



European Securities and
Markets Authority

Final Report

**Technical Advice on the evaluation of certain elements of the Short
Selling Regulation**

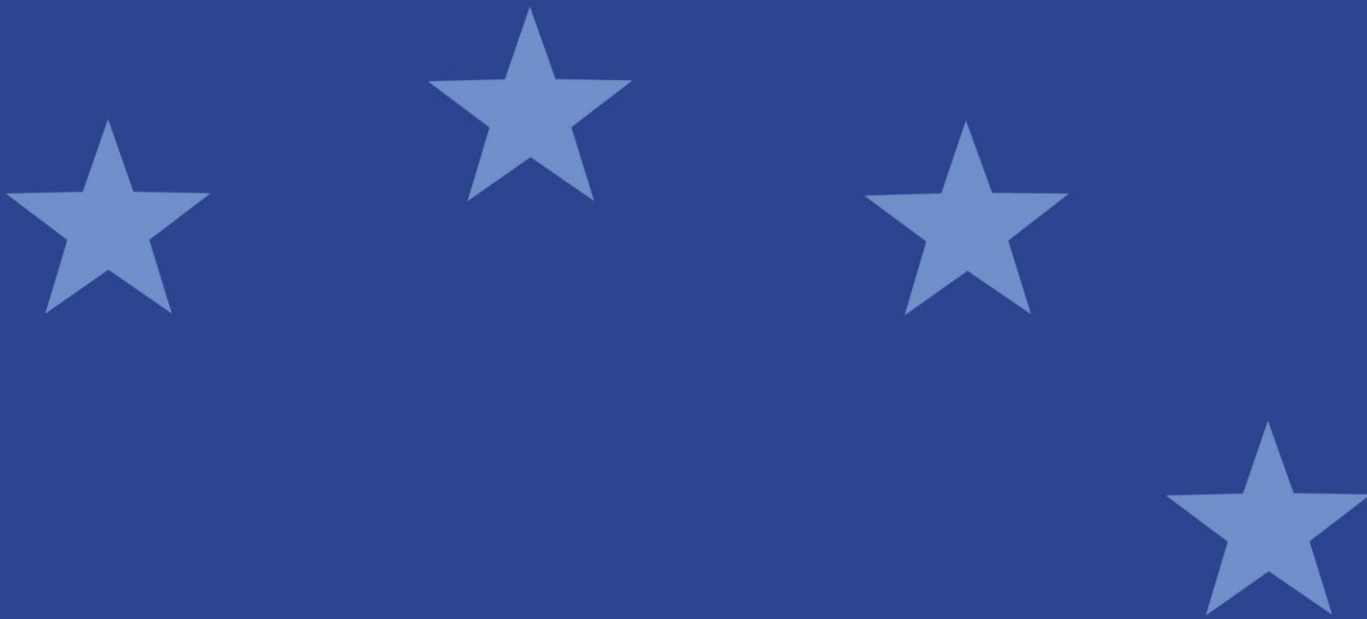


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Acronyms and definitions

CDS	Credit default swap
CP	Consultation Paper on the evaluation of certain elements of the Short Selling Regulation, published by ESMA on 23 June 2017 (ESMA70-145-127)
EC	European Commission
ESMA	European Securities and Markets Authority
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)
EU	European Union
MiFID	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on market in financial instruments ¹
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ²
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No 648/2012 ³
MTF	Multilateral trading facility
OJ	The Official Journal of the European Union
OTC	Over the Counter
OTF	Organised trading facility
RM	Regulated market
SSR	Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspect of credit default swaps ⁴
NCA	National competent authority
DEA	Direct electronic access

¹ OJ L145 30.4.2004 , p. 1

² OJ L173 12.6.2014 , p. 349

³ OJ L173 12.6.2014 , p. 84

⁴ OJ L86 24.3.2012, p. 1

1 Executive Summary

Reasons for publication

ESMA received a formal mandate from the European Commission (“Commission”) on 19 January 2017 seeking Technical Advice on the evaluation of certain elements of the SSR that became applicable on 1 November 2012. The mandate required ESMA to deliver its Technical Advice by 31 July 2017. Subsequently, on 22 February 2017, further to ESMA’s request, the Commission postponed the deadline for delivery of the Technical Advice to 31 December 2017. This ESMA advice should contribute to the actions announced by the Commission in its Communication on the Call for Evidence on the EU regulatory framework for financial services published on 23 November 2016.

ESMA published a consultation paper on 7 July 2017. This Final Report is the follow-up of the CP.

Contents

This Final Report is organised on four sections, a section on ESMA’s preliminary remarks and three other sections dedicated to the areas for which the Commission requested a Technical Advice from ESMA, namely the exemption for market making activities, the short term restrictions on short selling in case of a significant decline in prices under Article 23 of the SSR (“short-term bans”) and the transparency of net short positions and related reporting and disclosure requirements.

Each section summarises the relevant provisions and their objectives, identifies the main issues and concerns and explores possible ways to address them. When available, the findings of the quantitative analysis are also presented.

Annex I includes the Commission mandate to provide Technical Advice. Annex II contains the content of ESMA’s Technical Advice. Annex III contains the details of the economic analysis on the effectiveness of the short-term bans. Annex IV addresses the crossing of the thresholds set to identify a significant drop in the price falls. Annex V contains the quantitative analysis of individual net short positions.

2 Preliminary remarks

1. On 19 January 2017 ESMA received a mandate from the European Commission to deliver Technical Advice on the following three main topics related to the SSR:
 - the exemption for market making activities and the definition of market making activities in Article 2(1)(k) of the SSR, including the impact of the membership requirement featured in that definition;
 - the procedure for imposing short-term restrictions on short-selling; and
 - the method of notification and disclosure of net short positions.
2. However, ESMA would like to point out that it may revise this Technical Advice in the future at its own initiative based on a broader data set.
3. On the first place, ESMA wishes to emphasize the limited feedback received to the CP: only 20 public responses were submitted. The public responses came from the buy-side (3), sell-side (5), firms providing investment services or related entities (4), one association of issuers, stock exchanges (3), one association of proprietary traders, one investors' association and a chamber of commerce. Some of these responses grouped more than one association, though. ESMA also received four confidential responses.
4. The number of responses was significantly lower than in previous consultations on the SSR (for instance, ESMA received 43 responses to consultation on its first Technical Advice on the SSR⁵ and 35 to the consultation on the ESMA Guidelines on the exemption for market making activities and primary market operations under the SSR⁶).
5. Additionally, regarding the market making exemption, ESMA understands that a key element of the analysis should be the identification of the number of firms that may potentially benefit from the exemption and their corresponding share of the market. Otherwise, there is a potential risk that the aggregated activity of firms benefitting from the market making exemption hinders the effectiveness of the measures foreseen in the SSR.
6. From that perspective, this Technical Advice leans partly on the analysis of concepts derived from MiFID II and MiFIR. Since MiFID II and MiFIR are to enter into application on 3 January 2018, at present regulators cannot benefit from:
 - the additional information to be provided by the new transaction report and record-keeping obligations under Articles 25 and 26 of MiFIR; or

⁵ [ESMA/2013/614](#).

⁶ [ESMA/2013/158](#).

- the information on the impact of the new regime (e.g. the number of firms that will become systematic internalisers under Article 4(1)(20) of MiFID II or that of firms that will be engaged in a market making agreement under Articles 17(3) and (4) and 48 (2) and (3) of MiFID II).
7. As requested in the Commission mandate, ESMA also undertook a survey amongst regulators to gather their views on the elements addressed in the CP. However, ESMA notes that the complete exemption from reporting requirements under Article 17 of the SSR provides regulators with a limited data set to assess whether the market making exemption allows for liquidity provision without undue circumvention.

3 Exemption for market making activities

Extract from the Commission formal request for Technical Advice

ESMA is asked to analyse whether the exemption for market making activities and the definition of market making activities is adequately clear, in view of current practices and as evidenced in previous reviews undertaken by ESMA in relation to its guidelines on that topic, whether the scope of such exemption is appropriate in view of its objective to safeguard the positive role of market making activities with respect to market liquidity and efficiency, and whether the notification procedure of Article 17(5) is adequate, effective and efficient. In particular, ESMA is asked to assess the impact of the membership requirement featured in the definition of Article 2(1)(k) on those entities making markets on financial instruments which are only traded OTC, and to assess the consequences, if any, of the absence of alignment between the definition of 'market making activities' in Article 2(1)(k) of the Regulation and that of 'market maker' in Article 4(1)(7) of Directive 2014/65/EU.

In carrying out its analysis of the issues covered by the mandate, ESMA is encouraged to use and rely upon empirical evidence and quantitative data which it deems relevant, and to seek the views of competent authorities and market participants, including [...] i. whether the exemption for market making activities allows for liquidity provision without undue circumvention.

3.1 Background

8. According to point (k) of Article 2(1) of the SSR, «'market making activities' means the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC, which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:
 - a. *by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;*
 - b. *as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;*
 - c. *by hedging positions arising from the fulfilment of tasks under points (i) and (ii)».*
9. That definition was further specified by the ESMA Guidelines on the exemption for market making activities and primary market operations under the SSR

(ESMA/2013/158) issued in April 2013 (hereinafter “the ESMA Guidelines”). Starting from an analysis of the definition of market making activities contained in Article 2(1)(k) of the SSR conducted by the Commission Legal Services, the ESMA Guidelines clarified that the market making activity is determined on a per-financial instrument basis and subject to various conditions, including being “*a member of the market on which it deals as a principal in one of the capacities defined in paragraph 11⁷, in the financial instrument for which it notifies the exemption*”.

10. Article 17 of the SSR provides for an exemption from Articles 5, 6, 7, 12, 13 and 14 of the SSR in favour of entities carrying out “*market making activities*”, allowing them:
 - to build net short positions without being obliged to notify to the relevant NCA and to the public;
 - to enter into short sales in relation to shares or sovereign debt without having a coverage for the short sales; and
 - to enter into transactions that lead to an uncovered position on sovereign CDSs.
11. Recital (26) of the SSR clarifies that the rationale for the market making activities exemption is that those activities play a crucial role in providing liquidity to markets within the EU and that the entities carrying out those activities need to take net short positions to perform their role. Imposing requirements on market making activities could severely inhibit market makers’ ability to provide liquidity and have a significant adverse impact on the efficiency of EU markets.

3.2 On the clarification of the definition of ‘*market making activities*’ and its eventual alignment of the definitions of ‘*market making activities*’ under Article 2(1)(k) of the SSR and that of ‘*market maker*’ under Article 4(1)(7) of MiFID II

3.2.1 Framework

12. In the request for Technical Advice received by ESMA, the Commission mentioned the absence of alignment between the definition of ‘*market making activities*’ contained in

⁷ Paragraph 11 of the ESMA Guidelines: “According to Article 2(1)(k) ‘*market making activities*’ means the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC (MiFID), which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:

- a. by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
- b. as part of its usual business, by fulfilling orders initiated by clients or in response to clients’ requests to trade;
- c. by hedging positions arising from the fulfilment of tasks under points (a) and (b)”.

Article 2(1)(k) of the SSR and that of '*market maker*' contained in Article 4(1)(7) of MiFID II.

13. According to Article 4(1)(7) of MiFID II, «'*market maker*' means a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against that person's proprietary capital at prices defined by that person».
14. In the CP ESMA asked market participants whether the absence of alignment between the definition of market making activities in the SSR and the definition of market maker in MiFID II was not considered appropriate and, in that case, what the respondents' suggestion would be.

3.2.2 Analysis following feedback from stakeholders

15. ESMA received fourteen responses to this question.
16. Half of the responses were against the alignment between the definition in the SSR and MiFID II. These respondents were in favour of maintaining the definition of the SSR as it is, because the SSR definition implies regulatory exemptions that are not included in the MiFID II's one, and the SSR better specifies the different activities covered by the market making. Some of these responses also allude to the risk of potential unintended consequences as a reason to avoid alignment.
17. Two respondents proposed changes to the definition of the SSR to ensure that the following activities are included in the scope of the '*market making activities*':
 - OTC activities and, in particular, the activity of systematic internalisers; and
 - Active strategies, which are not based on passively posting simultaneous two-way quotes.
18. Five respondents were clearly in favour of the alignment.
19. ESMA notes that the reference to "*market maker*" in MiFID II is not further specified and that it is linked to the obligation to be authorised as an investment firm under Article 2(1)(d)(i) of MiFID II.
20. There are several elements suggesting that the intention of the co-legislators has always been to keep the definitions of MiFID and SSR separated:
 - firstly, the concept of '*market maker*' exists already in the original MiFID but the SSR consciously used a different, broader, wording. This is consistent with the co-legislator's intention to include the hedging as part of the market making activity, that is not explicitly acknowledged as part

of the activity of a ‘*market maker*’ neither under Article 4(1)(7) of MiFID II nor under Article 4(1)(8) of MiFID;

- recital (60) of MiFID II decouples explicitly the definition of ‘*market making activities*’ in the SSR from other similar definitions in MiFID II, such as that of ‘*market making strategy*’;
 - finally, recital (26) of the SSR specifies that the definition in Article 2(1)(k) should be applicable to ‘*different types of market-making activity*’. ESMA understands that by doing this the SSR acknowledges that any activity that materially meets the requirements of the SSR should be caught by the definition, regardless of how they are named in other areas of the EU legislative framework.
21. ESMA also considers that market participants and NCAs would benefit from further clarification in the SSR on the scope of the MiFID II/MiFIR activities that may benefit from such exemption.
 22. MiFID II and MiFIR contain several references to activities that may qualify as ‘market making activities’ under the SSR. See, for instance, Article 17(3) and (4) of MiFID II (‘market making strategies’), Article 4(1)(20) of MiFID II (‘systematic internalisers’), Article 20(3) of MiFID II (OTFs may deal on their own account on their OTF for illiquid sovereign bonds) or Article 9(5)(d) of MiFIR (liquidity providers). It is worth noting that the MiFID II/MiFIR regulatory framework maintains the differentiation between the above-mentioned categories (see, for instance, Article 64(1) of Commission Delegated Regulation (EU) 2017/565⁸ or Article 1 of Commission Delegated Regulation (EU) 2017/575⁹).
 23. Two responses to the CP claimed that the definition of ‘*market making activities*’ should be amended to permit active strategies to benefit from the exemption, focusing on the contribution of those active strategies to price discovery, while not demonstrating their actual contribution to the available liquidity in the market, as required by recital (26).
 24. Since those responses do not demonstrate the link between active strategies and the provision of an investment service or activity available to other market participants, those strategies should be considered as proprietary trading as described in recital (18) of MiFID II. ESMA wishes to remind that recital (26) of the SSR specifies that the

⁸ Article 64(1) of [Commission Delegated Regulation \(EU\) 2017/565](#): “for the purposes of this Article and Articles 65 and 66, ‘execution venue’ includes a regulated market, an MTF, an OTF, a systematic internaliser, or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing” (emphasis added).

⁹ Article 1 of [Commission Delegated Regulation \(EU\) 2017/575](#): “This Regulation lays down the specific content, the format and the periodicity of the data to be published by execution venues relating to the quality of execution of transactions. It shall apply to trading venues, systematic internalisers, market makers, or other liquidity providers” (emphasis added).

exemption ‘*should apply to the different types of market-making activity but not to proprietary trading*’.

3.2.3 Content of the Technical Advice

25. ESMA is of the view that the differentiation between the concepts of ‘*market maker*’ under MiFID II and ‘*market making activities*’ under the SSR should remain.
26. ESMA also recommends revising the definition of ‘*market making activities*’ in Article 2(1)(k) of the SSR to ensure that the following activities are encompassed.
27. Regarding **market making activities carried out on a trading venue**, ESMA considers that the following activities might be able to benefit from the exemption:
 - a. Continuous auction order book trading system:
 - Firms engaged in market making agreements under Article 17(3) and 48(2) of MiFID II.
 - Any other form of liquidity providers. Under this category would fall firms engaged in a contract with an issuer¹⁰ not posting simultaneous two-way quotes but reacting to orders submitted by other market participants according to their agreement with the venue or the issuer.
 - b. Quote-driven trading system: market makers participating in those systems provided that they are bound to provide firm quotes on an ongoing basis unless exceptional circumstances arise.
 - c. Periodic auction trading system: market makers participating in those systems provided that they are bound to participate in the auctions unless exceptional circumstances arise.
 - d. Request-for-quote trading system: members or participants bound to provide firm quotes upon request on an ongoing basis unless exceptional circumstances arise. Under this category would also fall firms posting simultaneous non-binding two-way quotes reacting to orders submitted by other market participants whereby they specify the quotes on the basis of the orders received (e.g. depending on the size of the order), according to their agreement with the venue or the issuer¹¹.
 - e. OTFs:

¹⁰ ESMA notes that the market-making activity on behalf of the issuer should be subject to specific scrutiny to ensure that it is effectively made on the market-maker’s own account and not on the issuer’s account.

¹¹ See previous footnote 10.

- Market makers engaged by the OTF under Article 20(5) MiFID II; and
 - Market making activity of an OTF operator in its own venue in illiquid sovereign debt under Article 20(3) of MiFID II.
- f. Other on-venue activities within the scope: ESMA considers that market making activities may also encompass negotiated transactions as defined in Article 4(1)(b) of MiFIR, i.e. negotiated privately but reported under the rules of a trading venue as long as they comply with the requirements applicable for the market making exemption.
28. In relation to **market-making activities carried out OTC** ESMA reiterates the assessment made in its 2013 Technical Advice on the evaluation of the SSR¹²:
- the arguments for an exemption for OTC market makers remain valid, given that the entities carrying out those activities need to take short positions and conduct short sales in order to fulfil their role;
 - any significant short positions that market makers enter into in the course of their activity should not be directional bets on the price of a financial instruments and should be maintained for very brief periods while they square their book.
29. Consequently, ESMA considers that investment firms or credit institutions authorised to perform OTC market-making activity by dealing on their own account should be able to benefit from the exemption.
30. ESMA considers that the definition currently contained in the second limb of Article 2(1)(k) of the SSR should be specified through technical standards with the requirements presently contained in the ESMA Guidelines, and in particular, clarifying that the activity is undertaken as part of the firm's regular business as described in paragraph 54 of the ESMA Guidelines. Therefore, either the firm already deals on a frequent and systematic basis in the financial instrument in question or, if the instrument is traded on an ad-hoc and infrequent basis, the firm stands ready and prepared to provide prices to clients at all times (i.e. during business hours).
31. ESMA proposes expanding the scope in terms of instruments also to 'pure' OTC instruments. From that perspective, market-making activity should also encompass the activity of an investment firm that enters into a bilateral OTC financial instrument in response to a client's request to trade, as long as the above mentioned requirements are met.

¹² See paragraphs 149 to 152 of the [Final Report](#) (ESMA/2013/614).

32. Finally, ESMA acknowledges that the above list of activities should not be considered a closed ended one, since market practices are not stable across time, and new forms of market making may arise over time. In this respect, ESMA may revise its own advice in the future in light of future market developments.

3.3 Scope of instruments for the purpose of the exemption for ‘*market making activities*’ under Article 2(1)(k) of the SSR

3.3.1 Framework

33. Under the current SSR, in addition to market-making activities on shares and sovereign debt (plus CDS), the exemption can also be used for hedging market-making activities in instruments which would create a long or short position in the former ones. Short positions entered into in the corresponding share or sovereign debt are then exempted to the extent that they are undertaken for the purposes of hedging market making activities in the financial instrument in question. This approach is confirmed in the ESMA Guidelines, which specify that the instruments within the scope of the market-making exemption are only those that appear in the list of Annex I of Commission Delegated Regulation (EU) 918/2012.
34. ESMA requested the views of market participants regarding the extension of the scope of the market making exemption to other instruments that are currently only traded OTC hedged through shares and sovereign debt. In particular, the CP addressed the possibility of expanding the scope of the market making activity to convertible bonds, subscription rights, dividend swaps (with respect to shares) and corporate bonds (with respect to sovereign debt). ESMA notes that convertible bonds, subscription rights and corporate bonds may be traded on a RM or an MTF, despite most of the trading activity of some of these instruments currently takes place OTC.
35. ESMA’s preliminary view was that the exemption would be applicable where those instruments show high correlation with the corresponding shares in the case of convertible bonds, subscriptions rights and dividend swaps, and in the case of corporate bonds, with either sovereign debts or a combination of the corresponding shares and sovereign debts. ESMA noted that if the proposal went forward it would be necessary to elaborate further the concept of “high correlation” that is currently not defined.
36. ESMA’s preliminary view was that the specification of the financial instruments for which the market making exemption would be available could be made by expanding the lists in Parts 1 and 2 of Annex I of the Commission Delegated Regulation (EU) 918/2012.

3.3.2 Analysis following feedback from stakeholders

37. ESMA received only ten responses to this question.
38. All respondents agreed to enlarge the set of financial instruments eligible for the exemption for market making activities. Most of them considered that at least the expansion should include convertible bonds and subscription rights (for the activity on shares) and corporate bonds (to be hedged through trades on sovereign debt). Two responses advocate for increasing the scope of instruments to corporate bonds (for sovereign debt), but requested from ESMA guidance on the concept of high correlation. Three responses explicitly mentioned dividend swaps but did not elaborate on how the activity on those instruments would be hedged through short positions in shares.
39. One respondent proposed including also unlisted structured products, transferable securities, supranational/sub-sovereign (SSA) debt, in addition to the instruments already mentioned. Again, there was no explanation on the grounds for that expansion.
40. One respondent requested expanding the scope of the SSR to financial instruments admitted to trading on a third-country market.
41. Regarding the requests to include within the scope financial instruments admitted to trading on a third-country venue, dividend swaps, unlisted structured products, transferable securities and supranational/ sub-sovereign (SSA) debt, ESMA considers that the interpretation of exemptions set out in European legislation has to be narrow by nature, unless there are compelling reasons to proceed otherwise. Despite the CP explicitly asked for justification of any expansion of the scope, the supporting responses provided no evidence to ground that expansion. In line with that, ESMA does not recommend expanding the scope any further.
42. Finally, two responses considered that there is no need for specific list of instruments and instead the scope of instruments benefitting from the market making exemption should correspond to the list of financial instruments included in Section C of Annex I of MiFID II.
43. With respect to OTC instruments, the regulatory framework set by MiFIR makes foreseeable that an increasing number of them will be subject to the obligation to be traded on trading venues. Nonetheless, ESMA agrees with the views expressed by some respondents indicating that not all financial instruments will be subject to that obligation and therefore, a significant number of financial instruments will only be traded OTC.
44. From that perspective, ESMA agrees with the views expressed by the majority of respondents to the CP according to which the positive contribution of 'market making activities' should not be limited to on-exchange activities.

