corporate bond is reflected by an increase of 7% or more in the yield of that the bond during a single trading day.

4) A significant fall in value for a money-market instrument is reflected by 10% or more increase in the yield of a money-market instrument during a single trading day

5) A significant fall in value for an Exchange Traded Fund, including the ones that are UCITS, is a decrease of 10% or more in the price during a single trading day. However, leverage ETFs or reverse ETFs should be treated as derivatives.

6) For options, futures, swaps, forward rate agreements and other derivative instruments including financial contracts for difference,

a) Where the derivative instrument has the sole underlying a financial instrument that is traded on a trading venue and for which a significant fall in value is specified, a significant fall in value in that derivative instrument occurs when the underlying financial instrument has reached its fall in value as established above.

b) In cases not covered by 6(a) and Where the derivative instrument is centrally cleared , a significant fall in value in that derivative instrument is defined in relation to a certain proportion of the variation of the price of the underlying used to determine CCP margins should be the threshold for each derivative. A 3/4 ratio of the margin level set by the clearing house per underlying of a derivative is proposed.

7) No threshold for a significant fall in the value of the unit price of a listed UCITS (except for ETFs that are UCITS) is proposed as although this price may vary freely in the trading venue, it is subject to a rule which keeps the prices close to the Net Asset Value of the UCITS (Article 1.2.b UCITS Directive 2009/65).

Explanatory text

153. ESMA proposes that the following criteria should be used to represent a significant fall in value of the financial instruments mentioned below.

Transferable securities

Illiquid shares

154. Article 22 of Regulation No 1287/2006 (Article 27 of Directive 2004/39/EC) sets out the determination of liquid shares as:

A share admitted to trading on a regulated market shall be considered to have a liquid market if the share is traded daily, with a free float not less than EUR 500 million, and one of the following conditions is satisfied:

(a) the average daily number of transactions in the share is not less than 500;

(b) the average daily turnover for the share is not less than EUR 2 million.

However, a Member State may, in respect of shares for which it is the most relevant market, specify by notice that both of those conditions are to apply. That notice shall be made public.

155. ESMA publishes a list of 'Shares Admitted to Trading on EU Regulated Markets' on its website, which currently lists 6,153 shares. This list includes both liquid and illiquid shares. The total number of financial instruments admitted to trading on trading venues in the EU is much larger than this figure therefore the vast majority of financial instruments fall outside the definition of liquid shares.

156. Within the number of illiquid shares admitted to trading on trading venues in the EU there will be a range of shares from some that are relatively liquid to others that are almost totally illiquid. In order to accommodate such a diverse group ESMA considers that it is necessary to have at least three categories.

157. ESMA is proposing the following criteria to be used to measure a significant fall in value in the price of an illiquid share.

158. The competent authority of the home Member State for the venue will consider whether it is appropriate to take any action if and when there is a fall in value of the share price during a single trading day in relation to the closing price on that venue on the previous trading day, as follows:

a. for a share that is included in the main index of a trading venue and is the underlying financial instrument for a derivative contract admitted to trading on a regulated trading venue, a fall in value of 10% or more in relation to the closing price of the share on that venue on the previous trading day;

b. where the share price is EUR 0.50 or higher (or the equivalent in the local currency), a fall in value of 20% or more in relation to the closing price of the share on that venue on the previous trading day;

c. Where the share price is less than EUR 0.50 (or the equivalent in the local currency), a fall in value of 30% or more in relation to the closing price of the share on that venue on the previous trading day.

Trigger thresholds

159. In determining the parameters for triggering consideration of whether to temporarily suspend short selling in non-liquid stocks, ESMA thinks two key factors should be taken into account. First, the level of price fall must clearly be significant and beyond the normal level of volatility for the type of stock in question. However, the trigger should not be set at a level which is rarely if ever reached since this would defeat the purpose of this Article. Guided by these considerations, ESMA has consulted representatives of equity exchanges on the appropriate levels to set and, taking into account the views they have expressed, it considers that a fall in price of 10% or more for relatively less liquid shares, a fall in price of 20% or more for more illiquid shares and a fall in price of 30% or more for the remaining group of illiquid shares should be proposed[9].

[9] On the basis a test run in 5 countries mainly on shares admitted to trading on regulated markets, the number of instances when a thresholds was triggered ranged:
- From 7 to 67, for MiFID Liquid shares and Non liquid but being part of a main index and derivative underlying (i.e. 10% fall)
- From 1 to 20, for others illiquid shares but no "penny stocks" (i.e. 20% fall)
- From 2 to 99, for "Penny stocks" (i.e. 30% fall)

Q41: Do you agree that three categories are necessary? If not please state you reasons.

Q42: For the more illiquid shares, do you agree that EUR 0.50 is the correct cut off point to use? If not please state you reasons.

Q43: Do you agree that 10%, 20% and 30% are the correct percentages to use in relation to the fall in value? If not, what other levels would you propose; please state your reasons.

Sovereign Bonds

160. ESMA considers that for sovereign bonds the best measure to trigger action by a competent authority should relate to an increase in the yield across the yield curve for the sovereign issuer. The yield curve is a graph that depicts the relationship between the bond yields to maturity of a series of bonds issued by the same issuer or issuer with similar credit risk and the maturities of those bonds. Although there are different methods to calculate the yield curve, the one that replicates the observable yields reflects most accurately the market situation (bootstrapping).

161. ESMA envisages that, if any competent authority was considering temporarily suspending short selling of sovereign bonds on a trading venue they would wish to do so in relation to all the debt of that sovereign issuer traded on that venue rather than just for a particular issue. Hence it appears sensible to choose a threshold which would apply to the sovereign issuer. The yield curve is considered to be the most relevant reference point from this perspective. The yield curve could adopt different shapes which represents the effect of a combination of factors. Hence, there are events that will impact on some tranches of the curve and not others. Those events are not deemed to be of especial relevance because they reflect on-going investors' analysis. However, any event that affect yields across the whole yield curve is really relevant and would require the national competent authority to consider whether a restriction on short selling sovereign bonds should be put in place.

162. After taking soundings with central banks and debt management agencies, ESMA proposes that an increase of 5% or more in the yield across the yield curve (i.e. to move from a YTM of 5.00% to 5.25%[10]) would be an appropriate trigger for the competent authority of the home Member State for the venue to consider whether it is appropriate to take any action. If the Member State does not have enough outstanding bonds to calculate a yield curve[11], the yield increase threshold should apply to the benchmarks that its debt management office has established (three benchmarks is the most typical structure but it could also be two or one: it will depend on the size of the total outstanding sovereign debt).

Q44: Do you agree that an increase in the yield across the yield curve is the appropriate measure to use for sovereign bonds? If not, what other measure would you propose, please state your reasons.

[10] The yield to maturity of each bond included in the curve should increase at least a 5%
[11] Usually 10 bonds are necessary for drawing up a curve.

Q45: Do you agree that an increase of 5% or more in the yield across the yield curve is the correct percentage to use? If not, please say what alternative threshold you would favour and state your reasons.

Corporate Bonds

163. ESMA proposes that the competent authority of the home Member State for the venue will consider whether it is appropriate to take any action when there is a 7% or more increase in the yield of the of the bond during a single trading day. An increase of 7% or more in the yield is considered to be outside the normal range of volatility while representing a significant fall in the price.

164. The price of any corporate or financial bond is related, in normal circumstances (i.e., not in a distress situation), to the yields of the sovereign bonds where the company is settled. Investors in fixed income set the price of a corporate bond adding a yield spread which covers the excess of credit risk of the corporate over the sovereign. Taking into account the different spreads on interest rates forcorporate bonds of different categories of credit risk, which have a range from minus some basis points (bp) to more than 500 bp (non-investment grade)[12], and the threshold set for sovereign bonds of 5%, ESMA proposes that an increase of 7% on the yield to maturity in one day for a particular corporate bond reflects, on average, a significant fall in the price[13].

Q46: Do you agree that an increase of 7% or more in the yield is the correct percentage to use for corporate bonds? If not please state your reasons.

Money-market instruments

165. Money-market instruments have maturities ranging from one day to one year and are extremely liquid. ESMA therefore proposes that the competent authority of the home Member State for the venue will consider whether it is appropriate to take any action when there is 10% or more increase in the yield of a money-market instrument during a single trading day. Again, an increase in the yield of 10% or more is considered to be outside the normal range of volatility while representing a significant fall in the price.

Q47: Do you agree that an increase of 10% or more in the yield curve is the correct percentage to use for money market instruments? If not please state your reasons.

Units in collective investment undertakings

[12] As a proxy of the spreads on interest rates for corporate bonds the indexes Itrx Europe (which encompasses CDSS of 125 investment grade of European corporate bonds), Itrx HiVol (which includes the CDS of 30 non financial corporate bonds with the highest spreads), and Itrx Xover (it is made up of the 50 most liquid non investment grade corporate bonds) can be used. In 2011, on average, these indices show the following levels: 133.76 bp, 195.70 bp, 536.61 bp, respectively. The average of those figures is 288.69 bp.

[13] As an illustration, using that approach on the evolutions of indexes Itrx Europe, Itrx HiVol, and Itrx Xover, the threshold would have been crossed respectively 6, 4 and 5 times over the period from 1/1/2008 to 17/1/2012

166. Short selling is a regular activity in financial markets which allows the prices of the securities to be aligned with their theoretical value or their economic fundamentals. However, this activity requires certain conditions that could be met in different ways. First, there must be trading in the financial instruments; second the price of the financial instruments could vary significantly from their fundamentals or theoretical value; third the existence of a lending market for the financial instrument or at least a sufficient amount of the financial instrument to allow borrowing to take place and thus settlement to be effected when it is due; four, the capacity to buy back the financial instrument in order to net the position (intraday trade) or to give the loan back. These conditions are mostly found in equities (liquid stocks, with enough liquidity to be bought back), derivatives launched by a futures exchange on equities, sovereign bonds, currencies or commodities (through holding a short position). They are much less present in sovereign debts instruments, corporate bonds and money market instruments. However, it is possible to find a situation where there will be short selling activity on the last three kinds of securities.

167. Undertakings for Collective Investment in Transferable Securities (UCITS) do not fulfil these conditions. Initially, all UCITS may be listed although there are some that are not listed. In any case, all UCITS must be assessed by the Management Fund daily so that the units' holders know the market value of the financial instruments included in the portfolio (Net Asset Value -NAV). In addition, any holders of units are able to sell them to the Management Fund directly or in the market. Although the price of a unit of any UCITS may vary freely in the market the price is subject to a rule which keeps the prices close to the NAV of the UCITS (Article 1.2.b UCITS Directive 2009/65). Consequently, the prices do not move away from the NAV and the interest of selling short those assets is negligible. There is also empirical evidence of a lack of lending activity on units of UCITS. Under these circumstances, ESMA considers that it is not worth setting a significant price fall threshold for this type of financial instruments.

168. In some countries, ETF are UCITS. In such cases, the provision related to ETF should be applicable.

Q48: Do you agree with the proposed ESMA approach to units in collective investment undertakings? If not please state your reasons.

Q49: If you consider that a trigger threshold in relation to fall in value in UCITS should be defined, what should be this percentage threshold and why?

Exchange Traded Funds ("ETF")

169. ETFs are regulated, open-ended investment funds that trade on a stock exchange, just like any other listed financial instrument. ETFs hold a portfolio of securities or derivatives which aims to track and replicate the performance of a specific index, a commodity or a basket of assets like an index fund. The listing on an exchange means the ETF shares or units can be bought and sold by investors on an intra-day basis and using real-time pricing, much like an equity security. Because of the highly liquid nature of ETFs, ESMA proposes that the competent authority of the home Member State for the venue will consider whether it is appropriate to take any action when there is a fall in value of the price of an ETF of 10% or more during a single trading day in relation to the closing price on that venue on the previous trading day. ETFs that are leveraged or reverse ETFs should be considered as traded derivative instruments.