3.3.3 Content of the Technical Advice

45. ESMA reiterates its 2013 Technical Advice on the evaluation of the SSR¹³.
46. With respect to **shares**, the instruments benefitting from the exemption should be the ones included in Part 1 of Annex I of Commission Delegated Regulation (EU) 918/2012 (i.e. options, covered warrants, futures, index-related instruments, CFDs, shares/units of ETFs, swaps, spread bets, packaged retail or professional investment products, complex derivatives, certificates linked to shares, global depository receipts), plus subscription rights and convertible bonds.
47. ESMA recommends that for those instruments to be included in the scope they should have the relevant share as underlying.
48. With respect to **sovereign debt**, the instruments benefitting from the exemption should be the ones included in Part 2 of Annex I of Commission Delegated Regulation (EU) 918/2012 (i.e. options, futures, index-related instruments, CFDs, swaps, spread bets, complex derivatives, certificates linked to sovereign debt), plus corporate debt which is highly correlated with the sovereign debt in question.
49. ESMA recommends that, with the exception of corporate debt, for those instruments to be included in the scope they should have the relevant sovereign debt as underlying.
50. ESMA considers that the concept of high correlation between the corporate debt and the sovereign debt instruments should be specified through technical standards.
51. As a result of ESMA's proposal to include subscription rights and convertible bonds (for shares) and corporate bonds (for sovereign debt and CDS), the list of instruments within the scope of the market making exemption would differ from the list of instruments that may create a net short position in an instrument included in Annex I, Parts 1 and 2 of Commission Delegated Regulation (EU) 918/2012.
52. Accordingly, ESMA recommends amending the SSR to permit the introduction of a different list of instruments that may benefit from the market making exemption through a revision of Commission Delegated Regulation (EU) 918/2012.
53. ESMA would like to underline that the proposal does not change the approach described in the ESMA Guidelines on the market making exemption: the exemption is

¹³ Paragraph 153: "...ESMA accepts that shares and sovereign debt are used for hedging products other than equity and sovereign debt derivatives. As noted above, it is a common strategy for market makers in corporate bonds to hedge their market making risks via trades in the relevant sovereign debt. Without the exemption, the corporate bond market maker would face additional costs and problems in doing so. Similar considerations apply to convertible bonds and subscription rights market making. Denying such market makers the exemption seems difficult to justify given that trading in the appropriate shares or sovereign debt is as legitimate a hedging strategy for them as for market makers in equity or sovereign debt derivatives. 154. ESMA therefore recommends that the scope of the financial instruments eligible for the market making exemption should be expanded, subject to the product being within the scope of the Regulation overall as currently defined in Article 1 of the Regulation".

granted on a per instrument basis and should not be considered as a global exemption for market making activities in general.

54. ESMA reiterates that activities in the corresponding share or sovereign debt will be exempted only to the extent that they are undertaken for the purpose of hedging market making activities (e.g. posting two-way quotes or fulfilling orders initiated by the clients) in the above-mentioned instruments: there should be a direct link between the market making activity in any of the instruments described above and the short position in the corresponding share or issuer of the sovereign debt.
55. ESMA recalls the points made in its Technical Advice on the evaluation of the SSR back in 2013¹⁴ regarding the application of the market maker exemption to OTC instruments.
56. Consequently, the scope in terms of instruments described above should be applicable regardless of whether the instrument is traded on a trading venue as defined in MiFID II or is only traded OTC, as long as the market making activity (hedging) involves a share admitted to trading in an EU RM or MTF or an EU sovereign debt instrument.
57. From that perspective, ESMA considers that the definition in the second limb of Article 2(1)(k) of the SSR should be further specified through technical standards with the following requirements:
 - The OTC financial instrument has to be within the expanded list proposed by ESMA in this Technical Advice and have the relevant share or sovereign debt as underlying (being corporate debt subject to specific rules); and
 - There has to be a strict link between the market making activity as described above and the hedging activity undertaken on a trading venue or OTC.

¹⁴ Paragraph 152: "ESMA considers that, in principle, the above reasons for providing a market maker exemption apply whether the market maker is dealing in an OTC product or an exchange-traded one. This needs to be clarified in the definition of market making activities set out in Article 2(1)(k) of the Regulation. For example, market makers in OTC equity derivatives may hedge their risk by taking a short position in the corresponding underlying equity. A requirement to obtain the necessary locate and other confirmations every time they conduct a short sale will add extra process and costs to their market making operations and affect the efficiency and cost of risk management of market making, especially in less liquid instruments. In turn this could result in reduced liquidity in these markets, and increase costs for customers. Under the current Guidelines OTC equity derivative market makers are therefore at a disadvantage to their exchange-traded equity derivative counterparts who would qualify for the market maker exemption under the ESMA Guidelines. Although this is in line with the interpretation of the working of Article 2(1)(k), it is not clear that this different treatment of market makers in OTC products is justified".

3.4 Membership requirement

3.4.1 Framework

58. The ESMA Guidelines list three preconditions for being exempted under the market making activities from the SSR provisions: (i) being a member of the market on which it (ii) deals as principal in one of the capacities listed under the definition of market making activities, (iii) in the financial instrument for which it notifies the exemption.
59. Clarification on those conditions was made following the legal analysis provided by the European Commission on Article 2(1)(k) of the SSR, according to which:
 - a. membership should be considered in relation to the trading venue on which the financial instrument subject to the exemption is traded; therefore,
 - b. market making activities in relation to pure OTC instruments cannot benefit from the exemptions provided in Article 17(1) of the SSR.
60. Five competent authorities reported that they were not complying with certain provisions of the ESMA Guidelines as they disagreed with the interpretations therein contained. This was the case in particular for (i) the 'membership' requirement and (ii) the 'product scope', which would not allow to exempt instruments other than shares or sovereign debts or instruments creating long or short positions in shares or sovereign debt.
61. The ESMA Peer Review on market making activities under the SSR published in 2016 found that most NCAs under review solely focused on the membership of the trading venue where the relevant instrument is traded (or just whether the notifying entity is member of a trading venue, regardless of where the market making activity takes place in another venue).
62. The Commission's mandate requested specifically to address whether the membership requirement should be required for entities which are making markets on financial instruments only traded OTC. ESMA asked market participants whether the membership requirement should be deleted with respect to the OTC market making activity (both on financial instruments only traded OTC and on financial instruments traded on-venue), including the case where the market making activity is carried out simultaneously OTC and on-exchange.

3.4.2 Analysis following feedback from stakeholders

63. With respect to the deletion of the membership requirement for 'pure' OTC instruments (i.e. for instruments that are not traded in any trading venue), ESMA received twelve responses, the majority of them in favour. Most of these respondents requested the membership requirement to be removed for the market making activity on all

instruments, highlighting that the MiFID definition does not require market maker to be member of a trading venue.

64. Two associations underlined that as MiFIR does not have as main purpose eliminating the universe of OTC instruments, even after its entry into some instruments (such as sovereign CDS single name market or OTC equity swaps) will not become traded on-exchange.
65. Two of these respondents were in favour of having the membership requirement amended so that it only requires a firm to be member of a single trading venue and not each trading venue where the instrument is traded. One respondent of this group argued that the membership requirement could be replaced, in the case of OTC activity by the qualification as a systematic internaliser.
66. Two associations expressed themselves in favour of maintaining the membership requirement with the exception of sovereign CDS to ensure that only entities that regularly contribute to liquidity and assume specific obligations benefit from the exemption.
67. With respect to OTC instruments, the regulatory framework set by MiFIR makes foreseeable that an increasing number of them will be subject to the obligation to be traded on trading venues. Nonetheless, ESMA agrees with the views expressed by some respondents indicating that not all financial instruments will be subject to that obligation and therefore, a significant number of financial instruments will only be traded OTC.
68. From that perspective, ESMA agrees with the views expressed by the majority of respondents to the CP according to which the positive contribution of 'market making activities' should not be limited to on-exchange activities.
69. With respect to OTC market making activity on exchange-traded instruments ESMA received twelve responses, the majority of which in favour of allowing this activity to benefit from the market-making exemption under the SSR.
70. One respondent explained that bilateral and on-exchange trading activities are often interlinked – e.g. one leg of a trade could be carried out OTC with a client, whilst the other leg can be done on an exchange or other venue. There are markets, particularly in fixed income areas, where OTC trading is prevalent even though there is also on-exchange trading available instruments. For these reasons, it argued that OTC market making should be able to benefit from the exemptions in any case.
71. Three respondents disagreed with granting the exemption to OTC market making activity on exchange-traded instruments. One of these respondents considered that one of the advantages of the membership requirement is the extra layer of checks performed by the trading venues on its members.

72. A number of respondents raised the issue of consistency between the SSR and MiFID II. A respondent noted that granting the exemption for OTC market making activities on exchange-traded instruments might not be consistent with the overarching objectives of MiFID II to make markets more transparent and accountable. Two other respondents stated that only OTC market making activities performed by systematic internalisers should benefit from the exemption, as they are subject to specific transparency requirements.
73. Despite the arguments expressed by the respondents to the CP, ESMA remains of the view that the membership requirement cannot be ruled out from the on-venue market-making activity.
74. ESMA has analysed the benefit of requiring the market maker to be member of one of the trading venues where the market-making activity effectively takes place. In favour of this approach, there are a number of arguments:
- a. This approach would ensure that the firms benefiting from the exemption are investment firms, credit institutions or comply with the other requirements set out in Article 53(3) of MiFID II.
 - b. It seems to favour the provision of liquidity across EU venues from a double perspective:
 - Firstly, ESMA understands that some trading venues may not require being a member or participant in order to engage into a liquidity provision scheme (i.e. these venues permit engaging through direct electronic access (DEA)¹⁵. At the same time, despite firms accessing through DEA are not subject to the revision foreseen in Article 53(3) of MiFID II they are still subject to a due diligence assessment foreseen in Article 22 of Commission Delegated Regulation (EU) 2017/589 on the organisational requirements for investment firms engaged in algorithmic trading.
 - Secondly, as highlighted by one of the responses to the consultation, firms become members/participants of a trading venue depending on whether that is economically efficient for their activity. This approach would permit firms already benefiting from the exemption in relation to one trading venue (as they are member) to make the market in other trading venues through DEA, without bearing the economic burden of becoming member/participant of every trading venue where they carry out their market making activity unless that fits their business model.

¹⁵ For the definition of DEA and further specifications, see Article 4(1)(41) of MiFID II, Article 20 of [Commission Delegated Regulation \(EU\) 2017/565](#) and [Q&A on MiFID II and MiFIR market structures topics](#).

75. ESMA also wishes to underline that firms engaged in a market making agreement under Article 17(3) and 48(2) of MiFID II should not automatically benefit from the exemption if they strictly meet the requirements in terms of presence set out in Commission Delegated Regulation (EU) 2017/578 on market making agreements and schemes (Commission Delegated Regulation (EU) 2017/578): 50% of daily trading hours during continuous trading excluding opening and closing auctions.
76. Unlike Commission Delegated Regulation (EU) 2017/578, the ESMA Guidelines require for the market making exemption a minimum presence time for liquid shares of 80% of the overall trading time. ESMA wishes to underline the different purpose and significant differences between Commission Delegated Regulation (EU) 2017/578 and the ESMA Guidelines.
77. Another element worth noting is that the membership requirement as such should be revised in light of the expansion of the concept of 'trading venue' under MiFID II that now also includes OTFs. As opposed to RMs and MTFs, OTFs have clients, not members nor participants¹⁶.
78. ESMA notes that the requirements on the access an OTF are different to those for RMs or MTFs: whilst the access to RMs and MTFs is regulated by Articles 53(3) and 19(2) of MiFID II¹⁷, the access to an OTF is governed by Articles 18(3)¹⁸ and 25¹⁹ of MiFID II.
79. ESMA also acknowledges that a certain degree of harmonisation between the access to RMs, MTFs and OTFs should take place since Article 48(1) and (6) of MiFID II, as supplemented by Articles 7, 9 and 10 of Commission Delegated Regulation (EU) 2017/584, is also applicable to OTFs²⁰. However, such alignment should only apply to OTFs that admit algorithmic trading to their systems.
80. From that perspective, it is not possible to know at this stage whether the requirements to access OTFs will be fully in line with those needed to become a member or a participant of a RM or MTF.
81. ESMA also notes that Article 20(5) of MiFID II explicitly foresees that OTF operators may engage another investment firm to act as market makers on the OTF on an independent basis. It is not possible to know at this stage whether OTFs will have any other type of liquidity provision schemes operating on them on top of what is described in Article 20(5) of MiFID II.
82. With respect to the deletion of the membership requirement when the market making activity was undertaken simultaneously OTC and on-exchange, and in line with the

¹⁶ See recital (16) and Article 20 of MiFID II.

¹⁷ The requirements established are focused on an analysis of the reputation of the applicant, its level of trading ability, competence and experience, its organisational arrangements and the resources for the role they are to perform.

¹⁸ The Article is focused on the objective and non-discriminatory access to the facility.

¹⁹ The Article concerns the assessment of the suitability and appropriateness of the client and the services provided.

²⁰ See Article 18(5) of MiFID II.

previous answers, the majority of respondents were in favour, cross-referring to their previous answers.

83. One respondent underlined that membership of a trading venue is instrumental to the market making activity: market makers only become members of a trading venue (or use any other form of access to the trading venue) when it is economically useful, e.g. for an OTC market maker to cover on-exchange the positions resulting from its OTC activities. Otherwise, such a membership should not be deemed necessary to effectively fulfil his market making activities.
84. The same respondent highlighted that the requirements with respect to market making strategies/agreements in Article 17 MiFID II and Commission Delegated Regulation (EU) 2017/578 (which require being a member of the market) still have to prove their effectiveness in practice. Moreover, this respondent considered that their impact should be limited given that its scope only covers certain liquid instruments and continuous auction order book trading systems which are activities which would not be covered by the definition of OTC market making activity under Article 2(1)(k)(ii) and (iii) of the SSR.
85. Another respondent considered that the membership requirement should remain with respect to the OTC market making activity on instruments traded on-venue.
86. One association requested to consider within the scope persons accessing EU markets through DEA and not as members of a trading venue.
87. When ESMA asked in the CP about other possible requirements to substitute the membership requirement, including the possibility to require market makers to be systematic internalisers, the majority of respondents were against the proposal. The responses noted that:
 - the purposes of MiFIR and the SSR are different;
 - under MiFID II 'market makers' and 'systematic internalisers' are mentioned as different 'execution venues' (see Article 64 Commission Delegated Regulation (EU) 2017/565); and
 - firms have to register as systematic internalisers when the internalised trading volume exceeds firm and market-based thresholds established in Commission Delegated Regulation (EU) 565/2016. These responses remarked that the activity of making markets for the firm's own clients does not change after qualifying as a systematic internaliser. These responses noted as well that the thresholds intend to protect small firms (or small business units within larger firms) from levels of expenditure that would render these business models uneconomical. For these respondents, if the proposal to require firms to become systematic internalisers (in order to benefit from the exemption) were followed, while big firms making markets OTC whose own account business exceeds the

MiFID II thresholds would “automatically” qualify, small firms would be forced to “opt in” the systematic internaliser-regime just to make use of the market making exemption. The potential consequences of such approach would be not only a competitive distortion in favour of large OTC market making firms but also a shrink of liquidity in the market to the extent that smaller firms (or business units) might have to cease trading because the costs would become prohibitive for them.

88. Two respondents were in favour of the requirement of being a systematic internaliser. One of them considered such requirement needed to increase market transparency and to contribute to the trading obligation for shares under Article 23 of MiFIR.
89. ESMA agrees with the views expressed by the majority of respondents to the CP according to which the positive contribution of ‘market making activities’ should not be limited to on-exchange activity and reiterates the points made in its Technical Advice on the evaluation of the SSR back in 2013²¹.
90. ESMA also agrees with the concerns expressed by respondents to other parts of the CP indicating that the exemption should not be based on reaching the thresholds set out to become a systematic internaliser (or forcing those firms to ‘opt-in’ the systematic internaliser regime). However, and with respect to shares, ESMA also notes that Article 23 of MiFIR introduces the obligation to trade shares on a RM, MTF or a systematic internaliser, unless the trades executed by an investment firm with its own clients are non-systematic, ad-hoc, irregular and infrequent. In that context, ESMA considers that only firms registered as a systematic internaliser could benefit from the exemption for shares.

3.4.3 Content of the Technical Advice

Membership requirement with respect to on-exchange market making activity on instruments admitted to trading on a trading venue

²¹ Paragraph 152: “ESMA considers that, in principle, the above reasons for providing a market maker exemption apply whether the market maker is dealing in an OTC product or an exchange-traded one. This needs to be clarified in the definition of market making activities set out in Article 2(1)(k) of the Regulation. For example, market makers in OTC equity derivatives may hedge their risk by taking a short position in the corresponding underlying equity. A requirement to obtain the necessary locate and other confirmations every time they conduct a short sale will add extra process and costs to their market making operations and affect the efficiency and cost of risk management of market making, especially in less liquid instruments. In turn this could result in reduced liquidity in these markets, and increase costs for customers. Under the current Guidelines OTC equity derivative market makers are therefore at a disadvantage to their exchange-traded equity derivative counterparts who would qualify for the market maker exemption under the ESMA Guidelines. Although this is in line with the interpretation of the working of Article 2(1)(k), it is not clear that this different treatment of market makers in OTC products is justified. ESMA therefore is of the view that the requirement in the Regulation for the market maker to be a member of a trading venue on which the product in which it is market making is admitted to trading should be reconsidered in Article 2(1)(k) of the Regulation- at least in respect of financial instruments not admitted to any EU trading venue”.

91. ESMA is of the view that the definition currently contained in Article 2(1)(k) of the SSR should be revised in order to require the market maker to be **member of one of the trading venues** where the market-making activity effectively takes place.
92. ESMA wishes to note that it is difficult to foresee at this stage the number or the market share of firms that may carry out market making activity through DEA and potentially benefitting from the exemption. In that context, ESMA may revise its Technical Advice once the MiFID II/MiFIR provisions have been in application for a sufficient time.
93. ESMA believes that firms benefiting from the market making exemption on the basis of their market making activity on a trading venue should always meet the following requirements:
 - Market makers should be **dealing strictly on own account**: firms making markets on behalf of the issuer should be specifically scrutinised to determine whether they meet this requirement. This requirement should be applicable in equal terms for firms operating OTC.
 - Minimum requirements in terms of **presence, size and spread** should be met by the firms benefitting from the exemption. ESMA recommends those requirements, some of which are currently laid down in ESMA Guidelines, should be set through technical standards for specific types of instruments.
94. ESMA is of the view that credit institutions/investment firms engaged as market makers on OTFs under Article 20(5) of MiFID II should also have the capacity to benefit from the exemption, insofar as they meet the other requirements analysed in this Technical Advice.

Membership requirement with respect to OTC market making activity for instruments only traded OTC

95. ESMA proposes not requiring the membership requirement with respect to the market making activity on instruments not traded in any EU trading venue. ESMA notes that also implies that investment firms/credit institutions authorised to deal on their own account could hedge their OTC market making activity on a trading venue, without having to be a member/participant (or client) of that venue.

Membership requirement with respect to OTC market making activity on instruments traded on-venue

96. ESMA proposes that firms undertaking OTC market making activities regarding instruments traded in an EU trading venue should be able to benefit from the exemption without being required to be members/participants of those venues.

97. ESMA notes that it also implies that investment firms/credit institutions authorised to deal on their own account could hedge their OTC market making activity on a trading venue, without having to be a member/participant (or client) of that venue.
98. ESMA wishes to underline that firms benefitting from the exemption due to their OTC market making activity will remain subject to the requirements set out in Articles 23 (obligation to trade shares on a RM, MTF or systematic internaliser) and 28 (obligation to trade classes of derivatives subject to the trading obligation on a RM, MTF or OTF) of MiFIR as long as they hedge their activity using shares or derivatives subject to the trading obligation.
99. Finally, ESMA notes that firms simultaneously undertaking a market making activity on-venue and OTC should be able to benefit from the exemption as long as they fulfil the membership requirement for the on-venue market making activity.

3.5 Extension of reporting requirements to NCAs for market makers benefiting from the exemption under Article 2(1)(k) of the SSR

3.5.1 Framework

100. Recital (26) of the SSR acknowledges that since market makers play a crucial role in providing liquidity to EU markets no requirements that would impair their ability to perform that function should be imposed on them. Recital (26) also points out that in the performance of that role market makers should not take significant short positions except for very brief periods.
101. Article 17(1) of the SSR exempts firms performing market making activities from transparency obligations on their net short positions, both with respect to the NCAs and to the public. However, Article 17(11) of the SSR provides that «*the competent authority of the home Member State may request information, in writing, from a natural or legal person operating*» under the exemption for market making activities in relation to short positions held or activities conducted under the exemption. This *ad hoc* request allows the NCA of the market maker to request for information about the net short positions held by that specific market maker.
102. Apart from the above, the SSR does not provide any general reporting requirement for market makers.
103. As elaborated in the ESMA Guidelines, short positions in the corresponding share or sovereign debt are exempted only to the extent they are undertaken for the purpose of hedging market making activities in the relevant financial instrument pursuant to point (iii) of Article 2(1)(k) of the SSR.

104. ESMA noted in the CP that under most, if not all, EU laws on financial markets (e.g. MIFID, MIFID II/MIFIR, CSDR, EMIR...) market makers are not fully exempt from reporting requirements to the relevant NCA of the financial instrument.
105. In the Peer Review on the compliance with the SSR regarding market making activities ESMA had observed the limited information available to NCAs regarding the activity carried out by firms benefiting from the market making exemption. In particular, ESMA raised the issue that *“close collaboration with other institutions involved in the supervision of market making activities and with trading venues when it comes to measuring performances of the market makers is one of the key features of the exemption process that allows competent authority to properly investigate suspicious transactions”*.
106. Therefore, ESMA advanced in the CP the possibility of proposing an amendment of the SSR to make firms benefitting from the market making exemption subject to reporting of their net short positions. No questions were asked in the CP.