Q50: Do you agree that 10% or more is the correct percentage to use for ETFs? If not please state your reasons.

Options, futures, swaps, forward rate agreements and other derivative instruments including financial contracts for difference

170. When considering what constitutes a significant fall in value for derivatives traded on trading venue (exchange traded derivatives), there are several issues to consider.

171. Such exchange traded derivatives can have a single underlying that is a share or a bond. There can also be exchange-traded derivatives whose underlying is a different asset (commodities, emissions, currencies, interest rates, credit risk, etc.). Technically, it is not possible to sell short a derivative (investors simply sell it or buy it but the notion of short selling is not directly applicable). Therefore, when considering what is a significant fall in price, ESMA will consider that the relevant use of this concept will be for competent authorities to consider, under the provisions of article 23 of the Regulation whether to "... limit transactions in that financial instrument on that trading venue on order to prevent a disorderly decline in the price of the financial instrument." This will typically include temporary suspension of trading but the measures could be different under the circumstances and the powers of each competent authority.

172. On all derivatives (irrespective of their underlying) the characteristics of each contract make it especially complex to establish a concept of significant fall in price looking only at the evolution of the price of the derivative itself. The sensitivity of the price of the derivative to changes in the underlying can be also different across products due to their inherent characteristics, like the leverage (multiplying factor) of each contract, the direction (whether it is a put or a call option, a reverse or direct index derivative, etc.). The range of derivatives traded on-exchange currently can be expected to increase in the future, for several reasons including regulatory ones. So what is basically a futures and options market today can be significantly enlarged by Contracts For Differences, swaps, covered warrants, etc. In these markets, product ranges are very wide, including products embedding exotic options and structures whose price behaves very differently from the price of other apparently related or similar derivatives with the same underlying (like warrants with knock-out/knock-in options with different barriers).

173. Establishing a threshold that depends solely on the evolution of the derivative price could lead to unintended or conflicting results when competent authorities have to consider taking action: Firstly, it could trigger the obligation to consider whether to take action when the price of the derivative is falling because the price of the underlying is rising, as can be the case with put options when the underlying share price is rising heavily or similar cases on reverse derivatives (those that pay out the buyer when the price of the underlying share falls). Secondly, it could trigger the obligation to consider whether to take action in different moments during the same period for the same underlying (for instance, when different derivatives with the same underlying share hit their thresholds on different times in a volatile session). Thirdly, it would require setting thresholds (in the price of the derivative itself) that are delta-adjusted, increasing significantly the number of thresholds and making supervision much more complex.

174. ESMA considers that due to the specifics of the exchange-traded derivatives markets, it is better to draw a distinction between two categories:

a) Derivatives whose sole underlying financial instrument is a financial instrument that is traded on a trading venue and for which a significant fall in value has been specified according to this Delegated Act (e.g. share, bond), and

b) Derivatives whose underlying is different from the above.

175. For the first category, ESMA thinks that the only practicable solution is to consider that the concept of significant fall in price should be coherent and compatible in time with the conditions to consider whether to take action on the relevant underlying. In this approach, the competent authority should consider whether to take action both on the financial instrument that is traded on a trading venue and for which a significant fall in value has been specified and in the related exchange-traded derivatives at the same time. For this reason, ESMA proposes to assume that a significant fall in value in the derivative has occurred when the underlying financial instrument has reached its fall in value as established according to the regulation, irrespectively of the size or the direction of the actual change in value of each of the different related derivatives.

176. For the second category, given that it covers such a wide range of derivative instruments and underlyings, the simplest criterion would be to rely on margins that are required by central clearing counterparties (CCP) on those products that are centrally cleared. Under this approach, ESMA to propose that a certain proportion of the variation of the price of the underlying used to determine CCP margins should be the threshold for each derivative. This relative threshold would determine the concept of significant fall in price for all derivatives in this category.

177. One of the key features of a derivative is the analysis of the screening range for determining the margin levels. The margin should cover the worst scenario if the position has to be cancelled. Most of the EU CCPs work with a margin level which covers 99.9% of the situations which means that the variation of the prices is usually 3.09 times the standard deviation of the variation of the prices of the underlying. This level involves, if the normal distribution of the standard deviation remains stable, leaving out of the range 1 per one thousand of the possible situations (i.e. 1 time per 1000 days).

178. With the view to have a meaningful threshold that would allow a regulator to trigger the provisions of Article 23 of the Regulation on some occasions, ESMA proposes to use a 3/4 ratio of the margin level set by the clearing house per underlying of a derivative. This ratio implies that the threshold will be crossed once every 100 days if the conditions are stable. Only when the prices of the underlying cross that level will the national competent authority be required to analyse the desirability of restricting or not the short selling activity or transactions in their derivatives.

179. There may be a third category of derivative instruments for which the significant fall in value cannot be determined in relation to the fall in the underlying or to a variation of the margin level. This category includes any derivative instrument that (i) has no single underlying admitted to trading on a trading venue and for which a significant fall in price is specified in the draft advice and (ii) is not centrally cleared.

180. This category potentially encompasses a wide variety of derivatives in terms of both their own characteristics and structures (different leverage, existence of barriers, etc.) and their underlying assets: basket of shares, indices, commodities, etc.

181. If there were a significant fall in their value to be defined for them, it should be based on the actual price of the concerned derivatives. However, defining a significant fall in value for each and every type of such derivatives appears to be an impossible task, in particular considering the financial creativity of the market participants issuing them. In that context, ESMA thinks that the only workable approach might be to set out a single figure for a significant fall in price value for all these kinds of derivatives. This would avoid having to design a highly complex mechanism though ESMA acknowledge the difficulty in defining the appropriate unique threshold.

Q51: Do you agree with the proposal of having a differentiated approach depending on whether the concerned derivative has a single financial instrument that is traded on a trading venue and for which a significant fall in value has been specified according to this Delegated Act as underlying? If not, please state your reasons.

Q52: Do you agree that a 3/4 ratio of the margin level set by the clearing house per underlying of a derivative is the appropriate level to use for an option, future, swap, forward rate agreement or other derivative instrument, including financial contracts for difference? If not, what alternative would you propose?

Q53: What could be an appropriate threshold to define a significant fall in price of a derivative compared to the closing price of the previous day when that derivative does not have a single underlying instrument admitted to trading on a trading venue and is not centrally cleared?

182. ESMA would welcome the views of the market participants and others on the suggested approaches, particularly in relation to derivatives, and the proposed percentage figures suggested. It should be noted that, before taking a final decision on the draft advice to be provided to the Commission, ESMA may revise them following the analysis of the responses to this Consultation..

VI.II. Regulatory Technical Standard on the specification of the method of calculation of the 10 % fall for liquid shares and of the fall in value (Article 23(8))

Background

183. In order to ensure consistent application of Article 23 of the Regulation, ESMA shall develop draft regulatory technical standards (RTS) specifying the method of calculation of the 10 % fall for liquid shares according to Article 23(5) and of the fall in value specified by the Commission as referred to in Article 23(7). The draft RTS is presented in Annex IV.

Approach

184. The advice on the Delegated Act relating to the significant falls in the price or value of a financial instrument sets out different approaches as to how the fall is expressed. Depending on the type of financial instruments concerned. Consequently, the method of calculation should be designed accordingly.

185. Regarding shares the regulation itself includes in Article 23(1) a definition of the starting point of the calculation of the fall. The fall should be calculated in relation to the closing price on that venue on the previous trading day. However the RTS could specify some additional conditions for such a closing price.

186. Taking into account the different definitions of closing prices regarding relevant turnover, timeframe etc. and the fact that Article 23 refers to the closing price on the relevant trading venue, this price must be defined in the context of the relevant rules of the trading venue where the share concerned is actually traded. Therefore a closing price for the purpose of Article 23(1) should be defined as the official closing price at the relevant trading venue as defined under their relevant rules.

187. The same method should also apply for any other financial instrument referred in the Delegated Act on Article 23(7) for which the fall in price or value is expressed in terms of percentage variation of the closing price (e.g. ETFs).

188. In relation to shares only, ESMA considers that downward movements of the price resulting from a share split, a corporate action or similar measures affecting the issued share capital of a company should not fall within the scope of the method of calculation. The purpose of Article 23 of the Regulation is to slow down market movements based on market reactions. In many cases there might be a fall of the price after such a corporate action. However, this fall is not caused by a market movement but by an activity of the company in respect of its issued capital. Such price movements are not the falls that Article 23 aims at preventing.

189. For financial instruments where the draft advice on the Delegated Act on Article 23 (7) refers to an increase in a yield of the financial instrument (e.g. corporate bonds, money market instruments), the starting point of the calculation is the yield of that instrument at the time trading closed on the trading venue. That yield should be established on the basis of the data available at that time. It should be compared to the actual yield for that instrument at the time of the calculation.

190. A similar approach should apply to a debt instrument issued by a sovereign issuer that is traded on a trading venue. IN this case, as explained in the draft advice on Delegated Act (previous section of the document), the method consists in calculating an increase across the whole yield curve of that

sovereign issuer. The yield curve of the previous trading day should be established on the basis of the available data at the time of closing of the trading on the venue where the debt instruments are admitted to trading. Reliance could be placed on publicly available information about the yield curve for a specific sovereign issuer, including where available the yield curve calculated and disclosed by the competent authority for that sovereign issuer.

191. For derivatives instruments for which the significant fall in value is expressed in terms of variation of the margin levels, the starting point of the calculation should be the margin level of the previous trading day as setby the central clearing counterparty for the trading venue on which that derivative contract.

Q54: Do you agree with the abovementioned proposal for the methods of calculation for various types of financial instrument? Do you have alternative or complementary methods to suggest, in particular in relation to the yield curve calculation method?

VII. Specification of criteria and factors to be taken into account by competent authorities and ESMA in determining when adverse events or developments referred to in Articles 18, 19, 20, 21 and 27 and the threats referred to in article 28(2) arise (Article 30)

Extract from the Commission's request

ESMA is invited to provide its technical advice on criteria and factors to be taken into account by competent authorities and ESMA in determining when adverse events or developments arise.

192. The possible outcomes of those adverse developments and threats are:

- serious threats to the financial stability or to market confidence in one or more Member States;
- serious threats to the orderly functioning and integrity of financial markets or to the stability of part of or the whole of the financial system in the Union.

BOX 11

Draft advice on criteria and factors to be taken into account in determining when adverse events or developments and threats arise

Non exhaustive list of qualitative events or acts that might suppose a serious threat to the financial stability, market confidence, orderly functioning and integrity of the markets in the EU.

1) Any act, result, fact, or event that is or could reasonably be expected to lead to the following:

- Any indication of serious financial (monetary, budgetary, financing) instability or uncertainty concerning an EU Member State or of a systemically important financial institution operating within the EU when this may threaten the orderly functioning and integrity of financial markets or the stability of the financial system in the Union.
- Unsubstantiated rumours about a rating action regarding or the possibility of a default by any EU Member State or a systemically important financial institution operating within the EU that causes or could reasonably be expected to cause severe uncertainty about their solvency or produce a self-fulfilling effect.
- Substantial selling pressures and unusual volatility causing significant downward spirals in any financial instrument related to any EU systemically important financial institution operating within the EU and sovereign issuers as the case may be.
- Any relevant damage to the physical structures of systemically important financial issuers, market infrastructures, clearing and settlement systems, supervisors etc., which may adversely affect markets in particular where such damage results from a natural disaster or terrorist attack.
- Any relevant disruption in any payment system or settlement process, in particular when it is related to interbank operations, that causes or may cause significant payments or settlement

failures or delays within the EU payment systems, especially when these may lead to the propagation of financial or economic stress in a systemically important financial institution or in a Member State of the EU.