3.5.2 Analysis following feedback from stakeholders

107. Only one joint response from two sell-side associations addressed the issue of a new reporting requirement for firms benefitting from the market making exemption under the SSR. These respondents considered such requirement likely to be duplicative as NCAs already have access to extensive information through other reporting requirements set out in other areas of the EU legislative framework.
108. In considering this issue, ESMA has identified the following advantages and disadvantages.
109. Whereas ESMA considers the exemption for market making activities useful, it also notes that the universe of firms benefitting from the exemption may expand to a wider range of firms in case the Commission decides to revise the SSR along the line proposed in this Technical Advice.
110. In that context, ESMA notes that the Peer Review demonstrated that NCAs may already find difficulties in monitoring the fulfilment of the requirements under the current SSR. Those difficulties are framed in a context where the range of firms benefitting from the exemption is far more limited than the scope proposed in this Technical Advice and mostly linked to on-venue trading activity.
111. ESMA would like to point out that, despite the view expressed by the respondents who reacted to the section on reporting requirements, the overhaul of MiFID has provided

NCA's with a limited set of additional tools to monitor the activity of firms benefitting from the market making exemption under the SSR²².

112. Overall, the main advantage of any reporting system would be an increased intelligence for NCA's on the activities carried out by firms benefitting from the market making exemption, in particular with respect with large net short positions held by these firms that, as foreshadowed in the CP, should be the exemption rather than the rule. On the basis of that information, NCA's would be able to undertake any further investigation (if) needed.
113. At the same time, ESMA also considers that the impact of such additional requirement should be limited given that, according to paragraph 43 of the ESMA Guidelines²³, firms benefitting from the market making exemption should have adequate monitoring arrangements that would help them to identify the type of situations addressed by this new reporting requirement.
114. The main disadvantage identified is that the proposed reporting requirement may represent a significant change for market makers that could limit their willingness to provide liquidity to the market.
115. Since the benefits linked to the exemption for market making activities are limited to the effective and appropriate performance of such activities, ESMA considers that the review of the SSR should provide regulators with additional tools to monitor the performance of firms benefitting from the market making exception.
116. In particular, NCA's should have visibility of situations where firms benefitting from the exemption incur in net short positions for periods sufficiently long to question the expectation described in recital (26) of the SSR²⁴.
117. The technical details should ensure that the thresholds and time periods avoid imposing any unjustified administrative burden on both NCA's and market makers, and that the technical means used to submit those notifications are neither IT-intensive nor cost-intensive.

²² In fact, despite Article 11(3) of [Commission Delegated Regulation \(EU\) 2017/590](#) for the reporting of transactions to NCA's foresees the specific reporting of short sales of firms benefitting from the exemption, that information does not automatically provide regulators with information regarding the net short positions held in the context of the market making activity.

²³ In particular, ESMA considers that the identification of these situations should be already covered by:

- the obligation to implement internal procedures with respect to the market making activities for which they claim the exemption that allow these activities to be immediately identified and the records readily available to the NCA upon request; and
- the obligation to possess effective compliance and audit resources and a framework to enable it to monitor the market making activities for which the firm requests the exemption.

²⁴ Recital (26) of the SSR: "...market makers would not be expected to take significant short positions except for very brief periods".

3.5.3 Content of the Technical Advice

118. ESMA considers necessary amending the SSR to ensure that firms benefiting from the exemption notify NCAs their net short position only once a minimum threshold has been reached and maintained over a certain period, so that NCAs may undertake any investigations they consider appropriate.
119. ESMA recommends specifying by regulatory technical standards the technical details of the proposal including:
 - a. the threshold that would trigger the obligation to notify;
 - b. the time period (if any) over which the net short position has been held;
 - c. the technical means for the notification; and
 - d. the time of notification to the NCAs.

3.6 Notification procedure

3.6.1 Framework

120. According to Article 17(5) of the SSR, the exemption for the market making activities shall apply *«only where the natural or legal person concerned has notified the competent authority [...] that it intends to make use of the exemption»*.
121. The ESMA Guidelines explain that the exemption process is not an authorisation or licensing process.
122. The ESMA Guidelines also specify in paragraph 65.ix that the notification has to specify the financial instrument(s) for which the notifying entity intends to use the exemption. In particular, the notification may take the form of a list of individual financial instruments or a clear specification of the instruments concerned (e.g. FTSE 100 on a particular date) providing a list of specific instruments that allows the NCA to identify all individual instrument for which the exemption is requested.
123. ESMA's proposal in the CP clarified that once an index has been notified, the notifying entity would not be forced to update its original notification each time a new financial instrument was added to the index. However, ESMA also maintained its original approach whereby in order to notify an index the firm should have the intention to undertake market making activities in all the instruments included in the index. ESMA also consulted whether sectoral categories (e.g. banking sector, utilities) could be used on top of the indices to facilitate the notification process.
124. ESMA acknowledged that it would not be appropriate to grant exemptions on a blanket basis, as it is necessary for NCAs to know to which financial instruments the exemption

applies in relation each market maker. On that basis, ESMA explained that too broad notifications (e.g. all financial instruments traded on a specific venue) would not be appropriate for these purposes.

125. The CP also addressed Article 17(5) of the SSR which requires that «*the notification shall be made not less than 30 calendar days before the natural or legal persons first intends to use the exemption*».
126. ESMA's asked whether the 30-day period could be made more functional and in particular: (i) whether the 30-day period should not apply to instruments admitted to trading for the first time for which there is no historical trading data available; (ii) how to reduce the 30-day period before the market maker can make use of the exemption; (iii) whether a simplified approach could apply in relation to the situation where market makers have already entered into a market making agreement/scheme with a trading venue or the issuer of the financial instrument himself, in order to be a "recognised" marker maker in such venue.

3.6.2 Analysis following feedback from stakeholders

127. With respect to the question on whether market makers should be able to notify the list of financial instruments using indices, ESMA received twelve responses, most of them agreeing with the proposal. Only one respondent was against the proposal arguing that the benefits to market makers are likely to be outweighed by the additional administrative burden upon the regulators (e.g. tracking changes to index constituents).
128. Two respondents just mentioned that one NCA already allows notification referred to indices when the market maker carries out its activity on all the shares included in the relevant index. A respondent pointed out that a high number of instruments for which the market maker exemption is availed are not included in any index. Finally, one association proposed, on top of notifying on a per index basis, that firms should be able to notify on a per category of instruments mirroring the asset class/sub asset class categorization in Commission Delegated Regulation (EU) 2017/583²⁵.
129. The following issues were highlighted: undertaking market-making activities in all the instruments of the index, inclusion of new instruments in the index and keeping market-making activities for instruments dropped off an index.
130. On the requirement to undertake market making activities in all instruments within the notified index:
 - One respondent mentioned that the market maker should include in the notification the intention to trade as market maker on the majority of the

²⁵ [Commission Delegated Regulation \(EU\) 2017/583](#) on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives.

instruments within that market segment/index. On the contrary, another response noted that for smaller markets it was preferable to keep the current per-instrument approach to prevent that firms be forced to undertake market making in all the instruments in the index (something that those firms might not be willing to make).

- Another respondent proposed that, where a notification per index/segment is made, the market maker should be able to notify the whole index and maintain a record of each of the instruments for which they avail themselves of the exemption for ex post analysis by the NCAs. They also requested that the notification would not include the underlying instruments.
131. On the ongoing update of indices, one respondent proposed a notification per trading venue or per index, permitting also that the market making exemption would remain operative for instruments dropped out of the index.
132. Regarding the identification of sectoral categories, one respondent pointed out the lack of a generally accepted classification of sectorial categories.
133. ESMA agrees with the proposal made by one sell-side association regarding the capacity of notifying entities to refer to indices provided by authorised benchmark administrators.
134. On the amendment of the 30-day period established in Article 17(5) of the SSR in general, ESMA only received nine responses, all of them in agreement with the proposal.
135. In that context, several respondents requested a complete overhaul of the SSR approach to the market-making exemption:
- Two responses requested changing into a pure notification of the firm/business unit undertaking market making and an *ex post* analysis by regulators of their activity. One of these respondents requested firms to benefit from the exemption since the time of notification, with the NCA retaining a right to reject it within 30 days upon which time the firm would need to immediately cease relying on the exemption. The other respondent considered that a different approach would facilitate managing corporate actions that may result in an ISIN-change (e.g. splits, mergers, name changes) and the list of instruments under Article 16(2) of the SSR.
 - One trading venue considered that there should be two different levels of analysis: a more demanding one, when a firm applies to benefit from the exemption for the first time in relation to an instrument. A less demanding analysis (and shorted deadlines) should be applied when the same firm

applies to expand its market making activity to other instruments within the same asset class.

- Finally, another respondent proposed moving into an *ex post* notification process whereby, similarly to the systematic internaliser regime, firms should be able to assess whether they meet the conditions in Article 2(1)(k) of the SSR.

136. With reference to the amendment of the 30-day period for obtaining the market making exemption when the notification refers to instrument admitted to trading for the first time, ESMA received only seven responses, all in favour of the proposal.

137. These respondents noted that the details of the admission (including the ISIN of the instrument) might not be publicly known 30 days before starting trading. In addition, firms willing to undertake market making in new instruments may not be able to provide an indication of expected daily/weekly volumes. Two responses also raised the issue of the constant creation of new financial instruments. One respondent suggested that a 5-day period should be considered instead.

138. ESMA agrees with a point raised by some respondents noting that a notification using sectorial categories could face some practical problem considering the lack of generally accepted classification of them. Therefore, it is ESMA's view that a notification using sectoral categories would create uncertainty among market participants as to whether an instrument is included in a certain category and hence it should not be permitted.

3.6.3 Content of the Technical Advice

139. Regarding the notification of instruments via indices, ESMA considers that for the SSR purposes, notifying entities should have the following possibilities:

- Notifying the intention to make the market in relation to an 'index', considered as a dynamic list, where the market maker will continue to benefit from the exemption in relation to the financial instruments included in the index in that moment, insofar as it makes the market in relation to all of them. This approach should avoid forcing market makers to re-notify every time there is a re-balance of the index in question and some instrument/s is/are dropped from the list and substituted with other/s.

To reduce the administrative burden imposed on firms, ESMA recommends that notifying entities should have the capacity to notify that they intend to undertake market-making activities in the components of the index even if they are dropped off the list. Otherwise, in case an instrument within an index is dropped off it and the entity wishes to continue making markets on that instrument, it would have to submit another notification.

The notification of market making activities in relation to an index should also include the possibility to notify market making activities on financial instruments included within the lists described in Annex I of Commission Delegated Regulation (EU) 918/2012 having that index, as such, as underlying.

Notifying entities should have the capacity to refer to indices provided by authorised benchmark administrators.

- Notifying a basket of instruments. In this case, it would be necessary to notify any changes in the basket of instruments.

140. Regarding the maximum delay to benefit from the exemption, and in line with the proposal put forward by one trading venue, ESMA proposes that the exemption process should differentiate between two different situations:

- a. the notification of an entity that, for the first time, is willing to benefit from the exemption with respect to one asset class (considering as such shares, sovereign debt or CDSs). In this case, NCAs should be able to avail themselves of a period of up to the 30-calendar day period. After that period the firm may make use of the exemption unless the NCA explicitly indicates otherwise; and
- b. further notifications from an entity already benefitting from the market making exemption in relation to an instrument/instruments within the same asset class. In this case, the firm should start benefitting from the exemption five-working days after the new notification, unless the NCA informs the market maker that it intends to avail itself of a period of up to 30-calendar days before the market maker can start benefitting from the exemption. This flexible approach should allow most market makers to take advantage of the exemption faster, while not preventing the NCA from taking more time to evaluate certain notifications before the market maker starts benefitting from the exemption.

141. ESMA notes that its Advice refers to maximum delays, i.e. nothing prevents NCAs from reacting before the maximum delay to the firms that have submitted a notification.

142. ESMA recommends harmonising through technical standards the assessment that NCAs should undertake with respect to notifications received. In this respect, ESMA reminds the conclusions of the Peer Review regarding the lack of harmonisation of the notifications assessment undertaken by the NCAs.

143. ESMA wishes to clarify that the amendments of the notification process should not affect the NCA's power to intervene at any time after the notification, provided that the conditions to benefit from the exemption are no longer met.

144. ESMA is aware that, if the Commission decides to follow this Technical Advice, NCAs are likely to receive at an initial stage a high number of new notifications making difficult

meeting the maximum delays described above. In light of that, ESMA recommends considering setting up a transitional regime in order to pursue a smooth transition to the new notification system.

3.7 Other issues in the context of the definition of ‘market making activities’

3.7.1 Content of the Technical Advice

Other proposed amendments of Article 2(1)(k) of the SSR

145. Regarding the category “*a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC*” which appears in the current Article 2(1)(k) of the SSR, ESMA notes that there is no corresponding letter under MiFID II. Accordingly, it is recommended the deletion of this reference in the revised SSR.
146. Third country firms should be able to benefit from the exemption for market-making activity (both on a trading venue and OTC) as long as they operate in the European Union according to the regime established under Chapter V of MiFID II (Articles 39 to 43) and Title VIII of MiFIR (Article 46 to 49).

Article 13(2) of the SSR

147. ESMA recommends amending the SSR to clarify that under Article 13(2) of the SSR transactions used to hedge a long position in ‘sovereign’ debt instruments the pricing of which has a high correlation with the pricing of a sovereign debt are exempted from the obligation to locate the instrument. ESMA’s request for clarification is based on the wording used by the SSR: Article 13(2) uses the term ‘issuer’ (which is not defined) and not ‘sovereign issuer’ (which is defined in Article 2(1)(d) of the SSR).

Publication of the list of firms benefitting from the exemption and also the instruments covered by the exemption

148. ESMA also recommends amending Articles 17(12) and (13) of the SSR to ensure that NCAs notify ESMA and ESMA publishes on its website not only the list of firms benefitting from the market making exemption, but also the list of instruments on which each firm intends to undertake market making activities.

Record-keeping obligations for firms benefitting from the exemption

149. ESMA remains of the view that it is necessary for NCAs to be able to monitor easily the effective market-making activity with respect to the financial instruments covered by the exemption. From that perspective, ESMA recommends the SSR to be amended to include:



- The obligation of firms benefitting from the exemption to maintain their records of orders and transactions relating to their market making activities for which they request the exemption, so they can be easily distinguished from their proprietary trading activity; and
- The requirement to be able to demonstrate at any time to the NCA that their market making activities meet the principles and criteria laid down in the SSR, its delegated and implementing regulation and its guidelines.

150. Finally, ESMA recommends aligning the timing for those record-keeping obligations with Article 25 of MiFIR (five years).

4 Short term restrictions on short selling in case of a significant decline in prices: Article 23 of the SSR

Extract from the Commission formal request for Technical Advice

ESMA is asked to analyse whether the procedure for imposing short-term restrictions on short selling in case of a significant decline in price is efficient, effective and relevant and fosters consistent approaches across the Union, and whether and how it could be simplified.

In carrying out its analysis of the issues covered by the mandate, ESMA is encouraged to use and rely upon empirical evidence and quantitative data which it deems relevant, and to seek the views of competent authorities and market participants, including [...] ii. whether the thresholds set to identify a significant drop in the price of financial instruments are appropriate for all instruments.

4.1 Background

151. ESMA was mandated by the Commission to provide Technical Advice in relation to the procedure for imposing short-term restrictions under Article 23 of the SSR. Note that the mandate did not cover the power of NCAs to adopt long term restrictions in exceptional circumstances, under Articles 18 to 21 of the SSR.
152. Article 23(1) of the SSR provides that «*where the price of a financial instrument on a trading venue has fallen significantly 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*».
153. The SSR and Commission Delegated Regulation (EU) 918/2012 set the thresholds to identify a significant drop in the price falls for shares and other types of financial instruments.
154. As indicated by the co-legislators, the aim of the short-term ban lies in the prevention of a disorderly decline in the price of a financial instrument traded on a trading venue. To that purpose, the NCA of the trading venue where the significant fall in price took place may:
 - prohibit or restrict the short selling of the financial instrument on that trading venue;

- otherwise limit transactions in that financial instrument on that trading venue.
155. Since the entry into application of the SSR only two NCAs have activated the power to prohibit short selling on shares traded on a trading venue. The power to otherwise limit transactions in a financial instrument has never been used.
156. The measures under Article 23(1) of the SSR 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 the trading day following the one on which the fall in price occurred there is, despite the measure being imposed, a further significant fall in value of at least half of the amount required to initially activate the measure, the NCA may extend the measure for a further period not exceeding two trading days.
157. According to Article 23(4) of the SSR, where a NCA intends to activate a measure under Article 23(1) of the SSR, it has to notify ESMA about its decision at the latest two hours after the end of the trading day. ESMA then immediately informs the NCAs of the trading venues that trade the same financial instrument.
158. The measure directly applies to the jurisdiction of the proposing NCA only. The other NCAs may:
- agree with the measure and adopt similar restrictions in their own jurisdictions;
 - not to disagree with the measure but take no action in their own jurisdictions; or
 - oppose the measure.
159. If any NCA disagrees with the proposed measure, e.g. because the proposed measure relates to a financial instrument that is also traded on a venue under its jurisdiction, ESMA may start a conciliation phase in order to assist those NCAs in reaching an agreement in accordance with Article 19 of the ESMA Regulation.
160. The conciliation should be completed before midnight of the same trading day. If the NCAs concerned fail to reach an agreement within the conciliation phase, ESMA may take a decision in accordance with Article 19(3) of the ESMA Regulation. In any case, the decision has to be taken before the opening of the following trading day.
161. ESMA has adopted a procedure to regulate the details of the notification process to ensure that, in case of disagreement between NCAs, the conciliation process come to a conclusion in accordance to the schedule laid down in Article 23(4) of the SSR.
162. In the first SSR review Technical Advice that ESMA transmitted to the Commission in June 2013 (ESMA/2013/614), after analysing the few bans adopted by that time, ESMA

found out that short terms bans seemed to have a limited negative effect on trading volumes and a small positive impact on returns of the shares under restriction, but did not seem to have a significant impact on price volatility.

163. In the 2013 Technical Advice ESMA already proposed:

- to simplify the procedure for adopting short-term bans by assigning a more relevant role to the NCA of the concerned financial instrument rather than the one of the trading venue where the fall in price has occurred; and
- to reconsider the scope of Article 23 of the SSR, keeping the -10% threshold for liquid shares and increasing the thresholds for other instruments, or removing them from the scope of the rule.

164. In its 2013 report on the evaluation of the SSR²⁶, the Commission observed that *«it has come to the attention of the Commission that in cases where a competent authority imposed a temporary “significant price fall” short selling ban on certain shares, similar bans on the same shares were not imposed by competent authorities of other Member States in which those shares were also traded, or they adopted divergent measures. This resulted in the ban being in force in some Member States and not being applied in other Member States. In certain other cases, even different competent authorities within one Member State have acted differently in deciding whether or not to impose a short selling ban applied by a Member State»*.

4.2 Main findings of the economic analysis

4.2.1 Short-term bans adopted

165. Between November 2012 and December 2016, the power to temporarily restrict short selling in a financial instrument has been exercised by two NCAs only (the Italian CONSOB and the Portuguese CMVM). The other EU NCAs have either taken similar actions following the measure adopted by CONSOB and CMVM or have taken no action. No NCA has opposed the restrictions.

166. NCAs have explained that, in the majority of the cases, they have not opposed other NCAs' restrictive measures because of the absence of dual listing of the instruments subject to the measure.

167. Despite the number of instances where the relevant levels of intraday price falls were crossed (see Annex IV), the restrictive measures under Article 23 of the SSR have only been adopted 46 times, exclusively in relation to shares and mostly in respect of liquid shares traded on RMs. The restrictions have been extended in five instances.

²⁶ [COM/2013/0885](#).

Article 23 bans adopted from 1 Nov 2012 till 31 Dec 2016 (starting authority only)					
Article 23 bans	threshold	status		entering into force of the restrictions	
		first adoption	renewal	intraday ban	start of the next day
shares included in the main national equity index	-10%	40	5	13	32
other liquid shares	-10%	5	0	2	3
non liquid shares with price > 0.5	-20%	0	0	0	0
non liquid shares with price < 0.5	-40%	1	0	0	1
TOTAL		46	5	15	36

168. NCAs have pointed out that they did not activate any restrictive measures in all those instances where they identified reasons for justifying the drop in the price (e.g. unexpected bad financial results, negative tests for biotech companies) or where there was no evidence of disorderly decline in the price.

169. In relation to other financial instruments, such as corporate bonds, sovereign bonds, money market instruments, ETF/ETC, despite the huge number of instances where the relevant levels of intraday price falls were crossed (around 33,212 for sovereign bonds, 20,862 for corporate bonds and 1,297 for ETF/ETC in the period between November 2012 and December 2016 – see Annex IV) no NCA has ever adopted a ban. For some financial instruments, this may be due to the fact that NCAs were aware of the fact that falls in the prices of such instruments could be explained by their low liquidity and/or other reasons such as, for fixed income instruments, the low level of interest rates.

4.2.2 Empirical evidence on the crossing of the thresholds set to identify a significant drop in the price falls

170. In order to fulfil the mandate received from the Commission in relation to the assessment of «*whether the thresholds set to identify a significant drop in the price of financial instruments are appropriate for all instruments*», ESMA carried out an empirical analysis based on five years of daily data. The analysis includes instruments as identified in the SSR, for which historical data from commercial databases were available²⁷.

171. The empirical evidence for each type of instrument, based on current SSR thresholds, is summarised in Table 1. The table displays the number of instruments and daily observations available, as well as the number and share of observations that have crossed the relevant threshold²⁸.

172. For example, using data on 966 liquid shares, percentage changes between the previous day's closing price and the lowest price of the day were computed, resulting in more than 1.1 million observations over the period 2012 to 2016²⁹. Around 3,500

²⁷ Money market instruments were not included in the analysis due to data limitations.

²⁸ The analysis is based on one observation per instrument per day.

²⁹ ISINs for which no data is available are excluded from the analysis.

observations (i.e. 0.3% of the total) are below the -10% SSR threshold, or on average three observations per day³⁰.

Table 1: Overview of SSR thresholds and significant price falls

Instrument type	Number of instruments	Number of observations	SSR threshold	Observations crossing the threshold	Share ^d	Daily average ^e
Liquid shares ^a	966	1,145,722	-10%	3,580	0.3%	3
Semi-liquid shares ^a	203	188,862	-10%	1,741	0.9%	1
Illiquid shares ^a	3,204	2,926,202	-20%	4,669	0.2%	4
Very illiquid shares ^a	890	654,150	-40%	3,809	0.6%	3
Sovereign bonds ^b	499	344,060	+7%	33,212	9.7%	28
Corporate bonds ^b	3,081	1,763,730	+10%	20,862	1.2%	18
Exchange-traded funds ^c	1,917	1,347,246	-10%	1,297	0.1%	1

Notes: Overview of price changes that crossed the SSR thresholds for significant price falls, by type of instrument. The calculations are based on one observation per instrument per day. Daily data from 1 January 2012 to 31 December 2016.

^a Daily observations for shares calculated as daily low price to previous day's closing price, in %. Liquid shares are shares trading on EU regulated markets (MiFID definition). Semi-liquid shares are non-liquid shares (MiFID definition) that were constituents of a main national equity index, as of January 2017; the sample may change over time due to shares being added to or dropped out of equity indices. Illiquid and very illiquid shares are non-liquid shares (MiFID definition) that are not constituents of a main national equity index; illiquid shares have a euro-equivalent price greater than or equal to EUR 0.5 per share as of end-2016; very illiquid shares have a euro-equivalent price smaller than EUR 0.5 per share as of end-2016.

^b Daily observations for bonds calculated as percent change in annual yields based on bid prices, in %, for EUR-denominated sovereign and corporate bonds that are constituents of the Markit iBoxx EUR sovereigns index and Markit iBoxx EUR corporates index. Sovereign bonds exclude sub-sovereign and local government issuers. Corporate bonds exclude covered bonds and collateralised bonds.

^c Daily observations for EU-domiciled exchange-traded funds calculated as daily low price to previous day's closing price, in %. Data including UCITS and non-UCITS exchange-traded funds.

^d Share of observations that have crossed the relevant SSR threshold during the sample period.

^e Average number of observations per day that have crossed the relevant SSR threshold during the sample period.

Sources: Shares: ESMA MiFID Register, Thomson Reuters Datastream; Sovereign and corporate bonds: Markit iBoxx; Exchange-traded funds: Thomson Reuters Eikon and Thomson Reuters Lipper; ESMA calculations.

173. Below are described the main findings based on the summary of empirical evidence, while the details and problems identified for shares, bonds and exchange-traded funds are spelled out in Annex IV.

³⁰ For simplicity, daily averages are calculated based on the number of week days over the entire period, rather than the number of trading days which differs from one country to another.

174. Shares: The proportion of observations that crossed the relevant SSR thresholds is below 1% for each category of shares, i.e. an average 11 observations per day across all categories of shares and EU countries. The number of significant price falls amounts to only a small part of the returns distribution, suggesting that SSR thresholds for shares mainly cover unusual market events (i.e. the 99th percentile).
175. Exchange-traded funds (ETFs): Compared to shares, an even smaller part of the returns distribution (0.096%) crossed the relevant SSR threshold, suggesting that the threshold for ETFs mainly covers extreme market events (i.e. the 99.9th percentile). This may reflect the index-tracking nature of ETFs, which can be prone to smaller price changes due to offsetting price movements of individual securities that their reference indices comprise.
176. Bonds: The large share of observations that crossed the relevant SSR thresholds, in particular for sovereign bonds, reflects the use of thresholds based on yields. Due to very low to negative interest rates, small nominal changes in basis points can result in large relative percentage changes. The definition and calibration of SSR thresholds for bonds likely needs to be revisited to adequately capture significant price falls.
177. Money market instruments: Money market instruments were not included in the analysis due to data limitations. These instruments include a variety of short-term assets, such as government T-bills, certificates of deposits and short-term corporate bonds. This makes the assessment and calibration of a single threshold based on prices a challenging exercise for public authorities.

4.2.3 Effects of the short-term bans on prices, volatility and liquidity

178. Since the entry into application of the SSR, only two NCAs have adopted short-term bans and they were all relating to short selling in shares: until the end of 2016, a total of 46 bans were imposed, including 28 in Italy and 18 in Portugal. Bans were imposed with immediate effect, either during the day or after markets close, until the end of the next trading day. In five instances, the bans introduced were extended for two additional trading days.
179. ESMA has carried out an economic analysis on the effects of the short-term bans adopted in the period ranging from 2013 to 2016³¹. Due to data availability, it has been conducted on 38 bans out of 46, corresponding to 20 different issuers (i.e. ISIN) with the aim to assess the effects on prices, volatility and liquidity. The analysis has been conducted separately for Italy and Portugal to take into account any country specificities though using the same approach. The main findings of the economic analysis are summarised below and reported in detail in Annex III.

³¹ No ban was introduced between the entry into application of the SSR in November 2012 and the end of 2012.

180. Using an event study methodology, the analysis suggests that the SSR temporary short-selling restrictions do not have a statistically significant impact on share prices. Although the positive sign of abnormal returns during the short-selling bans is in line with findings in the economic literature, the mean is not significantly different from 0. This result holds across countries and benchmark indices used in the analysis. Similarly, the effect on stock price returns of lifting the ban is non-statistically significant.
181. The volatility analysis based on two different measures shows that share price volatility declines when the ban is introduced and continues to do so after the ban is lifted. Despite further investigations, it was not possible to determine conclusively the existence of a causality link. The analysis of bid-ask spreads also suggests that the introduction and lifting of a temporary short-selling ban on share do not have a statistically significant impact on the liquidity of that share.
182. It is important to keep in mind that the analysis presents a few caveats, given the nature of the events tested using statistical methods that are usually better suited to long-term policy changes.
183. The results may also reflect the specificities of short-term bans. The constraint imposed on short-selling activities is a relatively weak one due to the short-term and temporary nature of the bans, the exemption for market making activities, and the ability to take short positions in securities covered by the prohibition using derivative instruments, which may explain their limited effects. Short-selling bans also vary in their use and applications. Only two NCAs have made use so far of this instrument since the end of 2012 and bans are not systematically imposed when the relevant threshold for significant price falls is crossed.
184. ESMA has also analysed the trend of net short position notifications around short-term bans (see section 5 of Annex III), based on the data collected from the NCAs that were used for the analysis of the impact of the public disclosure threshold.
185. The average number of notifications received is broadly stable around short-selling bans: between 26 and 30 notifications per day. In the days preceding and following bans, the number of short-position increases exceed the number of short-position decreases, by a ratio of around 3 increases to 2 decreases.
186. There were a total of seven net short position increases reported to NCAs during bans, although the number of decreases was larger (19). Out of the nine shares on which net short positions changed during the ban, the number of increases exceeded the number of decreases in only one instance.
187. The average number of short position holders is 4.7 per ban, and the median is 4. One noteworthy development is the growing number of notifications for shares on which NCAs have imposed more than one ban (Banco Popolare, BCP, Banco Espírito Santo, Monte dei Paschi, Portugal Telecom and Saipem). This reflects increased short-selling activity over time and is largely due to the growing number of net short position holders

active on these shares, which increases from 2.5 on average for the first ban to 6.5 for the third ban on the same share.

4.3 Procedure for NCAs to adopt a short-term ban under Article 23 of the SSR

4.3.1 Framework

188. In the CP, ESMA proposed changing the procedure to adopt short term bans, to reduce its burdens and in the view of making the short-term measure more effective.
189. In particular, ESMA proposed that only the NCA of the most relevant market in terms of liquidity for that financial instrument can adopt a ban on that instrument.
190. According to ESMA's proposal, the relevant NCA should inform ESMA and all other NCAs of its intention to adopt a ban and publish it on its website. By that time, the ban should be effective in all Member States.
191. In the CP, ESMA considered whether other NCAs should have any power to oppose the measure. Where a power to oppose the measure adopted by the NCA of the most relevant market in terms of liquidity was to be given to other NCAs, ESMA proposed that such power should be exercised only where the short-term ban would represent a threat to the investors or the market integrity of the opposing NCA. In such cases, the short-term ban would not affect the trading activities executed in the trading venues located in the Member State of the NCA opposing the measure. The opposing NCA would have been required to publish on its website a notice explaining its decision and the reasons therefor.
192. In the CP, ESMA was also contemplating the possibility to change the procedure contained in Article 23 of the SSR with reference to the price to be used to calculate the crossing of the thresholds to identify a significant drop in the price falls of financial instruments. With particular reference to shares, ESMA proposed that NCAs could adopt a ban under Article 23 of the SSR also where the trading of a share is halted on a trading venue, and the share's indicative/theoretical price calculated by the trading venue shows a significant fall (i.e. at least -10%, -20% or -40% depending on the liquidity of the share) in relation to the closing price on that venue on the previous trading day.
193. The rationale for such proposal was to allow a NCA to take action in situations where trading cannot take place on a trading venue because a significant sale pressure has activated circuit breakers, trading halts and/or any other mechanism provided for in Article 48(5) of MIFID II, aimed at halting trading in case of volatility episodes.

4.3.2 Analysis following feedback from stakeholders

194. In relation to the procedure for NCAs to adopt a short-term ban under Article 23 of the SSR ESMA received contributions from ten respondents.
195. Although the majority of the respondents expressed their views that the power of NCAs to adopt short-term bans should be altogether eliminated, some of them expressed a number of suggestions where the possibility to adopt short-term bans was to be maintained.
196. Two respondents supported the proposal to entrust the NCA of the most relevant market in terms of liquidity for a financial instrument with the power to activate the short-term ban under Article 23 of the SSR. Three respondents were against such proposal, highlighting the risks of having bans being directly applicable across the EU on the basis of the analysis and the judgement of a single NCA.
197. One respondent pointed out that no power to oppose the short-term measures under Article 23 of the SSR should be given to the other NCAs.
198. The same respondent supported the proposal to give the NCAs the possibility to adopt a short-term ban under Article 23 of the SSR also in those cases where the trading of the share on a trading venue is halted.
199. Two respondents highlighted the lack of evidence of the effectiveness of the short-term ban and the fact that other instruments provided by MiFID II, such as trading halts and circuit breakers, are far more effective in the case of a significant fall in price.
200. Some respondents pointed out they would welcome any easier way to access the information regarding the other NCA's reaction (agree, not to disagree and oppose) to the short-term ban proposed by a NCA, as such information is not always available.
201. Finally, one respondent suggested to introduce a notice before any short-term ban enters into application.
202. ESMA took note of the opinion of the majority of the respondents suggesting that, in the absence of any evidence of the effectiveness of the short-term bans, the power of NCAs to adopt them should be altogether eliminated. That is somehow confirmed by the findings of the economic analysis carried out by ESMA, highlighting that temporary short-selling restrictions do not have a statistically significant impact on share prices.
203. However, ESMA is of the view that the reasons for the lack of strong evidence about the effectiveness of the short-term bans could lie in its uneven application throughout the Union (even though not opposing the short-term ban adopted by the proposing NCA, some NCAs did not take similar actions in their jurisdictions) and its limited scope, that covers short selling while not affecting entering into new net short positions or increasing existing ones through derivatives. Additionally, ESMA considers that in

some instances of sharp decline in the price of a financial instrument, the adoption of a short-term ban may represent the only swift regulatory measure that can be adopted as an alternative to trading suspension.

204. In relation to the proposal made by a respondent to the consultation envisaging a notice to be given to the market before the entry into application of the short-term ban, ESMA would like to stress that any prior notice would delay the entry into application of the measure and allow front-running it, which is in contradiction with the need to have a tool that ensure a swift reaction to a significant decline in the instrument's price.
205. ESMA is also proposing the publication of ESMA's website to accommodate some respondents' concerns about an easy way to access the information regarding the entry into application of a short-term ban, which is of high importance where the short-term ban is adopted during trading hours.
206. In relation to any power of other NCAs to oppose the short-term ban adopted by another NCA, ESMA notes that:
- given the very short duration of the measure under Article 23 of the SSR, any power given to other NCAs to oppose the measure would add an additional layer of complexity to the procedure;
 - no NCA has ever opposed any short-term ban since the SSR entered into application;
 - no power to oppose the more intrusive long-term measure under Article 20 of the SSR is given to the other NCAs;
 - only the NCA of the most relevant market in terms of liquidity for the concerned financial instruments would be entrusted with the power to adopt a short-term ban, as that NCA is the best placed to assess the need to introduce a restrictive measure which is applicable across the Union.
207. Finally, with reference to shares, ESMA explored in the CP the possibility for NCAs to adopt a ban where, following a trading halt, the relevant threshold identifying a significant fall in price (i.e. at least -10%, -20% or -40% depending on the liquidity of the share) has been crossed by the share's indicative/theoretical price calculated by the trading venue during the trading halt.
208. However, ESMA decided not to include such proposal in the final Technical Advice, given:
- the limited duration of trading halts, circuit breakers and the other mechanisms provided for in Article 48(5) of MIFID II;

- the limited relevance of the theoretical price, if the trading price at the end of the trading halts or circuit breaker has not crossed the threshold;
- the extremely limited support from the respondents to the CP (only one response in favour).

4.3.3 Content of the Technical Advice

209. ESMA proposes amending the current procedure under Article 23 of the SSR to provide that only the NCA of the most relevant market in terms of liquidity for the instrument can adopt a short-term ban that is effective in all Member States. The NCA of the most relevant market in terms of liquidity should be determined according to Article 26 of MiFIR and Article 16 of Commission Delegated Regulation (EU) 2017/590 on the reporting of transactions to NCAs.
210. ESMA also proposes that the other NCAs should not have any power to oppose the short-term measure.
211. According to the proposed revised procedure, the relevant NCA should inform ESMA and all other NCAs of its intention to adopt a short-term ban. The NCA adopting the short-term ban should then liaise with ESMA to ensure coordinated publication of the information concerning the short-term ban on the adopting NCA's and ESMA's website.
212. The ban should be effective in all Member States upon publication on the website of the adopting NCA.

4.4 Scope of the short-term ban under Article 23 of the SSR

4.4.1 Framework

213. Even though the scope of the short-term bans under Article 23 of the SSR is not strictly covered by the mandate received by the Commission, ESMA included in the CP some potential changes to the scope that could contribute to make the short-term bans more effective.
214. In order to avoid the circumvention of the short-term ban (e.g. through the use of derivatives), ESMA proposed in the CP to change the scope of Article 23 of the SSR transforming it from a ban on short selling into a ban on entering into new net short positions or increasing existing net short positions.
215. Additionally, ESMA proposed to restrict the scope of the short-term bans to shares traded on a trading venue, given that other financial instruments have not so far been subject to any bans under Article 23 of the SSR.

216. Lastly, ESMA proposed in the CP to keep the current thresholds set to identify a significant drop in the price falls for shares traded on a trading venue as they were considered to represent a valid and consistent approach among NCAs.

4.4.2 Analysis following feedback from stakeholders

217. In relation to the proposal to change the scope of the short-term ban under Article 23 of the SSR, ESMA received contributions from eight respondents.
218. The majority of the respondents to the consultation suggested that the power of NCAs to adopt short-term bans should be altogether eliminated.
219. The majority of the respondents did not support the proposal to transform the current measure under Article 23 of the SSR into a short-term ban on entering into new net short positions or increasing existing net short positions. Some of them claimed that there is no evidence that OTC trading or derivatives contribute to share price falls, increase volatility or damage liquidity in markets. These respondents highlighted that such new proposed measure would impede hedging long positions across entities within the same group and adjusting net long positions during the bans.
220. Two respondents supporting the elimination of short-term bans pointed out that, if short-term bans were to be maintained, the change in their scope is reasonable, as the empirical evidence and event studies show that, due to the possibility of circumvention, short term bans are overall ineffective.
221. Two respondents proposed restricting the scope of short-term bans to uncovered short selling, both in shares and in derivatives. In that respect, ESMA notes that uncovered short selling of shares is already subject to the general prohibition laid down in Article 12 of the SSR.
222. One respondent suggested keeping the thresholds for shares at the current level and removing the threshold for the other financial instruments.
223. As already pointed out in the previous section, ESMA took note of the opinion of the majority of the respondents suggesting that, in the absence of any evidence of the effectiveness of the short-term bans, the power of NCAs to adopt them should be altogether eliminated.
224. However, ESMA remains of the view that in some instances of sharp decline in the price of a financial instrument, the adoption of a short-term ban may represent the only swift regulatory measure that can be adopted as an alternative to trading suspension.
225. Additionally, one of the reasons for the lack of evidence of the effectiveness of the short-term ban may be relating, among other things, to its limited scope, which covers short selling while not affecting entering into new net short positions or increasing existing ones through derivatives. As highlighted by two respondents to the

consultation, the current short-term bans can be easily circumvented by trading in derivatives.

226. The economic analysis carried out by ESMA showed that during short-term bans there were seven notified increases in net short positions, amounting to 27% of the notifications received during the bans. Although the number of notifications of decreases in net short positions over the bans was larger (19), ESMA considers that such data demonstrates that under the current framework some market participants could have circumvented the bans through OTC trading and derivatives.
227. Moreover, ESMA would like to highlight that the economic analysis was carried out on the basis of the notifications received by NCAs, and thus did not take into account net short positions below the threshold of 0.2% of the issued share capital. Therefore, ESMA cannot assess whether there were any attempts to circumvent the short-term bans on short selling by entering into net short positions below the 0.2% threshold.
228. ESMA also notes the comments made by other respondents claiming the lack of evidence linking OTC trading or derivatives with price falls, increased volatility or damaged liquidity in markets.
229. In that respect, ESMA recognises that there is no clear consensus on the causal link between OTC trading, derivative trading and volatility of the underlying instruments in the academic literature. However, a significant number of papers do support the existence of a link between derivatives, underlying stock price volatility and market efficiency³².
230. ESMA recognises that the proposed new short-term ban may have potential cross-border impacts and be more intrusive compared to the one under current Article 23 of the SSR, especially given ESMA's proposal to entrust the NCA of the financial instrument concerned with the power to adopt the short-term measure, without any other NCAs' power to oppose nor the requirement of an ESMA opinion (required in relation to the long-term bans under Article 20 of the SSR). However, ESMA is of the view that, given the short duration of the measure, the need for the fall in price to cross the relevant threshold represents a sufficient condition for triggering the NCA's power to activate the measure.

4.4.3 Content of the Technical Advice

231. ESMA proposes modifying the scope of the short-term measure to prevent its circumvention through the use of derivatives or OTC trades, changing its scope from a ban on short selling on a trading venue into a ban on entering into or increasing net

³² See for example Ansi and Ben Ouda (2009), "How options markets affect price discovery on the spot markets: a survey of the empirical literature and synthesis", *International Journal of Business and Management* Vol. 4, No. 8.

short positions. The definition of net short positions is comprehensive, as it includes short positions entered into through short selling, derivatives, and OTC trading.

232. In relation to the proposal to extend the scope of the short-term measure, ESMA would like to point out that:

- the scope of the proposed new short-term ban should not include index trading (i.e. positions held indirectly through or by way of an index as referred to in Article 3(3) of the SSR should be allowed), in order to avoid that the restrictive measure has a major negative impact on market liquidity;
- where a NCA adopts a short-term measure, it should expressly mention whether it envisages any exemption for market making activities, in the absence of which the liquidity of the market may be affected;
- the proposed new short-term ban would affect all the instruments (other than index trading) considered in the calculation of the net short positions in the instrument subject to the measure. The new short-term ban may thus affect instruments for which the adopting NCA is not the relevant NCA (e.g. GDRs). In that respect, given the short duration of the measure, ESMA proposes that those instruments should be subject to the restrictive measure without any request for the consent of the relevant NCA.

233. On a different level, further to the consultation ESMA is proposing to restrict the scope of the proposed new short-term ban to:

- shares traded on a trading venue, as the only category of financial instruments that has so far been subject to bans under Article 23 of the SSR;
- sovereign debt instruments traded on a trading venue, given their critical role for the financial stability of the Member States, even though no restrictive measure has so far been adopted in relation to them.

234. ESMA is of the view that the current thresholds set to identify a significant drop in the price falls for shares traded on a trading venue (i.e. -10%, -20% or -40% depending on the liquidity of the shares) should be kept.

235. ESMA also notes that the thresholds set to identify a significant drop in the price falls for sovereign debt should be revisited to adequately capture only significant falls in price.

5 Transparency of net short positions and reporting requirements

Extract from the Commission formal request for Technical Advice

ESMA is asked to analyse whether the method of notification and disclosure of net short positions is appropriate, effective and efficient, whether it could be made less burdensome and costly for notifying entities while still providing competent authorities with the information needed for proper supervision, whether further harmonisation of the notification process is needed, and whether public disclosure of net short positions in shares are efficient, effective and relevant in view of their effects on trading behaviours, market efficiency and volatility.

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

- i. [...]
- ii. [...]
- iii. *whether reporting mechanisms are operating efficiently.*

5.1 Background

236. Chapter II of the SSR provides for transparency requirements in relation to net short positions. In particular, significant short position in shares must be notified to NCAs as well as published when certain thresholds are reached. Significant short positions in EU sovereign debt should also be notified to NCAs. ESMA was requested to assess the method and mechanisms of notification and disclosure of net short positions in three different areas: (i) the appropriateness, effectiveness and efficiency of notifications, (ii) possible simplification while maintaining a sufficient level of information to the authorities for their supervision and (iii) harmonisation of the process. Besides, ESMA is also expected to report on the market impacts of public disclosure of net short positions in shares in terms of market efficiency, volatility and trading behaviours.

237. The SSR lays down various requirements concerning the reporting by market participants of significant net short positions in shares and sovereign debt. The purpose of the enhanced transparency is to benefit both regulators and market participants. For regulators, the objective is to enable them to monitor and, where necessary, investigate short selling that could create systemic risks, be abusive or create disorderly markets. Public disclosure is intended to provide useful information to other market participants about significant individual net short positions in shares.

238. In order to conduct a complete study on the aforementioned topics, ESMA requested and obtained data on net short positions from NCAs to perform an empirical analysis (see Annex V). The analysis reflects the diversity of the SSR data which cover different instruments and level of aggregation and its findings have been taken into account by ESMA in the Technical Advice.

5.2 Notification to NCAs and public disclosure of significant net short positions in shares

5.2.1 Framework

239. Article 5 of the SSR requires the holder of a net short position in a share at or above 0.2% of the issued share capital of the company to make an initial private notification to the relevant NCA, with subsequent notifications required for each incremental 0.1% threshold crossed (upwards and downwards) above 0.2%. A final notification is required once the position has fallen below 0.2%.

240. For net short positions in shares at or above 0.5% of the issued share capital of the company, according to Article 6 of the SSR, a public disclosure is required, with further disclosures when the position reaches or falls below increments of each 0.1% above that level. A final disclosure is required once the position has fallen below 0.5%.