2) In considering the above non-exhaustive criteria ESMA will take into account the possibility of any spillovers or contagious effects onother systems or issuers and, especially, the existence of any type of self-fulfilling phenomena.

3) Systemically important financial institutions include not only banks but also other financial institutions deemed important to the global financial system such as insurance companies, market infrastructure providers and asset management companies.

Explanatory text

193. Subject to the fulfilment of specified criteria and factors (along with some other considerations such as necessity of the "restrictive measure", potential effects on the financial markets and proportionality), competent authorities (articles. 18, 19, 20 and 21 of the Regulation) or ESMA (articles 27 and 28 of the Regulation) may take some restricting measures (requiring special notifications or publication of positions, obligation to notify significant changes in lending fees, prohibition of short selling or constitution of new short position, limitation of CDS transactions etc.).

194. Such measures could be necessary due to a variety of adverse events or developments including not just financial or economic events but also for example natural disasters or terrorist acts. Furthermore, some adverse events or developments requiring measures could arise in one Member State only and not have any cross border implications. Such powers need to be flexible enough to enable competent authorities to deal with a range of different exceptional situations. In taking such measures, the competent authorities must pay due regard to the principle of proportionality.

195. The Regulation considers it necessary that ESMA itself needs to have the power to take measures where short selling and other related activities threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union (Articles 9 and 18 ESMA Regulation EU No 1095/2010).

196. The list of criteria and factors should be non-exhaustive and general. It should cover those situations which can cause risks and threats to financial stability without offering unlimited discretion for competent authorities and ESMA for taking action. However it is essential to make sure that competent authorities and ESMA can take steps before the risk situation spreads. The possibility of the development of self-fulfilling phenomena, like rumours of bank runs or sovereign or financial issuer defaults is a particular factor to watch when assessing adverse market conditions.

197. The Commission has noted, as expressed in its formal request to ESMA for technical advice on Delegated Acts, that the criteria and factors to be taken into account by CAs in determining when adverse events or developments could be either qualitative in nature, quantitative, or a combination of both. In this respect, ESMA acknowledges that on one hand it may be useful to offer a list of quantitative indicators to determine the market conditions in which ESMA or competent authorities could introduce the restrictive measures foreseen in the Regulation. However, on the other hand ESMA considers that a very prescriptive and detailed list of quantitative events could lead to

implementation problems regarding the restrictive measures. If ESMA or competent authorities need to wait to the fulfilment of quantitative indicators to introduce restrictive measures there is always the risk of a deferred decision that may make them ineffective. Quantitative criteria may be also perceived to be somehow misleading if market participants presume that ESMA or competent authorities would only act when these quantitative indicators or events are met. Consequently, ESMA only proposes a non-exhaustive list of qualitative events or acts that might involve a serious threat to the financial stability, market confidence, orderly functioning and integrity of the markets in the EU.

198. Systemically important financial institutions are those institutions included in the list of such institutions provided and updated annually by the Financial Stability Board . However, for the sole purpose of applying this regulation, ESMA or competent authorities may also look at other financial institutions not included in the list whose distress or disorderly failure because of their size, complexity and systemic interconnectedness, may cause significant disruption to the wider financial system and economic activity to decide if those are deemed to be systematically important.

Q55: Do you agree with the proposal for qualitative criteria should be set out?

Q56: Are there any additional criteria or factor that you would suggest adding to the list?

Annex I

Summary of questions

On Ownership

Q1: Do you agree with the proposal concerning Article 2(1)(r) of the Regulation?

Q2: Are there other cases which need to be excluded from the definition of a short sale?

Q3: Are there other definitions in Article 2(1), which need further clarification? Please explain which one(s) and why further clarification is required.

On holding

Q4: Do you agree with the above proposal? If not, please give reasons.

Q5: Do you have any suggestions on possible further criteria to describe the holding of a share or sovereign debt?

Having a net short position and method of calculation

Q6: Do you agree with the above proposal? If not, please give reasons.

Q7: Do you agree with setting a quantitative threshold for high correlation? If so, what would be the best correlation co-efficient to use for this purpose ?

Q8: Do you think it is practicable to measure correlation for sovereign debt with a liquid market price and a long price history on a historical basis using data for the 24 month period before the position in the sovereign debt is taken out? Do you consider that a 24 month reference period is the most appropriate one?

Q9: Do you think it is practicable to measure correlation for assets with no liquid market price or with no sufficiently long price history by using a proxy? What could be a good proxy? What criteria do you think are necessary?

Q10: Do you consider that this Delegated Act needs to provide further specifications on the calculation of whether the high correlation test is met? Do you have any suggestions on what they may contain (e.g. use of a maturity bucket)?

Q11: Do you think that there is a need for a buffer period addressing the issue of temporary fluctuations in the correlation of the sovereign debt (e.g. period of 3 months during which the correlation is less than the standard level (e.g. 90% or 80%) but at least met a prescribed lower threshold (e.g. 75% or 70%)?

Q12: Do you think it is appropriate the “delta adjusted method” for the calculation of short position for shares?

Q13: Is there any comment you would like to make in relation to the calculation of the position in shares set out in Box 4?

Q14: Is there any additional method of calculation for shares that you would suggest ESMA to consider?

Q15 Which in your view is the most appropriate method for the calculation of short position for debt instruments of a sovereign issuer? Are there methods other than the nominal or sensitivity adjusted ones outlined above which you think ESMA should consider?

Q16: Is there any comment you would like to make in relation to the calculation of the position in sovereign debt of a sovereign issuer set out in Box 4?

Netting and aggregation

Q17: Do you agree with the approaches described above to cater for specific situations when different entities in a group have long or short positions or for fund management activities related to separate funds? If not, can you state your reasons and provide alternative method(s) of calculation?