241. In the CP, ESMA consulted on whether the current levels of the thresholds regarding the notification to NCAs and the public disclosure of significant net short positions in shares should be changed.

242. Article 11 of the SSR requires NCAs to provide on quarterly basis information in summary form to ESMA on aggregated net short positions without any requirement to publish such information.

243. Recital (40) of the SSR fosters transparency of net short positions with the aim of reducing information asymmetries, ensuring that all market participants are adequately informed about the extent to which short selling is affecting prices. ESMA noted in the CP that, at the moment, a reduced number of NCAs are voluntarily publishing on regular basis, though not daily, aggregated net short positions in the shares of issuers under their competence, based on the public and non-public notifications received and without mentioning the name of the notifying entities for confidentiality reasons.

244. In the CP, ESMA consulted on whether there would be benefits with the introduction of a new requirement to publish anonymised aggregated net short positions by issuer on a regular basis.

5.2.2 Analysis following feedback from stakeholders

245. On the threshold for notification and public disclosure, the ten respondents that answered the question supported ESMA's preliminary proposal to maintain the current thresholds regarding the notification to NCAs (0.2%) and the public disclosure (0.5%) of significant net short positions. The feedback received confirms that the current levels provide meaningful information to both regulators for supervisory purposes and the market for transparency purposes.
246. In addition, respondents generally supported the current incremental levels (0.1%) of the thresholds regarding the notification to NCAs and the public disclosure of significant net short positions in shares as they found them appropriate. Moreover, the respondents highlighted that a change in the thresholds would increase costs for all position holders that will need to update their systems to take into account the new levels of the thresholds
247. In relation to the threshold for public disclosure of net short positions, the evidence presented in Annex V confirms its relevance: some investors avoid crossing the 0.5% threshold, as reflected in the lower frequency of short position increases and relatively longer duration of positions just below the threshold.
248. One joint response from two associations, in the context of the publication of aggregated publication of net short positions, questioned the value of the publication of net short positions claiming that introduces the risk of pricing inefficiencies through asymmetric information and potential herding, as well as the risk of abusive practices seeking to squeeze those market participants.
249. ESMA agrees that the risk of pricing inefficiencies exists given the avoidance of some investors to cross the public disclosure threshold, and public disclosure appears to reinforce herd behaviour. However, the evidence presented in Annex V also shows that a significant number of investors do increase their position beyond the public disclosure threshold: around 36% of net short positions immediately below the 0.5% threshold are increased and publicly disclosed. This demonstrates that for a percentage of market participants the trade-off between disclosure and the profitability of their strategy is positive.
250. Some respondents had additional comments. In particular, three associations highlighted that the reporting of all changes (upwards and downwards) of net short positions at increments of 0.1% is not appropriate and does not result in meaningful information but duplicates costs and burdens on market participants.
251. These respondents suggested removing the incremental thresholds arguing that NCAs will have access to the data for the exact positions of individual market participants through transaction reports of MIFID II or *ad hoc* requests when needed. According to these respondents, regulators have little benefit in requiring these incremental

notifications whereas the costs of these notifications for market participants is significant (up to hundreds of thousands Euros per year, with the renotification requirement being a significant component of this cost). Therefore, according to these respondents, removing the incremental thresholds would lower the administrative burden on position holders.

252. On the reporting of incremental levels of the thresholds, some respondents highlighted the costs and burden of this reporting requirement and the fact that NCAs will be able to access to the exact positions through the transaction reports foreseen in Article 26 of MiFIR. ESMA would like to stress that, without the incremental levels of the thresholds, it would be challenging for NCAs to monitor the dynamics of the market as well as to assess the upcoming trends.
253. In addition, ESMA reminds that neither transaction reporting under MiFIR nor other areas of European legislation (e.g. central securities depositories) are intended to determine individual positions of one market participant in an instrument. ESMA also reminds that other regulatory requirements (e.g. position reporting regime under Article 58 of MiFID II) are also based on the obligation of market participants to report their net positions despite of the fact that they are also subject to transaction reporting obligations.
254. With reference to the introduction of a new requirement to publish anonymised aggregated net short position, five of the seven respondents supported the introduction of a new requirement to publish anonymised aggregated net short positions by issuer, stressing that these data would provide investors with valuable information for investment decision purposes and could have a positive effect on market efficiency. These respondents also highlighted that the benefits of enhanced transparency could outweigh the costs of implementing this new requirement by NCAs.
255. Two respondents further argued that anonymised aggregated data by issuer including net short positions below 0.5% have more informative value to investors than non-anonymised data on individual net short positions above 0.5%. Nevertheless, there was no clear explanation on the grounds for that statement.
256. On the frequency of such publication, one respondent mentioned a daily publication. Another respondent highlighted that a monthly basis would be insufficiently timely and suggested a weekly basis.
257. Only one joint response from two associations disagreed with both the publication of individual net short positions and with the introduction of such new requirement. For this respondent, the publication of individual net short positions introduces the risk of market distortions in the form of asymmetric information, herding behaviour and squeezing the participants with net short positions. For this association, despite these risks persist in the case aggregated publication, it should only be introduced as a

replacement for the current public significant net short position disclosure under Article 6 of the SSR.

258. ESMA notes that the respondents did not provide any quantification of the benefits of the proposed new requirement to their activity. Despite the majority of respondents considered that it would bring more information to the investors (with certain caveats), the joint response from two associations pointed out that publication could entail pricing inefficiencies, due to asymmetric information and abusive practices seeking to squeeze market participants with open short positions.
259. Even though ESMA is of the view that publishing anonymised aggregated net short positions by issuer on a regular basis may provide relevant information to the market, it also acknowledges the potential risks it entails.
260. From that perspective, ESMA has identified the following arguments against the publication of aggregated net short positions by issuer:
- a. as described by some respondents to the CP, the publicly available information on the issued share capital may be incorrect in some instances. The publication of an aggregated net short positions based on incorrect information might be misleading for market participants that may understand that the aggregated figure has been endorsed by the NCAs and adapt their trading strategy on the basis of the published information;
 - b. the aggregated publication of net short positions that crossed the 0.2% threshold together with those that crossed the 0.5% threshold may unduly expose a notifying entity. For instance, for a share in which a limited number of market participants are holding net short positions, the publication of an aggregated position of 0.8% is very likely to expose the situation of one market participant if there has been a public disclosure of net short position of 0.6% held by another market participant.
261. For the above reasons, ESMA does not consider necessary at this stage harmonising the aggregated publication of net short positions.

5.2.3 Content of the Technical Advice

262. ESMA is of the view that the current initial and incremental thresholds should be maintained as they provide meaningful information to both regulators for supervisory purposes and the market for transparency purposes.
263. ESMA also recommends that NCAs should be allowed to periodically publish anonymised aggregated net short positions by issuer on a voluntarily basis when they consider that the issues described above can be adequately addressed in their jurisdiction.

5.3 Timing for notification and disclosure

5.3.1 Framework

264. Article 9 of the SSR includes requirements in relation to the timing of the notifications or disclosure that should be made no later than 15:30 of the trading day following the trading day on which the threshold was reached. The 15:30 deadline has to be calculated according to the local time of the Member State of the relevant NCA.
265. In the CP ESMA's preliminary assessment was twofold: (i) the information is not considered sensitive by the SSR as it should be published during trading hours (until 15:30); (ii) the 15:30 deadline applies to both the notification and the disclosure. Therefore, according to the SSR NCAs may receive notifications at 15:30 and they should publish them immediately at 15:30.
266. In light of the above, ESMA asked whether the notification time should be kept at 15:30 on the following trading day or whether the publication time should be changed at no later than 17:30 on the following trading day.

5.3.2 Analysis following feedback from stakeholders

267. The eight respondents to the question on the notification time were split. Four respondents would keep the notification time at no later than 15:30 on the following day because there are no practical issues with respect to the current notification time. In these respondents' opinion, it would strike the right balance between allowing investors to calculate their net short positions and ensuring that NCAs possess up-to-date information and publish it in a timely manner.
268. A second group did not support the 15:30 notification time. The majority of these respondents highlighted that the notification time should be delayed to a later time than 15:30. Some of these respondents suggested 17:30. A joint response of two buy-side associations proposed delaying the notification time to 15:30 on T+2 in order to allow further time for calculations and monitoring of large and international market participants that have different units responsible for carrying out SSR calculations in different continents and time-zones.
269. ESMA received only seven responses to the question on the possible change of the publication time. The majority of the respondents supported ESMA's proposal to change the publication deadline to no later than 17:30 on the following trading day. This would allow NCAs to perform basic checks hence avoiding disclosure of erroneous information to the market. One association was of the view that the publication should occur after the markets are closed.
270. The feedback received from market participants confirmed ESMA's view outlined in the CP, i.e. that the deadline for publication of the notifications received should be after the

deadline for submitting the notifications, to allow NCAs to perform consistency checks on the notifications received before their publication.

271. ESMA is of the view that the analysis of the notification time has to be combined with the publication time since both processes are linked.
272. In that respect, ESMA notes that checking the received notifications often requires interaction with market participants. Therefore, delaying the deadline for notification to 17:30 may involve that NCAs will not be able to complete the relevant checks within the day, with the consequence of delaying the publication to the next working day. As highlighted in Recital (7) of the SSR, individual net short positions above the 0.5% of the issued share capital should be publicly disclosed to the market in order to provide useful information to other market participants. Therefore, ESMA is of the view that the publication of net short positions should not be overly delayed.
273. Although there is no evidence that the information to be published is of sensitive nature, ESMA acknowledges that setting the deadline for publication at 17:30 may end up having the information published during the closing auctions of many markets, which is a phase of the trading session particularly sensitive as it provides the closing price for the day.
274. Therefore, it is ESMA's view that a publication no later than 18:00 strikes the right balance between a non-overly delayed publication and the possibility for NCAs to perform checks on the submitted notifications, and should not coincide with the closing auctions of many markets.
275. Finally, ESMA recalls that, given the time zones of the different Member States the publication of the net short positions may occur before or after the closing of the markets.

5.3.3 Content of the Technical Advice

276. ESMA proposes that notifications should be submitted to NCAs at no later than 15:30 and publication should be made at no later than 18:00.
277. As mentioned in the CP, notifying entities remain responsible for the accuracy of the notified information and its publication will be made without prejudice to potential enforcement actions that NCAs may carry out where the notification proved to be inaccurate at a later stage.

5.4 Reporting and disclosure mechanisms

5.4.1 Framework

278. Article 9(4) of the SSR requires that the public disclosure of significant net short positions in shares should be posted on a central website operated or supervised by the relevant NCA. This regime requires the holder of a net short position in different Member States to register to the reporting systems of different NCAs.
279. Recital (3) of the SSR states that the SSR should *«ensure that provisions directly imposing obligations on private parties to notify and disclose net short positions relating to certain instruments and regarding uncovered short selling are applied in a uniform manner throughout the Union»*. However, ESMA recognised in the CP that the processes for registration and submitting notifications, for the publication of data and for accessing published information are not harmonised. ESMA acknowledged that such lack of harmonisation creates additional administrative burdens and costs for position holders.
280. On that basis, ESMA requested stakeholders' opinion as to whether it would be appropriate to provide, and what would be the benefit of, a centralised notification system. Moreover, ESMA asked market participants to express their views on levying a fee on position holders to have access to and report through such a centralised system.
281. ESMA also requested the views of market participants regarding any other possible amendments to make the notification less burdensome.

5.4.2 Analysis following feedback from stakeholders

282. The majority (eight) of the ten respondents supported the creation of a centralised notification and publication system at Union level, stressing the need for harmonisation across the Union and reduction of the administrative burden and costs on market participants. A number of these responses underlined that each NCA has implemented its own system for receiving notifications (pre-approval processes to register, online platforms, email, fax, direct posting).
283. Two associations from both sell-side and buy-side highlighted that such centralised system would permit market participants to develop automated reporting systems and reduce the hours employees currently spent each day manually checking and submitting net short position notifications. Another association even quantified the benefits of such centralised notification system.
284. Two other respondents noted that the process for this centralised system should take into account the fact that NCAs and not ESMA are entrusted with direct supervision under the SSR, and thus proposed that the system should not permit any manual

interference by ESMA. Another respondent argued that if the proposal of a centralised system is not pursued, then at least ESMA should consider a standardised template and communication method (e.g. in Excel format to be sent by email). In that respect, ESMA would like to highlight that a standardised template is already provided by the Commission Delegated Regulation (EU) 826/2012³³.

285. Three respondents did not support the centralised system. Two of them noted that any assessment of the proposal would require knowing the full details of a new short-selling regulation.
286. ESMA notes that the quantitative analysis contained in Annex V shows the number of NCAs the position holders have reported to since the entry into application of the SSR. The analysis of net short positions shows that around 50% of position holders report to just one or two NCAs. However, the most active investors (i.e. reporting to three or more NCAs), which would benefit from a centralised system, also account for the vast majority of notifications (95%). This confirms that short-selling activity is highly concentrated, with a few investors that are very active on shares across several countries.
287. ESMA acknowledges the responses received to the CP and the support for a centralised reporting and disclosure system at Union level. As mentioned in the CP, such system would allow investors currently reporting in different Member States to have a unique process for registration, reducing the administrative burden and costs that position holders currently bear when submitting notifications to multiple reporting systems.
288. As ESMA would have access to all notifications through the centralised reporting system, NCAs would no longer be required to provide ESMA on a quarterly basis, in accordance with Article 11(1) of SSR, with the information on net short positions relating to issued share capital and issued sovereign debt, and uncovered positions relating to sovereign credit default swaps.
289. As mentioned in the CP and highlighted by two respondents, it is important that any centralised system enable NCAs to perform an efficient monitoring and enforcement. To that respect, the centralised system should ensure that NCAs can access on a real-time basis the information on the net short positions of their competence, in order to carry out their supervisory duties and to perform the checks on the notifications.
290. The majority of the respondents did not support the introduction of a fee for position holders to access and report through such a centralised system. They were of the view that the cost of any new system should be completely borne by NCAs, as the running

³³ [Commission Delegated Regulation \(EU\) 826/2012](#).

costs of such a system should be significantly lower than the current different systems in the different member states.

291. One buy-side association and one joint response from two sell-side associations agreed to pay a reasonable cost-based fee for the centralised reporting platform, highlighting that currently Member State publication platforms are not free. However, this joint response strongly envisaged a periodical invoice (on a quarterly, semi-annual or annual basis) rather than per notification and also expected that such platform should also provide the centralised source of issued share capital.
292. ESMA is of the view that building a new EU wide system would involve costs for NCAs that would need to be at least partly compensated by setting up a fee for position holders to have access to and report through such EU-wide system. In addition, as mentioned by some other respondents, currently in some country (e.g. Germany) market participants have to pay the relevant platforms a fee for the public disclosure of significant net short positions.
293. Finally, with reference to the question raised by ESMA on what other possible amendments to make the notification less burdensome would be, market participants proposed the following amendments:
 - a. On the calculation of net short positions,
 - adopting a proportionate approach in relation to the calculation of net short positions held in shares indirectly through short positions in stock market indices and ETFs, i.e. to be excluded from the calculation unless the individual share represents more than 20% of the index or ETF or the investor holds more than 1% of the individual share. This is because of the burden of this task and also because generally short positions in stock market indices or ETFs are held for hedging purposes. In this respect, ESMA reiterates the views expressed in its previous Technical Advice: *“indices can be used to assume a synthetic short position on the whole market. Therefore, ESMA believes that the current rules on the look-through of indices are appropriate and no change is needed”*;
 - enabling convertible bonds to contribute to the long position a participant has in the share of an issuer and not to the short position. Also in this respect, ESMA remains of the view expressed in its previous Technical Advice: *“ESMA considers that long positions in subscription rights and convertible bonds should remain excluded from the calculations, but recommends to amend Delegated Regulation No. 826/2012 so that investor have a possibility to flag such positions in their notifications and disclosures of net short positions. Without challenging the method of calculation, this technical amendment to the reporting and disclosure forms would allow for commonly used shorting strategies to be visible to*

competent authorities or the market; this is of particular importance when companies are raising capital and thus more likely to be subject to short selling”.

- b. Establishing a centralised source of total issued share capital for all issuers whose main shares’ market is within the Union and a centralised register of all in-scope issuers.
- c. Providing a list of shares under the scope of the SSR. In that regard, ESMA understands that the Financial Instrument Reference Data System (FIRDS) together with the list published under Article 16(2) of SSR should provide market participants with the information needed for these purposes.

294. ESMA also acknowledges the difficulties reported for accessing publicly available data on the total issued share capital. Along that line, ESMA considers that the information relating to the issued share capital has to be obtained acting reasonably having regard to the publicly available information.

5.4.3 Content of the Technical Advice

295. ESMA is of the view that building that notification and publication system would involve costs for NCAs that would need to be at least partly compensated by setting up a fee for position holders to have access to and report through such EU-wide system.

296. In relation to the ways to retrieve the information about the issued share capital for the purpose of the SSR, ESMA understands that the following means should be acceptable:

- a. the issuer’s website: the information published in accordance with Article 4 (annual financial report), Article 5 (half-yearly report) and Article 15³⁴ (disclosure by the issuer of the total number of voting rights and capital at the end of each calendar month during which an increase or decrease of such total number has occurred) of Directive 2004/109/EC 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. ESMA acknowledges that the mentioned obligation applies only to issuers whose securities are admitted to trading on a RM, whereas according to the SSR the notification and publication of net short position in shares should be made in relation to issuers whose shares are admitted to trading on a RM or a MTF; and
- b. data vendors.

³⁴ According to Article 15 of Directive 2004/109/EC of the European Parliament and of the Council, “*the home Member State shall at least require the disclosure to the public by the issuer of the total number of voting rights and capital at the end of each calendar month during which an increase or decrease of such total number has occurred*”.

5.5 Content of the notifications

5.5.1 Framework

297. The content of the information to be notified to the relevant NCA and to be published has been standardised across the Union through the Commission Delegated Regulation (EU) 826/2012.
298. Table 1 of Annex 1 of that Regulation includes the list of fields for notification purpose of net short positions in shares, sovereign debt and uncovered sovereign CDS to NCAs. When the position holder is a legal person, the identification code to be used is the Bank Identifier Code (BIC), if available.
299. ESMA noted that the Financial Stability Board promotes the Legal Entity Identifier (LEI) system for financial markets³⁵ as the code that should replace the BIC code currently in place.
300. Accordingly, in the CP ESMA proposed requiring the LEI to identify in the notification the position holder, unless this latter is a physical person or a group.
301. Therefore, ESMA asked whether the identification code of the position holder should be the LEI and whether such code should be mandatory for legal entities.

5.5.2 Analysis following feedback from stakeholders

302. Among the ten responses received, the large majority of the respondents supported the mandatory use for legal entities of the LEI as an identification code of the position holder as this is a widely used and internationally established code for financial markets and this standardisation would simplify the reporting.
303. Only one respondent expressed the view that the mandatory use of LEI is for the time being premature mainly because the LEI for branches has not been implemented yet and this would impact branches within the Union which are subject to SSR separately.
304. The responses received confirmed ESMA's view described in the CP on the mandatory use of the LEI for legal entities, as the LEI is a widely used code and internationally established for financial market. The use of LEI would be beneficial for both NCAs and market participants as it will allow to identify the position holder without relying on its name, which is contained in a text field with no identified rules and prone to errors. Further, the LEI would allow for further checks to the quality of the information received throughout the Union.

³⁵ See "[A Global Legal Entity Identifier for Financial Markets](#)".

305. ESMA acknowledges the comment received from a market participant regarding the absence of LEI for branches. In this case, ESMA is of the view that the LEI of the parent company should be used.
306. ESMA recalls that the Q&A on the Short Selling Regulation³⁶ (see Question 5f) recommended that, where a group has to notify a net short position to a NCA, a good practice would be to consider that the parent company of the group is the relevant legal entity to represent the group.

5.5.3 Content of the Technical Advice

307. ESMA confirms its advice of requiring the LEI to identify in the notification the position holder.
308. As the LEI is not relevant for the identification of natural persons, ESMA is of the view that natural persons should be identified using the same process as in Article 6 of Commission Delegated Regulation (EU) 2017/590³⁷ on the identification of natural persons for the reporting of transactions to competent authorities. The notifying natural person should use the client identifier that is used by the investment firm carrying out the trading for the natural person in order to limit the inconsistency in client identifiers for a same person and facilitate cross-checking with transaction reports received under MiFIR. Also, and as specified in Annex II of Commission Delegated Regulation (EU) 2017/590, if the natural person is not trading through an EU/EEA firm and is not of EEA nationality then the national client identifier as specified in “all other countries” should be used.
309. ESMA proposes that where a group has to notify a net short position, the LEI of the parent company should be used.

5.6 Methodology of calculation of net short positions in sovereign debt

5.6.1 Framework

310. Recital (8) of the SSR states that the “*requirement to notify regulators of significant net short positions relating to sovereign debt in the Union ... assist[s] regulators in monitoring whether such positions are in fact creating systemic risks or being used for abusive purposes*”.

³⁶ [Q&As. Implementation of the Regulation on short selling and certain aspects of credit default swaps.](#)

³⁷ [Commission Delegated Regulation \(EU\) 2017/590](#) for reporting of transactions to competent authorities.

311. Article 7 of the SSR provides the obligation to notify to NCAs significant net short positions in sovereign debt. The thresholds for those notifications are determined by Article 21 of Commission Delegated Regulation (EU) 918/2012.
312. The method of calculation of net short positions in sovereign debt is set out in Article 11 and Annex II of Commission Delegated Regulation (EU) 918/2012, where it is established that cash positions should be taken into account using their nominal value duration-adjusted whereas options and other derivatives should be adjusted by their delta.
313. Since the entry into application of the SSR, whilst most NCAs received less than 25 notifications relating to sovereign debt between 1 November 2012 and 31 December 2016, two NCAs received approximately 200 notifications over the same period.
314. ESMA listed in the CP the different reasons that might justify the relative low number of short position notifications in sovereign debt, ranging from the high initial thresholds and incremental levels for the notification to the current and persistent environment of decreasing and low interest rates or to the inconsistent calculation rules.
315. In that context, ESMA considered necessary to evaluate first the calculation methodology of net short positions in sovereign debt rather than revising the levels of the thresholds, as those levels are dependent on the methodology used.
316. ESMA proposed in the CP revising the current method of calculation of the net short position in sovereign debts, where spot positions are duration-adjusted and derivatives instruments are only delta-adjusted. Two options were proposed to align the method of calculation for positions in cash and derivatives:
 - a. Using the “nominal method”, where spot instruments and derivatives should be taken into account using their nominal amount and derivative instruments adjusted only by their delta, which 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);
 - b. Using the “duration adjusted method”, with an explicit mention to the fact that derivatives should also be adjusted by the duration of the underlying in order to have a consistent approach between cash positions and derivative instruments. This methodology takes into account the interest rate risk which is the main risk linked to a debt instrument and is consistent with the methodology used for risk management purposes.
317. In the CP, ESMA asked which method should be favoured for the alignment, the nominal method or the duration-adjusted method. Additionally, ESMA asked whether, in the latter case, the thresholds should be changed.

5.6.2 Analysis following feedback from stakeholders

318. Among the eight responses received, a small majority of the respondents favoured the duration-adjusted method for consistency between the calculation methodology of cash and derivative instruments and to avoid that the net position figures differ from economic reality. The other respondents would prefer the nominal method for its greater simplicity. One respondent saw no need for any change.
319. The responses received from market participants confirmed ESMA's view described in the CP that the current methodology used for the calculation of net short positions in sovereign debt should be aligned.
320. ESMA stresses that it is of the utmost importance that the current inconsistencies are removed and the same method of calculation of net short positions in sovereign debt for cash and derivative instruments is adopted.
321. ESMA reiterates what already pointed out in its 2013 Technical Advice: *"while the duration adjusted method better reflects the fact that taking short positions in issues of different duration will have different market impacts and captures adequately the level of risk to changes in yields, a duration adjusted method is less useful than the nominal method in times of market stress which is when net short position reports will be most useful. Taking into account all pros and cons, ESMA considers the nominal method more appropriate for calculating net short positions in sovereign debt. The nominal method offers greater simplicity for calculation while still being very useful when the market in debt instruments is mostly led by events other than interest rate risk (e.g. credit risk or distress situation)"*.
322. None of the responses received expressed any views regarding the thresholds. Only one joint response from two sell-side associations specified that only once the methodology is clear it would be possible to analyse the thresholds.

5.6.3 Content of the Technical Advice

323. ESMA proposes amending Commission Delegated Regulation (EU) 918/2012 so that the nominal method is used in the calculation of net short positions in sovereign debt for both spot and derivative instruments.

6 Annexes

6.1 Annex I: Commission mandate to provide technical advice

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

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

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

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

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

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

In December 2013 the Commission published an evaluation on the functioning of the Regulation². This report was based on ESMA's technical advice published in May 2013³.

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

The Commission also indicated that a new evaluation of the appropriateness and impact of the Regulation, similar in scope to that specified in Article 45 of the Regulation, could be

¹ Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (OJ L 86, 24.3.2012, p. 1), as amended.

² COM(2013) 885 final.

³ ESMA/2013/614.

carried out based on more empirical data and evidence and once the competent authorities have accumulated sufficient regulatory experience of applying the Regulation. The Commission stated that the input of ESMA would then be sought again, as well as the feedback of competent authorities and market participants.

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

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

1. Context

1.1 Scope

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

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

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

- **Transparency:** Significant net short positions in shares must be reported to the relevant competent authorities when they equal to at least 0.2% of a company's issued share capital and every 0.1% above that. They must be disclosed to the public when they at least equal to 0.5% of a company's issued share capital and every 0.1% above that. Significant net short positions in sovereign debt should be reported to the relevant competent authorities when crossing one of the thresholds published by ESMA for sovereign issuers.
- **Settlement:** Restrictions on naked short selling are introduced through a "locate" rule for short sales. Any person entering into a short sale of shares or sovereign debt securities must be covered by either having borrowed the instruments concerned, having arranged to borrow them, or having an arrangement with a third party (e.g. a

prime broker) who has confirmed that the share or the sovereign debt security has been located.

- A ban on naked sovereign CDS is introduced: Any person entering into credit default swaps positions related to a sovereign issuer must have an underlying exposure to the risk of default of that sovereign issuer or of a decline in the value of the sovereign debt of that issuer. Regulators may however suspend the ban if the liquidity of their sovereign debt market falls significantly.
- Intervention powers: The Regulation gives national regulators and ESMA the power to adopt measures in exceptional situations to mitigate threats to financial stability.

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

1.2 Principles that ESMA should take into account

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

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

it is important that the presentation of the advice produced by ESMA makes maximum use of the data gathered.

- ESMA should provide comprehensive technical analysis on the subject matters described below covered by the relevant Commission's request included in this mandate.

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

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

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

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

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

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

- iv. whether the exemption for market making activities allows for liquidity provision without undue circumvention,
- v. whether the thresholds set to identify a significant drop in the price of financial instruments are appropriate for all instruments,



vi. whether reporting mechanisms are operating efficiently.

3. Indicative timetable

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

6.2 Annex II: Content of the Technical Advice

1. Exemption for market making activities

Extract from the Commission formal request for Technical Advice

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

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

In carrying out its analysis of the issues covered by the mandate, ESMA is encouraged to use and rely upon empirical evidence and quantitative data which it deems relevant, and to seek the views of competent authorities and market participants, including [...] i. whether the exemption for market making activities allows for liquidity provision without undue circumvention.

On the clarification of the definition of 'market making activities' and its eventual alignment of the definitions of 'market making activities' under Article 2(1)(k) of the SSR and that of 'market maker' under Article 4(1)(7) of MiFID II

ESMA is of the view that the differentiation between the concepts of 'market maker' under MiFID II and 'market making activities' under the SSR should remain.

ESMA also recommends revising the definition of 'market making activities' in Article 2(1)(k) of the SSR to ensure that the following activities are encompassed.

Regarding **market making activities carried out on a trading venue**, ESMA considers that the following activities might be able to benefit from the exemption:

- a. Continuous auction order book trading system:
 - Firms engaged in market making agreements under Article 17(3) and 48(2) of MiFID II.

- Any other form of liquidity providers. Under this category would fall firms engaged in a contract with an issuer¹ not posting simultaneous two-way quotes but reacting to orders submitted by other market participants according to their agreement with the venue or the issuer.
- b. Quote-driven trading system: market makers participating in those systems provided that they are bound to provide firm quotes on an ongoing basis unless exceptional circumstances arise.
- c. Periodic auction trading system: market makers participating in those systems provided that they are bound to participate in the auctions unless exceptional circumstances arise.
- d. Request-for-quote trading system: members or participants bound to provide firm quotes upon request on an ongoing basis unless exceptional circumstances arise. Under this category would also fall firms posting simultaneous non-binding two-way quotes reacting to orders submitted by other market participants whereby they specify the quotes on the basis of the orders received (e.g. depending on the size of the order), according to their agreement with the venue or the issuer².
- e. OTFs:
 - Market makers engaged by the OTF under Article 20(5) MiFID II; and
 - Market making activity of an OTF operator in its own venue in illiquid sovereign debt under Article 20(3) of MiFID II.
- f. Other on-venue activities within the scope: ESMA considers that market making activities may also encompass negotiated transactions as defined in Article 4(1)(b) of MiFIR, i.e. negotiated privately but reported under the rules of a trading venue as long as they comply with the requirements applicable for the market making exemption.

In relation to **market-making activities carried out OTC** ESMA reiterates the assessment made in its 2013 Technical Advice on the evaluation of the SSR³:

- the arguments for an exemption for OTC market makers remain valid, given that the entities carrying out those activities need to take short positions and conduct short sales in order to fulfil their role;
- any significant short positions that market makers enter into in the course of their activity should not be directional bets on the price of a financial instruments and should be maintained for very brief periods while they square their book.

Consequently, ESMA considers that investment firms or credit institutions authorised to perform OTC market-making activity by dealing on their own account should be able to benefit from the exemption.

¹ ESMA notes that the market-making activity on behalf of the issuer should be subject to specific scrutiny to ensure that it is effectively made on the market-maker's own account and not on the issuer's account.

² See previous footnote 1.

³ See paragraphs 149 to 152 of the [Final Report](#) (ESMA/2013/614).

ESMA considers that the definition currently contained in the second limb of Article 2(1)(k) of the SSR should be specified through technical standards with the requirements presently contained in the ESMA Guidelines, and in particular, clarifying that the activity is undertaken as part of the firm's regular business as described in paragraph 54 of the ESMA Guidelines. Therefore, either the firm already deals on a frequent and systematic basis in the financial instrument in question or, if the instrument is traded on an ad-hoc and infrequent basis, the firm stands ready and prepared to provide prices to clients at all times (i.e. during business hours).

ESMA proposes expanding the scope in terms of instruments also to 'pure' OTC instruments. From that perspective, market-making activity should also encompass the activity of an investment firm that enters into a bilateral OTC financial instrument in response to a client's request to trade, as long as the above mentioned requirements are met.

Finally, ESMA acknowledges that the above list of activities should not be considered a closed ended one, since market practices are not stable across time, and new forms of market making may arise over time. In this respect, ESMA may revise its own advice in the future in light of future market developments.

Scope of instruments for the purpose of the exemption for 'market making activities' under Article 2(1)(k) of the SSR

ESMA reiterates its 2013 Technical Advice on the evaluation of the SSR⁴.

With respect to **shares**, the instruments benefitting from the exemption should be the ones included in Part 1 of Annex I of Commission Delegated Regulation (EU) 918/2012 (i.e. options, covered warrants, futures, index-related instruments, CFDs, shares/units of ETFs, swaps, spread bets, packaged retail or professional investment products, complex derivatives, certificates linked to shares, global depository receipts), plus subscription rights and convertible bonds.

ESMA recommends that for those instruments to be included in the scope they should have the relevant share as underlying.

With respect to **sovereign debt**, the instruments benefitting from the exemption should be the ones included in Part 2 of Annex I of Commission Delegated Regulation (EU) 918/2012 (i.e. options, futures, index-related instruments, CFDs, swaps, spread bets, complex derivatives, certificates linked to sovereign debt), plus corporate debt which is highly correlated with the sovereign debt in question.

ESMA recommends that, with the exception of corporate debt, for those instruments to be included in the scope they should have the relevant sovereign debt as underlying.

⁴ Paragraph 153: "...ESMA accepts that shares and sovereign debt are used for hedging products other than equity and sovereign debt derivatives. As noted above, it is a common strategy for market makers in corporate bonds to hedge their market making risks via trades in the relevant sovereign debt. Without the exemption, the corporate bond market maker would face additional costs and problems in doing so. Similar considerations apply to convertible bonds and subscription rights market making. Denying such market makers the exemption seems difficult to justify given that trading in the appropriate shares or sovereign debt is as legitimate a hedging strategy for them as for market makers in equity or sovereign debt derivatives. 154. ESMA therefore recommends that the scope of the financial instruments eligible for the market making exemption should be expanded, subject to the product being within the scope of the Regulation overall as currently defined in Article 1 of the Regulation".

ESMA considers that the concept of high correlation between the corporate debt and the sovereign debt instruments should be specified through technical standards.

As a result of ESMA's proposal to include subscription rights and convertible bonds (for shares) and corporate bonds (for sovereign debt and CDS), the list of instruments within the scope of the market making exemption would differ from the list of instruments that may create a net short position in an instrument included in Annex I, Parts 1 and 2 of Commission Delegated Regulation (EU) 918/2012.

Accordingly, ESMA recommends amending the SSR to permit the introduction of a different list of instruments that may benefit from the market making exemption through a revision of Commission Delegated Regulation (EU) 918/2012.

ESMA would like to underline that the proposal does not change the approach described in the ESMA Guidelines on the market making exemption: the exemption is granted on a per instrument basis and should not be considered as a global exemption for market making activities in general.

ESMA reiterates that activities in the corresponding share or sovereign debt will be exempted only to the extent that they are undertaken for the purpose of hedging market making activities (e.g. posting two-way quotes or fulfilling orders initiated by the clients) in the above-mentioned instruments: there should be a direct link between the market making activity in any of the instruments described above and the short position in the corresponding share or issuer of the sovereign debt.

ESMA recalls the points made in its Technical Advice on the evaluation of the SSR back in 2013⁵ regarding the application of the market maker exemption to OTC instruments.

Consequently, the scope in terms of instruments described above should be applicable regardless of whether the instrument is traded on a trading venue as defined in MiFID II or is only traded OTC, as long as the market making activity (hedging) involves a share admitted to trading in an EU RM or MTF or an EU sovereign debt instrument.

From that perspective, ESMA considers that the definition in the second limb of Article 2(1)(k) of the SSR should be further specified through technical standards with the following requirements:

- The OTC financial instrument has to be within the expanded list proposed by ESMA in this Technical Advice and have the relevant share or sovereign debt as underlying (being corporate debt subject to specific rules); and
- There has to be a strict link between the market making activity as described above and the hedging activity undertaken on a trading venue or OTC.

⁵ Paragraph 152: "ESMA considers that, in principle, the above reasons for providing a market maker exemption apply whether the market maker is dealing in an OTC product or an exchange-traded one. This needs to be clarified in the definition of market making activities set out in Article 2(1)(k) of the Regulation. For example, market makers in OTC equity derivatives may hedge their risk by taking a short position in the corresponding underlying equity. A requirement to obtain the necessary locate and other confirmations every time they conduct a short sale will add extra process and costs to their market making operations and affect the efficiency and cost of risk management of market making, especially in less liquid instruments. In turn this could result in reduced liquidity in these markets, and increase costs for customers. Under the current Guidelines OTC equity derivative market makers are therefore at a disadvantage to their exchange-traded equity derivative counterparts who would qualify for the market maker exemption under the ESMA Guidelines. Although this is in line with the interpretation of the working of Article 2(1)(k), it is not clear that this different treatment of market makers in OTC products is justified".

Membership requirement

Membership requirement with respect to on-exchange market making activity on instruments admitted to trading on a trading venue

ESMA is of the view that the definition currently contained in Article 2(1)(k) of the SSR should be revised in order to require the market maker to be **member of one of the trading venues** where the market-making activity effectively takes place.

ESMA wishes to note that it is difficult to foresee at this stage the number or the market share of firms that may carry out market making activity through DEA and potentially benefitting from the exemption. In that context, ESMA may revise its Technical Advice once the MiFID II/MiFIR provisions have been in application for a sufficient time.

ESMA believes that firms benefiting from the market making exemption on the basis of their market making activity on a trading venue should always meet the following requirements:

- Market makers should be **dealing strictly on own account**: firms making markets on behalf of the issuer should be specifically scrutinised to determine whether they meet this requirement. This requirement should be applicable in equal terms for firms operating OTC.
- Minimum requirements in terms of **presence, size and spread** should be met by the firms benefitting from the exemption. ESMA recommends those requirements, some of which are currently laid down in ESMA Guidelines, should be set through technical standards for specific types of instruments.

ESMA is of the view that credit institutions/investment firms engaged as market makers on OTFs under Article 20(5) of MiFID II should also have the capacity to benefit from the exemption, insofar as they meet the other requirements analysed in this Technical Advice.

Membership requirement with respect to OTC market making activity for instruments only traded OTC

ESMA proposes not requiring the membership requirement with respect to the market making activity on instruments not traded in any EU trading venue. ESMA notes that also implies that investment firms/credit institutions authorised to deal on their own account could hedge their OTC market making activity on a trading venue, without having to be a member/participant (or client) of that venue.

Membership requirement with respect to OTC market making activity on instruments traded on-venue

ESMA proposes that firms undertaking OTC market making activities regarding instruments traded in an EU trading venue should be able to benefit from the exemption without being required to be members/participants of those venues.

ESMA notes that it also implies that investment firms/credit institutions authorised to deal on their own account could hedge their OTC market making activity on a trading venue, without having to be a member/participant (or client) of that venue.

ESMA wishes to underline that firms benefitting from the exemption due to their OTC market making activity will remain subject to the requirements set out in Articles 23 (obligation to trade shares on a RM, MTF or systematic internaliser) and 28 (obligation to trade classes of derivatives subject to the trading obligation on a RM, MTF or OTF) of MiFIR as long as they hedge their activity using shares or derivatives subject to the trading obligation.

Finally, ESMA notes that firms simultaneously undertaking a market making activity on-venue and OTC should be able to benefit from the exemption as long as they fulfil the membership requirement for the on-venue market making activity.

Extension of reporting requirements to NCAs for market makers benefiting from the exemption under Article 2(1)(k) of the SSR

ESMA considers necessary amending the SSR to ensure that firms benefiting from the exemption notify NCAs their net short position only once a minimum threshold has been reached and maintained over a certain period, so that NCAs may undertake any investigations they consider appropriate.

ESMA recommends specifying by regulatory technical standards the technical details of the proposal including:

- a. the threshold that would trigger the obligation to notify;
- b. the time period (if any) over which the net short position has been held;
- c. the technical means for the notification; and
- d. the time of notification to the NCAs.

Notification procedure

Regarding the notification of instruments via indices, ESMA considers that for the SSR purposes, notifying entities should have the following possibilities:

- Notifying the intention to make the market in relation to an 'index', considered as a dynamic list, where the market maker will continue to benefit from the exemption in relation to the financial instruments included in the index in that moment, insofar as it makes the market in relation to all of them. This approach should avoid forcing market makers to re-notify every time there is a re-balance of the index in question and some instrument/s is/are dropped from the list and substituted with other/s.

To reduce the administrative burden imposed on firms, ESMA recommends that notifying entities should have the capacity to notify that they intend to undertake market-making activities in the components of the index even if they are dropped off the list. Otherwise, in case an instrument within an index is dropped off it and the entity wishes

to continue making markets on that instrument, it would have to submit another notification.

The notification of market making activities in relation to an index should also include the possibility to notify market making activities on financial instruments included within the lists described in Annex I of Commission Delegated Regulation (EU) 918/2012 having that index, as such, as underlying.

Notifying entities should have the capacity to refer to indices provided by authorised benchmark administrators.

- Notifying a basket of instruments. In this case, it would be necessary to notify any changes in the basket of instruments.

Regarding the maximum delay to benefit from the exemption, and in line with the proposal put forward by one trading venue, ESMA proposes that the exemption process should differentiate between two different situations:

- a. the notification of an entity that, for the first time, is willing to benefit from the exemption with respect to one asset class (considering as such shares, sovereign debt or CDSs). In this case, NCAs should be able to avail themselves of a period of up to the 30-calendar day period. After that period the firm may make use of the exemption unless the NCA explicitly indicates otherwise; and
- b. further notifications from an entity already benefitting from the market making exemption in relation to an instrument/instruments within the same asset class. In this case, the firm should start benefitting from the exemption five-working days after the new notification, unless the NCA informs the market maker that it intends to avail itself of a period of up to 30-calendar days before the market maker can start benefitting from the exemption. This flexible approach should allow most market makers to take advantage of the exemption faster, while not preventing the NCA from taking more time to evaluate certain notifications before the market maker starts benefitting from the exemption.

ESMA notes that its advice refers to maximum delays, i.e. nothing prevents NCAs from reacting before the maximum delay to the firms that have submitted a notification.

ESMA recommends harmonising through technical standards the assessment that NCAs should undertake with respect to notifications received. In this respect, ESMA reminds the conclusions of the Peer Review regarding the lack of harmonisation of the notifications assessment undertaken by the NCAs.

ESMA wishes to clarify that the amendments of the notification process should not affect the NCA's power to intervene at any time after the notification, provided that the conditions to benefit from the exemption are no longer met.

ESMA is aware that, if the Commission decides to follow this Technical Advice, NCAs are likely to receive at an initial stage a high number of new notifications making difficult meeting the maximum

delays described above. In light of that, ESMA recommends considering setting up a transitional regime in order to pursue a smooth transition to the new notification system.

Other issues in the context of the definition of ‘market making activities’

Other proposed amendments of Article 2(1)(k) of the SSR

Regarding the category “a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC” which appears in the current Article 2(1)(k) of the SSR, ESMA notes that there is no corresponding letter under MiFID II. Accordingly, it is recommended the deletion of this reference in the revised SSR.

Third country firms should be able to benefit from the exemption for market-making activity (both on a trading venue and OTC) as long as they operate in the European Union according to the regime established under Chapter V of MiFID II (Articles 39 to 43) and Title VIII of MiFIR (Article 46 to 49).

Article 13(2) of the SSR

ESMA recommends amending the SSR to clarify that under Article 13(2) of the SSR transactions used to hedge a long position in ‘sovereign’ debt instruments the pricing of which has a high correlation with the pricing of a sovereign debt are exempted from the obligation to locate the instrument. ESMA’s request for clarification is based on the wording used by the SSR: Article 13(2) uses the term ‘issuer’ (which is not defined) and not ‘sovereign issuer’ (which is defined in Article 2(1)(d) of the SSR).

Publication of the list of firms benefitting from the exemption and also the instruments covered by the exemption

ESMA also recommends amending Articles 17(12) and (13) of the SSR to ensure that NCAs notify ESMA and ESMA publishes on its website not only the list of firms benefitting from the market making exemption, but also the list of instruments on which each firm intends to undertake market making activities.

Record-keeping obligations for firms benefitting from the exemption

ESMA remains of the view that it is necessary for NCAs to be able to monitor easily the effective market-making activity with respect to the financial instruments covered by the exemption. From that perspective, ESMA recommends the SSR to be amended to include:

- The obligation of firms benefitting from the exemption to maintain their records of orders and transactions relating to their market making activities for which they request the exemption, so they can be easily distinguished from their proprietary trading activity; and
- The requirement to be able to demonstrate at any time to the NCA that their market making activities meet the principles and criteria laid down in the SSR, its delegated and implementing regulation and its guidelines.

Finally, ESMA recommends aligning the timing for those record-keeping obligations with Article 25 of MiFIR (five years).

2. Short term restrictions on short selling in case of a significant decline in prices: Article 23 of the SSR

Extract from the Commission formal request for Technical Advice

ESMA is asked to analyse whether the procedure for imposing short-term restrictions on short selling in case of a significant decline in price is efficient, effective and relevant and fosters consistent approaches across the Union, and whether and how it could be simplified. [...]

In carrying out its analysis of the issues covered by the mandate, ESMA is encouraged to use and rely upon empirical evidence and quantitative data which it deems relevant, and to seek the views of competent authorities and market participants, including [...] ii. whether the thresholds set to identify a significant drop in the price of financial instruments are appropriate for all instruments.

Procedure for NCAs to adopt a short-term ban under Article 23 of the SSR

ESMA proposes amending the current procedure under Article 23 of the SSR to provide that only the NCA of the most relevant market in terms of liquidity for the instrument can adopt a short-term ban that is effective in all Member States. The NCA of the most relevant market in terms of liquidity should be determined according to Article 26 of MiFIR and Article 16 of Commission Delegated Regulation (EU) 2017/590 on the reporting of transactions to NCAs.