Q18: Which do you consider the better definition of a group for the purpose of this Regulation?

Q19: Are there other situations that should be taken into account?

Uncovered CDS

Q20: Do you agree with the general conditions proposed for determining when a sovereign CDS position can be considered covered? Are there any modifications you would propose?

Q21: Do you have any comments or alternative suggestions on the proposed test for correlation? Do you have any estimates of the costs which applying the qualitative test envisaged by ESMA would entail for market participants or the costs which would be associated with the imposition of a quantitative test?

Q22: Do you consider the proposals for demonstrating correlation provide a workable framework for market participants?

Q23: Are any changes required to the proposals for determining whether a sovereign CDS position is proportionate?

Q24: Do you think that a position that had become partially uncovered due to fluctuations in the value of the assets or liabilities being hedged and/or the CDS used as the hedge should be allowed only for a certain period of time? If so, what would be an appropriate time limit?

Q25: Do you agree that sovereign CDS positions which are obtained involuntarily as a result of the operations of a CCP clearing sovereign CDS should not fall to be considered as entering into a CDS transaction for the purposes of the Regulation?

Q26: Do you consider there are any other illustrative cases of a risk which would be eligible to be hedged by a sovereign CDS position which should be included in the indicative list?

Q27: Do you agree that the net CDS position is the correct one to use in the calculations?

Q28: Do you consider that there should be different methods for calculating the value of the positions to be hedged by the sovereign CDS according to whether a static or dynamic hedging strategy is used?

Q29: Are there refinements which can be made to the proposed methodology? Are there any standard calculation formulae which can be used when applying risk adjustments which we should include in the draft advice?

Q30: Do you agree with the proposed method of treating indirect exposures?

Levels of the notification thresholds for sovereign debt position

Q31: Do you agree that the relevant notification threshold should be based on a percentage of the total amount of outstanding issued sovereign debt for each sovereign issuer?

Q32: Do you agree with the proposal to convert these percentages into monetary amounts which would be updated quarterly to reflect changes in the issued sovereign debt? If not, what other arrangement would you suggest?

Q33: Do you agree with ESMA's proposal to group sovereign issuers into categories for the purposes of setting the notification thresholds or would you prefer an alternative approach (e.g. a single threshold for all sovereign issuers or setting individual thresholds for each sovereign issuer)? Please state your reasons.

Q34: If you support grouping sovereign issuers into categories, do you agree with ESMA's proposal to set the three categories of notification thresholds suggested above? If not, what other grouping would you suggest and why?

Q35: Do you consider the proposed initial amounts and the incremental levels as reasonable and optimal? If not, what amounts and incremental levels do you consider as more appropriate and why?

Q36: If given the thresholds ESMA has proposed above are implemented, how many notifications do you expect to make in a month to each relevant competent authority?

Q37: What level of net short position do you regard as significant for the particular sovereign debt markets?

Liquidity thresholds

Q38: Do you agree with the general proposal suggested by ESMA for setting the parameters and methods for calculating the threshold of liquidity of the issued sovereign debt for suspending restrictions on short sales? If not, please state your reason and explain what could be an appropriate alternative.

Q39: In particular, do you agree that a measure in percentiles of the monthly volume traded in the last twelve months is suitable to define a threshold that represents a significant decline relative to the average level of liquidity for the sovereign debt concerned?

Q40: In light of your response to the question above, do you think that a threshold of a) the 5th percentile, b) 2nd percentile or c) 1st percentile would best represent a significant decline relative to the average level of liquidity for sovereign debt? Please explain why providing data if possible.

Significant fall in value

Illiquid shares

Q41: Do you agree that three categories are necessary? If not please state you reasons.

Q42: For the more illiquid shares, do you agree that EUR 0.50 is the correct cut off point to use? If not please state you reasons.

Q43: Do you agree that 10%, 20% and 30% are the correct percentages to use in relation to the fall in value? If not, what other levels would you propose; please state your reasons.

Sovereign bonds

Q44: Do you agree that an increase in the yield across the yield curve is the appropriate measure to use for sovereign bonds? If not, what other measure would you propose, please state your reasons.

Q45: Do you agree that an increase of 5% or more in the yield across the yield curve is the correct percentage to use? If not, please say what alternative threshold you would favour and state your reasons.

Corporate bonds

Q46: Do you agree that an increase of 7% or more in the yield is the correct percentage to use for corporate bonds? If not please state your reasons.

Money market instruments

Q47: Do you agree that an increase of 10% or more in the yield curve is the correct percentage to use for money market instruments? If not please state your reasons.

UCITS

Q48: Do you agree with the proposed ESMA approach to units in collective investment undertakings? If not please state your reasons.

Q49: If you consider that a trigger threshold in relation to fall in value in UCITS should be defined, what should be this percentage threshold and why?

ETF

Q50: Do you agree that 10% or more is the correct percentage to use for ETFs? If not please state your reasons.

Options, futures, swaps, forward rate agreements and other derivative instruments including financial contracts for difference

Q51: Do you agree with the proposal of having a differentiated approach depending on whether the concerned derivative has a single financial instrument that is traded on a trading venue and for which a significant fall in value has been specified according to this Delegated Act as underlying? If not, please state your reasons.

Q52: Do you agree that a 3/4 ratio of the margin level set by the clearing house per underlying of a derivative is the appropriate level to use for an option, future, swap, forward rate agreement or other derivative instrument, including financial contracts for difference? If not, what alternative would you propose?

Q53: What could be an appropriate threshold to define a significant fall in price of a derivative compared to the closing price of the previous day when that derivative does not have a single underlying instrument admitted to trading on a trading venue and is not centrally cleared?

On the method for calculating the fall

Q54: Do you agree with the abovementioned proposal for the methods of calculation for various types of financial instrument? Do you have alternative or complementary methods to suggest, in particular in relation to the yield curve calculation method?