ESMA also proposes that the other NCAs should not have any power to oppose the short-term measure.

According to the proposed revised procedure, the relevant NCA should inform ESMA and all other NCAs of its intention to adopt a short-term ban. The NCA adopting the short-term ban should then liaise with ESMA to ensure coordinated publication of the information concerning the short-term ban on the adopting NCA's and ESMA's website.

The ban should be effective in all Member States upon publication on the website of the adopting NCA.

Scope of the short-term ban under Article 23 of the SSR

ESMA proposes modifying the scope of the short-term measure to prevent its circumvention through the use of derivatives or OTC trades, changing its scope from a ban on short selling on a trading venue into a ban on entering into or increasing net short positions. The definition of net short positions

is comprehensive, as it includes short positions entered into through short selling, derivatives, and OTC trading.

In relation to the proposal to extend the scope of the short-term measure, ESMA would like to point out that:

- the scope of the proposed new short-term ban should not include index trading (i.e. positions held indirectly through or by way of an index as referred to in Article 3(3) of the SSR should be allowed), in order to avoid that the restrictive measure has a major negative impact on market liquidity;
- where a NCA adopts a short-term measure, it should expressly mention whether it envisages any exemption for market making activities, in the absence of which the liquidity of the market may be affected;
- the proposed new short-term ban would affect all the instruments (other than index trading) considered in the calculation of the net short positions in the instrument subject to the measure. The new short-term ban may thus affect instruments for which the adopting NCA is not the relevant NCA (e.g. GDRs). In that respect, given the short duration of the measure, ESMA proposes that those instruments should be subject to the restrictive measure without any request for the consent of the relevant NCA.

On a different level, further to the consultation ESMA is proposing to restrict the scope of the proposed new short-term ban to:

- shares traded on a trading venue, as the only category of financial instruments that has so far been subject to bans under Article 23 of the SSR;
- sovereign debt instruments traded on a trading venue, given their critical role for the financial stability of the Member States, even though no restrictive measure has so far been adopted in relation to them.

ESMA is of the view that the current thresholds set to identify a significant drop in the price falls for shares traded on a trading venue (i.e. -10%, -20% or -40% depending on the liquidity of the shares) should be kept.

ESMA also notes that the thresholds set to identify a significant drop in the price falls for sovereign debt should be revisited to adequately capture only significant falls in price.

3. Transparency of net short positions and reporting requirements

Extract from the Commission formal request for Technical Advice

ESMA is asked to analyse whether the method of notification and disclosure of net short positions is appropriate, effective and efficient, whether it could be made less burdensome and costly for notifying entities while still providing competent authorities with the information needed for proper supervision,

whether further harmonisation of the notification process is needed, and whether public disclosure of net short positions in shares are efficient, effective and relevant in view of their effects on trading behaviours, market efficiency and volatility.

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

- vii. [...]
- viii. [...]
- ix. *whether reporting mechanisms are operating efficiently.*

Notification to NCAs and public disclosure of significant net short positions in shares

ESMA is of the view that the current initial and incremental thresholds should be maintained as they provide meaningful information to both regulators for supervisory purposes and the market for transparency purposes.

ESMA also recommends that NCAs should be allowed to periodically publish anonymised aggregated net short positions by issuer on a voluntarily basis when they consider that the issues described above can be adequately addressed in their jurisdiction.

Timing for notification and disclosure

ESMA proposes that notifications should be submitted to NCAs at no later than 15:30 and publication should be made at no later than 18:00.

As mentioned in the CP, notifying entities remain responsible for the accuracy of the notified information and its publication will be made without prejudice to potential enforcement actions that NCAs may carry out where the notification proved to be inaccurate at a later stage.

Reporting and disclosure mechanisms

ESMA is of the view that building that notification and publication system would involve costs for NCAs that would need to be at least partly compensated by setting up a fee for position holders to have access to and report through such EU-wide system.

In relation to the ways to retrieve the information about the issued share capital for the purpose of the SSR, ESMA understands that the following means should be acceptable:

- a. the issuer's website: the information published in accordance with Article 4 (annual financial report), Article 5 (half-yearly report) and Article 15⁶ (disclosure by the issuer of the total number of voting rights and capital at the end of each calendar month during which an increase or decrease of such total number has occurred) of Directive 2004/109/EC 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. ESMA acknowledges that the mentioned obligation applies only to issuers whose securities are admitted to trading on a RM, whereas according to the SSR the notification and publication of net short position in shares should be made in relation to issuers whose shares are admitted to trading on a RM or a MTF; and
- b. data vendors.

Content of the notifications

ESMA confirms its advice of requiring the LEI to identify in the notification the position holder.

As the LEI is not relevant for the identification of natural persons, ESMA is of the view that natural persons should be identified using the same process as in Article 6 of Commission Delegated Regulation (EU) 2017/590⁷ on the identification of natural persons for the reporting of transactions to competent authorities. The notifying natural person should use the client identifier that is used by the investment firm carrying out the trading for the natural person in order to limit the inconsistency in client identifiers for a same person and facilitate cross-checking with transaction reports received under MiFIR. Also, and as specified in Annex II of Commission Delegated Regulation (EU) 2017/590, if the natural person is not trading through an EU/EEA firm and is not of EEA nationality then the national client identifier as specified in "all other countries" should be used.

ESMA proposes that where a group has to notify a net short position, the LEI of the parent company should be used.

Methodology of calculation of net short positions in sovereign debt

ESMA proposes amending Commission Delegated Regulation (EU) 918/2012 so that the nominal method is used in the calculation of net short positions in sovereign debt for both spot and derivative instruments.

⁶ According to Article 15 of Directive 2004/109/EC of the European Parliament and of the Council, "*the home Member State shall at least require the disclosure to the public by the issuer of the total number of voting rights and capital at the end of each calendar month during which an increase or decrease of such total number has occurred*".

⁷ [Commission Delegated Regulation \(EU\) 2017/590](#) for reporting of transactions to competent authorities.

6.3 Annex III: Temporary short-selling restrictions

1. Introduction

In accordance with Article 23 of the SSR, when the threshold for significant price fall of an instrument (compared to the previous day's closing price) is crossed, authorities may decide to prohibit short selling of this instrument. The restrictions adopted so far did not apply to market-making activities nor did they apply to derivatives instruments.

a. Overview of temporary restrictions on short selling

Since the entry into force of the SSR, only two countries have initiated temporary prohibitions on short selling in EU shares: from 2013 to 2016, a total of 46 bans were imposed, including 28 in Italy and 18 in Portugal (Table 1). Bans are imposed with immediate effect, either during the day or after markets close, until the end of the next trading day, and may in some cases be extended up to two days.

Table 1: List of temporary short-selling restrictions

	2013	2014	2015	2016
Italy	9	10	2	7
Seat PG	30 January 2013			
Saipem	31 January 17 June		12-13 January 5 June	
Finmeccanica	12-13 February			
Banca Carige	26-27 February			
Intesa San Paolo	26-27 February			
Banco Popolare	27-28 February	28 January		21 January 18 March
Banca Mediolanum	27 February			
Banca Monte dei Paschi	2-3 April	15-16 April 8-11 August 17 October 27-28 October		12 January 18-21 January* 6 July
Banca Popolare di Milano		14-15 April		
Fiat		8 May		
BPER		8 August		
Tod'S		8-11 August		
Safilo Group		4 September		
Credito Valtellinese				7 July
Telecom Italia				7 July
Portugal	4	10	1	3

Banif	4 July			
Banco Comercial Portugues	4 July	7 August		2 June 6 - 8 June*
Banco Espirito Santo	4 July	1 July 11-15 July* 16 July 31 July - 4 Aug*		
Sonae Industria	4 July			
Espirito Santo Financial Group		1 July		
Jeronimo Martins		31 July		
Portugal Telecom		21-23 October* 5 November	8 January	
Banco BPI		18 December		
Mota-Engil				19 January
Total	13	20	3	10

Note: Number and dates of temporary short-selling bans initiated in the EU from 2013 to 2016, by country and company. Bans spanning two business days were introduced before market close on the first day.

* Bans extended for two additional days.

Source: ESMA.

a. Literature review

In a seminal paper, Miller (1977) formulated a major hypothesis that laid the ground for a large part of the theoretical thinking around short-selling restrictions: binding short-selling constraints and differences of opinion among investors should lead to overpricing, as bearish investors are prevented from acting on their beliefs.

Short-selling constraints may take different forms, including for example unavailability or excessive borrowing cost of a stock in securities lending markets, but also legal and institutional restrictions introduced by regulatory authorities. This provided the theoretical background supporting the view that short selling restrictions may help to prevent market panics and improve financial stability¹.

Empirical researchers have tested this hypothesis using a variety of approaches and stock market samples, and several studies have confirmed Miller's intuition. Bris et al. (2003) find that the lifting of short-sales restrictions is associated with increased negative skewness in individual stock returns. They also find little evidence that short-sales constraints prevent or mitigate severe price declines, and that they do not prevent market crashes. According to Jones et al. (2002), stocks that are expensive to short have high valuations and low subsequent returns. Using abnormal returns, Chang et al. (2007) find that short-selling restrictions tend to cause stock overvaluation. Lastly, Boehmer et al. (2009) find that the

¹ Recital (1) of the SSR highlights that "due to concerns that at a time of considerable financial instability, short selling could aggravate the downward spiral in the price of shares, notably in financial institutions".

introduction in of a ban on 1,000 US financial stocks in September 2008 is associated with a sharp increase in share prices.

One exception seems to nuance these findings: in one of the most comprehensive study to date, Beber and Pagano (2013) find that bans on short-selling have mixed effects on stock prices across 30 different countries: bans are not significantly correlated with excess returns in countries with short-selling bans on financials, except in the US. Kolasinski et al. (2013) highlight in addition that short-selling restrictions may have complex effects: to circumvent borrowing constraints from the bans, sophisticated traders obtain short exposures by using options to create synthetic short positions. This increases the proportion of informed short sellers and the negative price effect of short interest announcements for affected stocks during the ban.

The literature also investigates other aspects of short-selling constraints with most of the recent studies concluding that short-selling activities are generally beneficial to market quality, reflected in higher liquidity and improved price discovery (e.g. Bris et al. (2003). Boehmer et al (2009), Beber et al. (2012)). Consequently, short-selling constraints may thus be disruptive to the normal functioning of financial markets.

b. Methodology and data

The short-selling bans analysed in this report differ in several respects from the bans investigated in the literature. As a result, the findings presented in this report may not be fully aligned with those of the literature without necessarily contradicting them.

First, SSR Article 23 bans are of very short nature, with 40 out of 44 bans introduced for just one full day, and four bans extended to three full days. In contrast, 16 out of the 20 bans analysed by Beber and Pagano (2013) last more than 234 days. The main implication is that the effects from the introduction of a short-selling restriction are likely to be short lived, especially since traders know that the restriction will be lifted almost immediately and are able to adapt their behaviour accordingly.

Moreover, several of the SSR bans were introduced during trading hours. As highlighted in ESMA's 2013 SSR Review, short selling bans introduced during trading hours (until the end of the next trading day) "*tend to be imposed with a non-trivial delay relative to the relevant deterioration of market conditions. (...) Prices have stabilised or rebounded and transaction volumes have started to normalise*". Therefore, to circumvent this problem and analyse the impact of SSR bans using daily data, ESMA focuses only on days where the ban is in place during the full trading session.

Finally, the market-making exemption usually applied implies that a number of market participants (mainly large banks) are still allowed to take short positions. While bans may effectively curtail speculative short-selling behaviours, this means that the ban does not constitute a full constraint on short sales, an assumption on which most of the empirical literature is based. Moreover, as in Kolasinski et al. (2013) traders are also able to rely on derivatives instruments as an alternative to take short positions.

The analysis is based on daily data on prices, bid-ask spreads and turnover from Thomson Reuters Datastream, for each of the relevant ISINs traded on the main stock exchange in Italy and Portugal (Milan Stock Exchange and Euronext Lisbon). Historical data are not available for seven bans, corresponding to three ISINs: Banif, which was absorbed by Banco Santander in 2015; and Banco Espírito Santo and Espírito Santo Financial Group, which both filed for bankruptcy in 2014. Moreover, due to several events around the 30 January 2013 ban on Seat PG (company announcements and credit rating downgrade to selective default) that make it impossible to isolate the impact of the ban, we exclude Seat PG from the sample. As a result, out of the 46 bans in Table 1 we analysed 38 bans corresponding to 20 different ISINs, with the number of bans per ISIN ranging from one to eight.

For each of these 38 events we investigate the effects of the short-selling bans on prices, liquidity and volatility in the following sections. The analysis is conducted separately for Italy and Portugal to take into account any country specificities, using the same approach.

The final section analyses net short position changes during the five days before and after the short-selling bans, based on data collected from NCAs (see Annex V).

2. Analysis of share prices

a. Methodology

To analyse the effect of short-selling bans on stock prices, we conduct an event study using abnormal returns.

For each ISIN, we calculate daily log returns using closing prices and pick two equity benchmarks to proxy market returns: one of the country's main equity benchmark, and the relevant Euro-area wide sectoral benchmark. This selection offers several advantages: the national equity index returns tend to be highly correlated with individual ISIN returns, and reflect local dynamics; the sectoral index returns reflect broader economic developments in each sector, and partly address the risk that large companies can move the national index due to their weight in the index composition. Table 2 displays the selection of benchmarks and the correlations between benchmark and company returns.

Table 2: Equity benchmarks, and correlations of benchmark and company returns

Italy	Benchmark 1	Correlation	Benchmark 2	Correlation
Saipem	FTSE MIB	0.48	Euro Stoxx Oil & Gas	0.51
Finmeccanica	FTSE MIB	0.64	Stoxx Europe Aerospace & Defense	0.54
Banca Carige	FTSE Italia Mid Cap	0.50	Euro Stoxx Banks	0.50
Intesa San Paolo	FTSE MIB	0.90	Euro Stoxx Banks	0.90
Banco Popolare	FTSE MIB	0.75	Euro Stoxx Banks	0.75
Banca Popolare di Milano	FTSE MIB	0.71	Euro Stoxx Banks	0.71
Banca Mediolanum	FTSE MIB	0.80	Euro Stoxx Insurance	0.73
Banca Monte dei Paschi di Siena	FTSE MIB	0.56	Euro Stoxx Banks	0.58

Fiat	FTSE MIB	0.70	Euro Stoxx Automobiles & Parts	0.73
BPER	FTSE MIB	0.77	Euro Stoxx Banks	0.76
Tod'S	FTSE Italia Mid Cap	0.51	Euro Stoxx Personal & Household Goods	0.60
Safilo Group	FTSE Italia Mid Cap	0.47	Euro Stoxx Personal & Household Goods	0.43
Credito Valtellinese	FTSE MIB	0.62	Euro Stoxx Banks	0.62
Telecom Italia	FTSE MIB	0.68	Euro Stoxx Telecommunications	0.72
Portugal	Benchmark 1	Correlation	Benchmark 2	Correlation
Banco Comercial Portugues	PSI 20	0.64	Euro Stoxx Banks	0.50
Sonae Industria	PSI 20	0.17	Stoxx Europe Retail	0.09
Jeronimo Martins	PSI 20	0.61	Stoxx Europe Retail	0.51
Portugal Telecom	PSI 20	0.43	Euro Stoxx Telecommunications	0.32
Banco BPI	PSI 20	0.63	Euro Stoxx Banks	0.51
Mota-Engil	PSI 20	0.55	Euro Stoxx Construction & Mats	0.40

Note: Benchmarks and correlation of benchmark vs. company returns from 2012 to 2016, by country and company in the sample. For the second benchmark, Stoxx Europe indices used where no Euro area sectoral index is available.

Source: Thomson Reuters Datastream, ESMA.

The estimation window includes data from 300 trading days to five trading days before each ban ($[-300, -5]$). There is broad agreement in the literature that a one-year estimation window is sufficient, while stopping five days before the event ensures that the sell-off leading to the event is excluded.

When the estimation windows overlap with other bans on the same company, we reduce the window to $[-200, -5]$ where possible. Otherwise, for multiple bans that are very close in time, we rely on the same estimation window. For example, we use one estimation window for the two bans on Saipem in 2013, one estimation window for the two bans on Banco Popolare in 2016, etc.

For each estimation window, we then regress company returns on benchmark returns (one regression per benchmark) using a simple specification²:

$$R_t = \alpha + \beta R_t^{ben} + \varepsilon_t \quad \text{for } t = -300, \dots, -5$$

where β is the market beta, R_t are the log returns of the stock, and R_t^{ben} are the log returns of the benchmark.

² OLS regression with robust standard errors. As a robustness check, OLS panel regressions with company fixed effects were also used.

Using the coefficients obtained (two per estimation window) we calculate abnormal returns (AR) for each company around the event(s) using on the predicted returns based on the coefficients estimated from the regressions:

$$AR_t = R_t - \hat{\alpha} - \hat{\beta}R_t^{ben} \quad for \ t = -2, \dots, 10$$

To analyse the behaviour of stock prices before, during and after the short-selling ban, we choose four main event windows, with T=0 the event date (i.e. the full trading day where the ban is in place). These event windows are: {-2, -1, 0, [1, 5]}. For the [1, 5] window, we rely on cumulated abnormal returns (CAR) calculated as

$$CAR_{[1,5]} = \sum_{t=1}^5 AR_t$$

For consistency of the dataset, and to avoid overlap of the event windows, we make several adjustments due to multiple bans on a single company that are too close in time. In particular, we drop bans that are less than ten trading days after another ban³:

- For Banca Monte dei Paschi di Siena, we drop the 27-28 October 2014 ban, the [1, 5] window of the 12 January 2016 ban, and the 18-21 January 2016 ban.
- For Banco Comercial Portugues, we drop the [1, 5] window of the 2 June 2016 ban, and the 6 June 2016 ban.

Due to extension of the 21 October 2014 ban on Portugal Telecom, we compute CARs over three days for the 21-23 October 2014 ban in order to obtain one single observation on event window T, with T+1 corresponding to 24 October (when the ban is lifted), T+2 to 25 October, etc. In addition, the shares of Portugal Telecom were suspended from trading on 9 January 2015, therefore there is no data for the [1, 5] event of the 8 January 2015 ban.

Finally, we perform a mean test of each event window for the remaining 25 bans in Italy, then for the 10 bans in Portugal, in order to assess whether abnormal returns are statistically significantly different from 0 around the short-selling bans.

b. Descriptive analysis

The analysis of the estimation windows already provides useful pieces of information (Table 3).

Daily log returns are on average negative (-0.02% for Italy and -0.09% for Portugal), highlighting that at least some of the stock prices had already lost value for some time, and that investors' perception of these companies' fundamentals had deteriorated, before a sell-off took place and a short-selling ban was imposed. This view is reinforced by high historical

³ The rationale for doing so is that any overpricing that might result from a short-selling ban should lead (according to the literature) to negative cumulated abnormal returns over several days once the ban is lifted. Thus, the effects of the first ban may still be felt when a second ban is imposed shortly thereafter.

volatility of returns (2.9% for both countries), compared to averages of 2.1% and 1.3% for the FTSE MIB and the PSI-20 from 2012 to 2016 (12-month rolling standard deviations).

A second important observation is that several stocks have breached the threshold for significant price falls more than once during the estimation window, without being followed by a short-selling ban⁴. For example, on 2 June 2014 the stock price of Saipem declined by 11.5%; on 24 June 2016 the stock price of Telecom Italia declined by 18%; on 9 October 2014, the stock price of Portugal Telecom fell 13.8%; and on 14 May 2014, shares of Banco Comercial Portugues were down 11.5%. The implication is that the use of temporary short-selling restrictions by authorities is discretionary, rather than systematic, which may create uncertainty for market participants. Another possible implication is that market participants may not have changed their behaviour in anticipation of a short-selling ban, when returns approached the relevant threshold.

Table 3: Log returns of prices during estimation windows

Italy	Mean	Std Dev	Min	Max
Saipem 1-2	-0.0011	0.0310	-0.4199	0.0665
Saipem 3-4	-0.0021	0.0233	-0.1148	0.0640
Finmeccanica	0.0008	0.0328	-0.0984	0.1475
Banca Carige	-0.0020	0.0292	-0.1148	0.1197
Intesa San Paolo	0.0004	0.0303	-0.1013	0.1185
Banco Popolare 1-2	0.0010	0.0359	-0.1084	0.1735
Banco Popolare 3-4	0.0004	0.0252	-0.0777	0.0937
Banca Popolare di Milano	0.0013	0.0288	-0.0935	0.1054
Banca Mediolanum	0.0014	0.0287	-0.0721	0.1485
Banca Monte dei Paschi di Siena 1	-0.0005	0.0406	-0.1162	0.1620
Banca Monte dei Paschi di Siena 2-3-4	0.0018	0.0274	-0.0782	0.1760
Banca Monte dei Paschi di Siena 6-8	-0.0029	0.0357	-0.1842	0.1222
Fiat	0.0026	0.0243	-0.0670	0.1519
BPER	0.0002	0.0288	-0.0841	0.0882
Tod'S	-0.0010	0.0158	-0.0843	0.0598
Safilo Group	0.0003	0.0221	-0.0674	0.1456
Credito Valtellinese	-0.0033	0.0326	-0.1704	0.1117
Telecom Italia	-0.0011	0.0285	-0.1817	0.0834
Portugal	Mean	Std Dev	Min	Max
Banco Comercial Portugues 1	0.0010	0.0325	-0.0920	0.1721
Banco Comercial Portugues 2	0.0030	0.0378	-0.1147	0.2386

⁴ However, for several windows the minimum values were recorded before the entry into force of the SSR (e.g. Saipem 1-2, Banca Carige, etc.)

Banco Comercial Portugues 3	-0.0036	0.0383	-0.1178	0.1229
Sonae Industria	-0.0004	0.0242	-0.0855	0.1083
Jeronimo Martins	-0.0013	0.0151	-0.0667	0.0428
Portugal Telecom	-0.0024	0.0256	-0.1383	0.0866
Banco BPI	0.0008	0.0245	-0.0924	0.0684
Mota-Engil	-0.0029	0.0339	-0.1134	0.1675

Note: Averages, standard deviations, minima and maxima of stock price daily log returns, by estimation window. Due to overlap between estimation windows and bans on the same company, some windows are used for multiple events. For example, Saipem 1-2 = estimation window used for the 31 January and 17 June 2013 short-selling bans on Saipem. As explained in the previous subsection, two short-selling bans on Banca Monte dei Paschi and one on Banco Comercial Portugues were excluded due to overlapping events.