Adverse events and threats

Q55: Do you agree with the proposal for qualitative criteria should be set out?

Q56: Are there any additional criteria or factor that you would suggest adding to the list?

Annex II: Commission's mandate to provide technical advice

http://ec.europa.eu/internal_market/securities/short_selling_en.htm

http://ec.europa.eu/internal_market/securities/docs/short_selling/mandate-%2021112011_en.pdf

Annex III

Cost-benefit analysis (draft RTS)

Articles 10(1) and 15(1) of the 1095/2010 ESMA Regulation states that before submitting draft technical standards to the Commission, ESMA shall conduct open public consultations on draft regulatory technical standards and analyse the potential related costs and benefits, unless such consultations and analyses are disproportionate in relation to the scope and impact of the draft technical standards concerned or in relation to the particular urgency of the matter.

Normal ESMA practice includes the requirement to include elements of cost-benefit analysis in the consultation documents, to allow the public to identify the main cost drivers and the main sources of benefits and be able to input into them or provide evidence that could help in finalizing the analysis.

However, the fact that the text of the Regulation was only agreed and approved in November 2011 and the delivery of the draft Technical Standards by ESMA is required by the end of March 2012 has prevented ESMA from elaborating a draft cost-benefit analysis ahead of the public consultation.

ESMA does not intend to use the exemption foreseen in the Regulation for reasons of urgency or disproportion and, therefore, intends to present and publish an analysis of costs and benefits before submitting the Standards to the European Commission. This is currently under preparation and will be carried out during and after the public consultation and will incorporate the evidence gathered through it. However, ESMA would welcome any evidence of costs and benefits of the proposals presented from the respondents to this consultation paper.

European Securities and Markets Authority

Annex IV

Draft Regulatory Technical Standards

COMMISSION DELEGATED REGULATION (EU) No …/..

supplementing Regulation (EU) No xxxx/2012 of the European Parliament and of the Council with regard to regulatory technical standards on method of calculation of the 10 % fall for liquid shares and of the fall in value for other financial instruments

THE EUROPEAN COMMISSION,
Having regard to the Treaty on the Functioning of the European Union,
Having regard to Regulation (EU) No xxxx/2012 of dd mmmm yyyy of the European Parliament and of the Council on short selling and certain aspects of credit default swaps[14], and in particular Articles 9(5), 11(3) and 16(3) thereof.

Whereas:

(1) The method for calculation the significant fall in value of a financial instrument has to be adapted to the various ways in which that fall is reflected depending on the type of financial instrument concerned. It can take the form an actual fall in price of the financial instrument, of an increase in the yield of a corporate or in the yield across the yield curve for sovereign issuers and for certain derivative instruments it can be expressed relative to margin levels set by a central clearing house.

(2) This Regulation is based on the draft regulatory technical standards submitted by ESMA to the Commission.

(3) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010.

[14] OJ.....

HAS ADOPTED THIS REGULATION:

Article 1- Subject Matter

This Regulation sets out the specification of the method of calculation of the 10 % fall for liquid shares and of the fall in value specified by the Commission as referred to in Article 23(5) and (7) Regulation (EU) xxxx/2012.

Article 2

Definition of method of calculation for shares

1) For a share traded on a trading venue, the fall in price shall be calculated from the official closing price at that trading venue defined according to the applicable rules of that trading venue.

2) The method of calculation shall exclude any downward movement of a price resulting exclusively from a split, a corporate action or similar measures adopted by the issuer on its issued share capital.

Article 3

Definition of method of calculation for other non-derivative financial instruments

1) This article applies to financial instruments other than shares and not falling into the categories of derivatives financial instruments under Section C of Annex 1 of the Directive 2004/39/EC of the European Parliament and of the council of 21 April 2004.

2) For a financial instrument for which the significant fall in value referred to in Article 23 of Regulation (EU) No xxxx/2012 is measured in relation to a price on the relevant trading venue, the fall shall be calculated from the official closing price at the relevant trading venue defined according to the applicable rules of that trading venue.

3) For a financial debt instrument issued by a sovereign issuer for which the significant fall in value referred to in Article 23 of Regulation (EU) No xxxx/2012 is measured in relation to a yield curve, the fall shall be calculated as an increase in comparison with the yield curve of the sovereign issuer at the close of trading of the previous trading day, as calculated based on data available on that trading venue.

4) For a financial instrument for which the significant fall in value referred to in Article 23 of Regulation (EU) No xxxx/2012 is measured in relation to a variation of the yield, the fall shall be calculated as an increase of the current yield as compared to the yield of that instrument at the close of trading, as calculated based on data available for that instrument on that trading venue.

Article 4

Definition of method of calculation for derivative financial instruments

1) This article applies to financial instruments falling into the categories of derivatives financial instruments under section B of Annex 1 of the Directive 2004/39/EC of the European Parliament and of the council of 21 April 2004.

2) For a derivative financial instrument which does not have as sole underlying a financial instrument that is traded on a trading venue and for which a significant fall in value has been specified according to the [reference to Delegated Act on Article 23(7) Regulation (EU) xxxx/2012], the threshold shall be calculated by reference to the margin level set out by any central counterparty clearing the transactions on that trading venue for that financial instrument.

3) The margin level referred to in paragraph 2) is the one set out at the end of the previous trading day for that financial instrument.

Article 5

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

It shall apply from 1 November 2012.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

Annex V: Tables on outstanding sovereign debt

Total Debt Outstanding end of 2010	Euro	Alternative percentage thresholds					
		0,025%	0,050%	0,100%	0,250%	0,500%	1,000%
Estonia	0	0	0	0	0	0	0
Latvia	1 932 000 000	483 000	966 000	1 932 000	4 830 000	9 660 000	19 320 000
Bulgaria	3 647 000 000	911 750	1 823 500	3 647 000	9 117 500	18 235 000	36 470 000
Malta	3 989 000 000	997 250	1 994 500	3 989 000	9 972 500	19 945 000	39 890 000
Luxembourg	4 000 000 000	1 000 000	2 000 000	4 000 000	10 000 000	20 000 000	40 000 000
Cyprus	7 833 000 000	1 958 250	3 916 500	7 833 000	19 582 500	39 165 000	78 330 000
Lithuania	8 721 000 000	2 180 250	4 360 500	8 721 000	21 802 500	43 605 000	87 210 000
Slovenia	11 741 000 000	2 935 250	5 870 500	11 741 000	29 352 500	58 705 000	117 410 000
Romania	18 012 000 000	4 503 000	9 006 000	18 012 000	45 030 000	90 060 000	180 120 000
Slovakia	25 749 000 000	6 437 250	12 874 500	25 749 000	64 372 500	128 745 000	257 490 000
Czech Republic	53 634 000 000	13 408 500	26 817 000	53 634 000	134 085 000	268 170 000	536 340 000
Hungary	71 896 000 000	17 974 000	35 948 000	71 896 000	179 740 000	359 480 000	718 960 000
Finland	75 152 000 000	18 788 000	37 576 000	75 152 000	187 880 000	375 760 000	751 520 000
Denmark	92 647 000 000	23 161 750	46 323 500	92 647 000	231 617 500	463 235 000	926 470 000
Ireland	93 498 000 000	23 374 500	46 749 000	93 498 000	233 745 000	467 490 000	934 980 000
Sweden	128 000 000 000	32 000 000	64 000 000	128 000 000	320 000 000	640 000 000	1 280 000 000
Portugal	151 775 000 000	37 943 750	75 887 500	151 775 000	379 437 500	758 875 000	1 517 750 000
Austria	162 956 000 000	40 739 000	81 478 000	162 956 000	407 390 000	814 780 000	1 629 560 000
Poland	167 273 000 000	41 818 250	83 636 500	167 273 000	418 182 500	836 365 000	1 672 730 000
Greece	286 455 000 000	71 613 750	143 227 500	286 455 000	716 137 500	1 432 275 000	2 864 550 000
Netherlands	306 470 000 000	76 617 500	153 235 000	306 470 000	766 175 000	1 532 350 000	3 064 700 000
Belgium	341 192 000 000	85 298 000	170 596 000	341 192 000	852 980 000	1 705 960 000	3 411 920 000
Spain	540 639 000 000	135 159 750	270 319 500	540 639 000	1 351 597 500	2 703 195 000	5 406 390 000
Germany	1 065 252 000 000	266 313 000	532 626 000	1 065 252 000	2 663 130 000	5 326 260 000	10 652 520 000
France	1 228 971 000 000	307 242 750	614 485 500	1 228 971 000	3 072 427 500	6 144 855 000	12 289 710 000
United Kingdom	1 257 308 000 000	314 327 000	628 654 000	1 257 308 000	3 143 270 000	6 286 540 000	12 573 080 000
Italy	1 526 334 000 000	381 583 500	763 167 000	1 526 334 000	3 815 835 000	7 631 670 000	15 263 340 000

Source: Responses from members of the EFC - Sub-Commitee on EU Government Bonds and Bills Markets (2011)

German federal states	Total Debt Outstanding (in €)	0.010%	0.025%	0.050%	0.100%	0.250%	0.500%
Berlin, State of	38,049,300,000	3,804,930	9,512,325	19,024,650	38,049,300	95,123,250	190,246,500
Hessen, State of (Hesse, State of)	27,618,000,000	2,761,800	6,904,500	13,809,000	27,618,000	69,045,000	138,090,000
Hamburg, State of (Freie und Hansestadt Hamburg)	8,015,300,000	801,530	2,003,825	4,007,650	8,015,300	20,038,250	40,076,500
Rheinland-Pfalz, State of	19,016,100,000	1,901,610	4,754,025	9,508,050	19,016,100	47,540,250	95,080,500
Baden-Wuerttemberg, State of	16,309,000,000	1,630,900	4,077,250	8,154,500	16,309,000	40,772,500	81,545,000
Saarland, State of	3,783,300,000	378,330	945,825	1,891,650	3,783,300	9,458,250	18,916,500
Schleswig-Holstein, State of	12,630,000,000	1,263,000	3,157,500	6,315,000	12,630,000	31,575,000	63,150,000
Thuringen, State of	4,041,700,000	404,170	1,010,425	2,020,850	4,041,700	10,104,250	20,208,500
North Rhine-Westphalia, State of (Nordrhein-Westfalen)	76,794,400,000	7,679,440	19,198,600	38,397,200	76,794,400	191,986,000	383,972,000
Bavaria, State of (Bayern)	10,164,800,000	1,016,480	2,541,200	5,082,400	10,164,800	25,412,000	50,824,000
Brandenburg, State of	11,360,600,000	1,136,060	2,840,150	5,680,300	11,360,600	28,401,500	56,803,000
Lower Saxony, State of (Niedersachsen)	31,370,000,000	3,137,000	7,842,500	15,685,000	31,370,000	78,425,000	156,850,000
Bremen, State of	10,584,000,000	1,058,400	2,646,000	5,292,000	10,584,000	26,460,000	52,920,000
Saxony, State of (Sachsen-Freistaat)	769,200,000	76,920	192,300	384,600	769,200	1,923,000	3,846,000
Saxony-Anhalt, State of (Sachsen-Anhalt)	10,268,000,000	1,026,800	2,567,000	5,134,000	10,268,000	25,670,000	51,340,000
Mecklenburg-Vorpommern	4,384,500,000	438,450	1,096,125	2,192,250	4,384,500	10,961,250	21,922,500
Sum of all federal states	285,158,200,000	28,515,820	71,289,550	142,579,100	285,158,200	712,895,500	1,425,791,000
Germany, Federal Republic of	1,107,000,000,000	110,700,000	276,750,000	553,500,000	1,107,000,000	2,767,500,000	5,535,000,000
As of 31 December 2011							