Source: Thomson Reuters Datastream, ESMA.

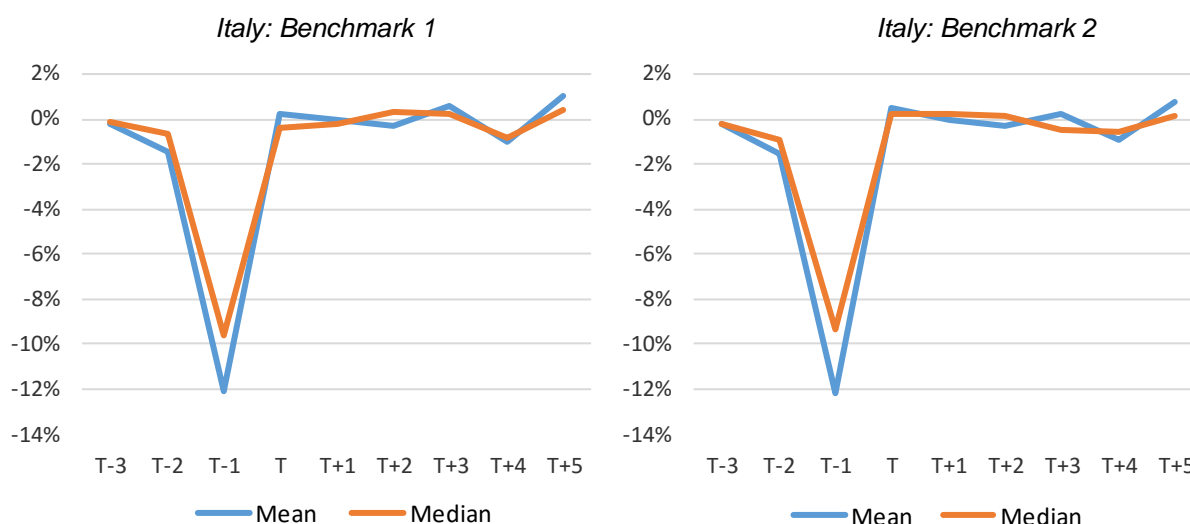
c. Analysis of abnormal returns

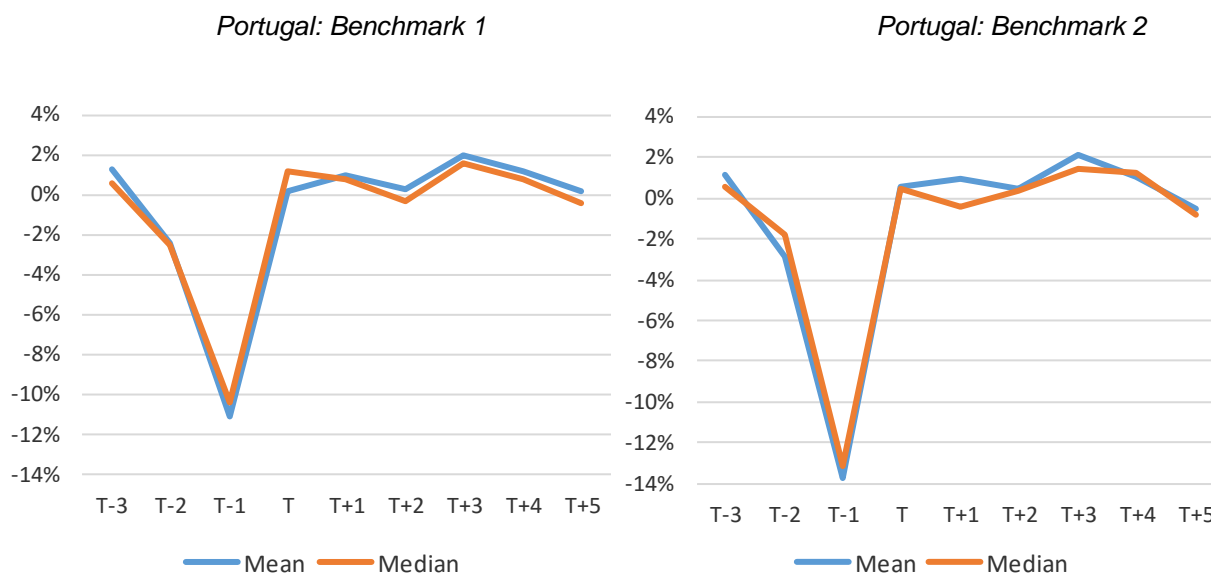
Abnormal returns (ARs) display a clear trend around sell-offs (Charts 1 and 2). The sell-off seems to begin on average two days before bans are imposed (T-2), with ARs of around -1.5% in Italy and -2.5% in Portugal. On T-1, when the price declines cross the SSR thresholds for significant price falls, abnormal returns average -12% in both countries.

On date T, i.e. the days where the bans are in place during the fully trading session, ARs become marginally positive (0.4% in both countries). Following the lifting of the ban, cumulated ARs over the [1, 5] event window amount to close to 0% in Italy, but more than 4% in Portugal.

Differences between Italy and Portugal may reflect differences in the composition of the samples, with a larger share of financial sector shares in Italy, and smaller average correlations between company and benchmark returns in Portugal, which may result in larger ARs. In other words, a larger part of stock returns in Portugal remains unexplained, and differences between the two countries should be interpreted cautiously.

Charts 1 and 2: Abnormal returns around short-selling bans





Note: Mean and median abnormal returns around short-selling bans, by country and benchmark. T= date where ban is in place during the full trading day.

Source: ESMA.

Median ARs tend to be smaller in absolute terms than the mean, albeit not by a large amount, suggesting that some individual companies are to an extent amplifying the trend highlighted above (e.g. ARs for the two bans on Saipem in T-1 are -39% and -35%). There are some noteworthy differences between ARs based on the first and the second benchmark, in particular in Portugal, where individual stock returns may drive the means to a greater extent due to a smaller number of events and lower stock-to-benchmark correlations. Nonetheless, differences remain limited across the four event windows.

Finally, we perform standard t-tests to assess whether ARs are statistically significantly different from 0 for the four event windows. The results of the tests confirm the trends in ARs during the sell-offs, but highlights that ARs are not statistically significant during the ban, and that cumulated ARs are not statistically significant for the days following the lifting of the ban. (Table 4)

Table 4: Abnormal returns – Mean tests

<i>Italy: Benchmark 1</i>			<i>Italy: Benchmark 2</i>		
Event window	Mean	Standard Error	Event window	Mean	Standard Error
-2	-0.0150**	0.0069	-2	-0.0152**	0.0068
-1	-0.1214***	0.0190	-1	-0.1222***	0.0185
T	0.0026	0.0075	T	0.0046	0.0078
[1,5]	0.0028	0.0135	[1,5]	-0.0034	0.0136

<i>Portugal: Benchmark 1</i>			<i>Portugal: Benchmark 2</i>		
Event window	Mean	Standard Error	Event window	Mean	Standard Error
-2	-0.0150**	0.0069	-2	-0.0152**	0.0068
-1	-0.1214***	0.0190	-1	-0.1222***	0.0185
T	0.0026	0.0075	T	0.0046	0.0078
[1,5]	0.0028	0.0135	[1,5]	-0.0034	0.0136

-2	-0.0248*	0.0138	-2	-0.0287**	0.0140
-1	-0.1110***	0.0146	-1	-0.1377***	0.0135
T	0.0012	0.0128	T	0.0061	0.0132
[1,5]	0.0453	0.0332	[1,5]	0.0401	0.0295

Note: Mean abnormal returns and standard errors around short-selling bans, by country and benchmark. T= date where ban is in place during the full trading day. Stars indicate statistical significance at the 10% (*), 5% (**) and 1% (***) levels.

Source: ESMA.

3. Analysis of share price volatility

a. Methodology

To analyse the effects of short-selling bans on volatility, we rely on a similar approach as with prices. We average volatility estimates over the estimation windows (see section 2), and statistical differences with the event windows are assessed using t-tests.

In order to increase the robustness of the analysis, we use two different measures of volatility: first, we compute historical volatility (HV) as the standard deviation of a stock's log returns over two days. Second, we calculate so-called high-low range volatility, or intraday volatility (IV), based on daily high and low trading prices, using Parkinson's (1980) approach:

$$IV = \sqrt{\frac{1}{4 \ln 2} \left(\ln \left(\frac{S_{Ht}}{S_{Lt}} \right) \right)^2}$$

where S_{Ht} is the stock's highest trading price on day t, and S_{Lt} is low stock's trading price.

Then we perform for both HV and IVs t-tests of the differences between the estimation windows and the following event windows, with T=0 the event date (i.e. the full trading day where the ban is in place):

- HV: {-1, 0, 1, 2, [2, 5]}
- IV: {-1, 0, 1, [1, 5]}

The different event windows tested reflect the fact that HV is calculated over two days, whereas IV is calculated on a single day, allowing us to cleanly separate changes in volatility before, during and after the events.

The same sample adjustments as in the analysis of abnormal returns are made (bans and event windows dropped). For the 21-23 October ban on Portugal Telecom, averages are used instead of sums.

b. Descriptive statistics

The data in Table 5 describe the mean and maximum values for each volatility measure during the estimation windows. The HV and IV measures are on average equal for Italy and Portugal. Mean value levels are similar between HV and IV, although IV is on average slightly higher, but maximum values are usually much larger for HV.

Table 5: Volatility of returns during estimation windows

Italy	HV mean	HV max	IV mean	IV max
Saipem 1-2	0.0153	0.0576	0.0146	0.0632
Saipem 3-4	0.0168	0.0798	0.0169	0.0716
Finmeccanica	0.0251	0.1271	0.0260	0.0873
Banca Carige	0.0212	0.1440	0.0233	0.0945
Intesa San Paolo	0.0234	0.1554	0.0247	0.0869
Banco Popolare 1-2	0.0266	0.1347	0.0291	0.0870
Banco Popolare 3-4	0.0191	0.0909	0.0192	0.0472
Banca Popolare di Milano	0.0225	0.1108	0.0240	0.0680
Banca Mediolanum	0.0214	0.1526	0.0230	0.1026
Banca Monte dei Paschi di Siena 1	0.0302	0.1365	0.0324	0.0977
Banca Monte dei Paschi di Siena 2-3-4	0.0182	0.1371	0.0231	0.1159
Banca Monte dei Paschi di Siena 6-8	0.0256	0.2059	0.0272	0.1404
Fiat	0.0189	0.1239	0.0190	0.0630
BPER	0.0225	0.0957	0.0232	0.0545
Tod'S	0.0121	0.0603	0.0122	0.0432
Safilo Group	0.0155	0.1223	0.0184	0.0635
Credito Valtellinese	0.0226	0.1461	0.0265	0.0909
Telecom Italia	0.0217	0.1613	0.0204	0.0672
Portugal	HV mean	HV max	IV mean	IV max
Banco Comercial Portugues 1	0.0227	0.1614	0.0247	0.1521
Banco Comercial Portugues 2	0.0246	0.2133	0.0271	0.1543
Banco Comercial Portugues 3	0.0281	0.1154	0.0307	0.0979
Sonae Industria	0.0169	0.1035	0.0213	0.0710
Jeronimo Martins	0.0111	0.0587	0.0120	0.0693
Portugal Telecom	0.0175	0.0887	0.0214	0.1020
Banco BPI	0.0178	0.0887	0.0226	0.0859
Mota-Engil	0.0233	0.1379	0.0285	0.1064

Note: Mean and maximum volatility of stock price daily log returns, by estimation window. HV= historical volatility computed as two-day standard deviations; IV= Intraday volatility based on high-low returns. Due to overlap between estimation windows and bans on the same company, some windows are used for multiple events. For example, Saipem 1-2 = estimation window used for the 31 January and 17 June 2013 short-selling bans on Saipem.

Source: Thomson Reuters Datastream, ESMA.

c. Results

In both countries, volatility measures are much higher around the short-selling ban, across all event windows, than during the estimation windows. Most of the differences are statistically significant.

This is due to the volatility peak on the day of the sell-off. Indeed, we observe a peak in HV and IV on the day before the ban, followed by a gradual decrease in both volatility measures over the next few days (Table 6). For HV, the higher values on the day of the ban (T) simply reflect the fact that historical volatility is computed over two days.

Table 6: Volatility – Mean tests

<i>Italy: Historical volatility</i>			<i>Portugal: Historical volatility</i>		
Event window	Mean	Standard Error	Event window	Mean	Standard Error
-1	-0.0494***	0.0120	-1	-0.0597***	0.0108
T	-0.0822***	0.0157	T	-0.0978***	0.0167
1	-0.0273**	0.0100	1	-0.0200**	0.0074
2	-0.0000	0.0037	2	-0.0116	0.0062
[2, 5]	-0.0044	0.0027	[2, 5]	-0.0116**	0.0045

<i>Italy: Intraday volatility</i>			<i>Portugal: Intraday volatility</i>		
Event window	Mean	Standard Error	Event window	Mean	Standard Error
-2	-0.0127***	0.0040	-2	-0.0164***	0.0050
-1	-0.0371***	0.0056	-1	-0.0859***	0.0130
T	-0.0192***	0.0042	T	-0.0447***	0.0132
1	-0.0131***	0.0033	1	-0.0318***	0.0085
[1, 5]	-0.0084**	0.0030	[1, 5]	-0.0198***	0.0069

Note: Mean volatility and standard errors around short-selling bans, by country and volatility measure. The difference tested is (Estimation – Event), therefore a negative value indicates higher volatility during the event. Historical volatility calculated over two days, i.e. for date T: $\text{StandardDev}(T-1, T)$. T= date where ban is in place during the full trading day. Stars indicate statistical significance at the 10% (*), 5% (**) and 1% (***) levels.

Source: ESMA.

We investigated the potential existence of causality between bans and the observed decline in volatility following the sell-off by comparing IV around bans with IV around days where the threshold for significant price fall is crossed but no ban is introduced. However, the results were inconclusive due to the absence of strong evidence in one direction or another.

4. Analysis of market liquidity

a. Methodology

To analyse the effect of short-selling bans on liquidity, we use the same approach as for volatility.

First, we compute the bid-ask spreads using the closing ask and bid prices for each ISIN. Daily bid-ask spreads are normalised using the following formula to correct for nominal differences and make reliable comparisons across companies and countries:

$$\text{Spread} = \frac{(\text{Ask price} - \text{Bid price})}{(\text{Ask price} + \text{Bid price})/2}$$

Then t-tests of the differences between the estimation windows and the following event windows: {-1, 0, 1, [1, 5]} with T=0 the event date (i.e. the full trading day where the ban is in place).

The same adjustments are made as in the analysis of volatility. In addition, for the estimation windows, we observe a structural break in bid-ask spreads for Italian shares following ECB President Draghi's speech on 26 July 2012. To avoid introducing a bias in the analysis, we rely on shorter estimation windows for nine different bans on Italian shares⁵.

b. Descriptive statistics

Table 7 provides descriptive statistics of liquidity over the estimation windows. Bid-ask spreads are higher on average (i.e. liquidity is lower) for shares in Portugal: 0.45 compared to 0.18 in Italy.

Table 7: Liquidity shares during estimation windows

Italy	Mean	Std Dev	Min	Max
Saipem 1-2	0.0537	0.0399	0.0251	0.2575
Saipem 3-4	0.0873	0.0499	0.0480	0.4097
Finmeccanica	0.0668	0.0367	0.0401	0.2670
Banca Carige	1.1188	1.1598	0.0584	6.1856
Intesa San Paolo	0.0911	0.0444	0.0656	0.3356
Banco Popolare 1-2	0.1237	0.0932	0.0503	0.4850
Banco Popolare 3-4	0.1090	0.0709	0.0502	0.4673
Banca Popolare di Milano	0.1060	0.1051	0.0201	0.8929
Banca Mediolanum	0.0981	0.0788	0.0424	0.5128
Banca Monte dei Paschi di Siena 1	0.1166	0.1014	0.0335	0.6146
Banca Monte dei Paschi di Siena 2-3-4	0.1364	0.1442	0.0353	1.3319
Banca Monte dei Paschi di Siena 6-8	0.0995	0.0682	0.0201	0.5950
Fiat	0.1004	0.0540	0.0413	0.4979
BPER	0.1220	0.0805	0.0403	0.5215
Tod'S	0.1164	0.0768	0.0500	0.5718
Safilo Group	0.3491	0.2337	0.0548	1.1392
Credito Valtellinese	0.2727	0.2084	0.0209	1.0856

⁵ This adjustment concerns all of the 2013 bans: Saipem 1&2 , Finmeccanica, Banca Carige, Intesa San Paolo, Banco Popolare, Banca Mediolanum, Banca Monte dei Paschi.

Telecom Italia	0.1048	0.0615	0.0500	0.5975
Portugal	Mean	Std Dev	Min	Max
Banco Comercial Portugues 1	1.1294	0.2208	0.8658	2.8986
Banco Comercial Portugues 2	0.1831	0.1614	0.0427	0.9662
Banco Comercial Portugues 3	0.2933	0.1783	0.1045	1.1662
Sonae Industria	1.0061	0.7356	0.1601	4.5249
Jeronimo Martins	0.1830	0.1389	0.0306	1.0804
Portugal Telecom	0.1851	0.1346	0.0270	0.6704
Banco BPI	0.2905	0.1992	0.0505	1.6125
Mota-Engil	0.3291	0.2499	0.0254	1.3559

Note: Liquidity of shares, by estimation window, based on bid ask-ask spreads and computed as $(Ask - Bid)/(Ask + Bid)/2 \times 100$. Due to overlap between estimation windows and bans on the same company, some windows are used for multiple events. For example, Saipem 1-2 = estimation window used for the 31 January and 17 June 2013 short-selling bans on Saipem.

Source: Thomson Reuters Datastream, ESMA.

c. Results

Contrary to volatility, liquidity differences between the estimation and event windows are not statistically significant in Italy nor Portugal. Moreover, the sign of the mean difference are of opposite signs for the two countries, which is confirmed by median values (Table 8).

Table 8: Liquidity – Mean tests

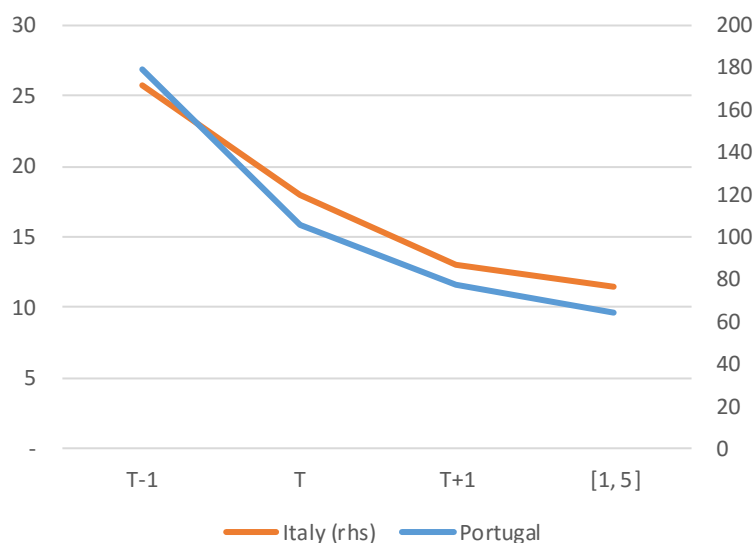
<i>Italy</i>			<i>Portugal</i>		
Event window	Mean	Standard Error	Event window	Mean	Standard Error
-1	0.0125	0.0689	-1	-0.2846	0.1634
T	0.0499	0.0374	T	-0.3193	0.2262
1	0.0418	0.0454	1	-0.5415	0.4039
[1, 5]	0.0085	0.0467	[1, 5]	-0.1260	0.1205

Note: Mean liquidity and standard errors around short-selling bans, by country. T= date where ban is in place during the full trading day. Stars indicate statistical significance at the 10% (*), 5% (**) and 1% (***) levels.

Source: ESMA.

We complement these findings with developments of average daily turnover in Italian and Portuguese shares in the sample around the short-selling bans. Reflecting the pattern in volatility estimates, the average turnover value peaks on T-1, and gradually recedes during the following days (Chart 3). The introduction and lifting of the ban does not seem to have an impact on the level or the evolution on average turnover.

Chart 3: Share turnover during event windows (million euros)



Note: Average daily turnover around short-selling bans in million euros, by country. T= date where ban is in place during the full trading day.

Source: ESMA.

5. Analysis of net short positions around bans

a. Methodology

Lastly, we look at net short positions around temporary bans, based on data collected from NCAs (also used for the analysis of the impact of the public disclosure threshold) and the consolidated data reported to ESMA on a quarterly basis. Net short position notifications exist for all companies, except Espirito Santo Financial Group.

First, we look at position changes 5 days before and after the ban dates from Table 1. There are five bans for which no short-selling position notifications were reported during the observation window: Banif, Banco BPI, Seat PG, Sonae Industria, and the 31 January 2013 ban on Saipem. This leaves us with a sample of 40 bans for a total of 304 net short position notifications.

Net short position notifications are regrouped into three categories: *Pre-ban* (from T-5 to T-1), *Ban*, and *Post-ban* (from T+1 to T+5). As in the previous sections, T+1 corresponds to the day the ban is lifted, and windows are shortened where necessary to prevent overlap between bans that are very close in time. We then split net short positions between increases and decreases to observe the behaviour of short sellers around temporary bans.

Second, we look at net short positions data consolidated by ISIN to see the evolution of aggregate net short positions around bans. ESMA receives daily data only for shares that are part of the main national equity benchmark, so the sample excludes Banca Carige, Banif, Banca Popolare di Milano, Safilo Group and Credito Valtellinese, also leaving us with a sample of 40 bans (no SSR data for Seat PG, Sonae Industria and the 31 January 2013 ban on Saipem).

b. Results

The average number of notifications received is broadly stable around short-selling bans: between 26 and 30 notifications per day. In the days preceding and following bans, the number of short position increases exceeds the number of short position decreases, by a ratio of around 3 increases to 2 decreases (Table 9).

There were 7 net short position increases reported to authorities during bans, although the number of decreases is larger than the number of increases during bans. Out of the 9 companies on which net short positions changed during the ban, the number of increases exceeded the number of decreases in only one instance.

Table 9: Changes in net short positions around SSR temporary bans

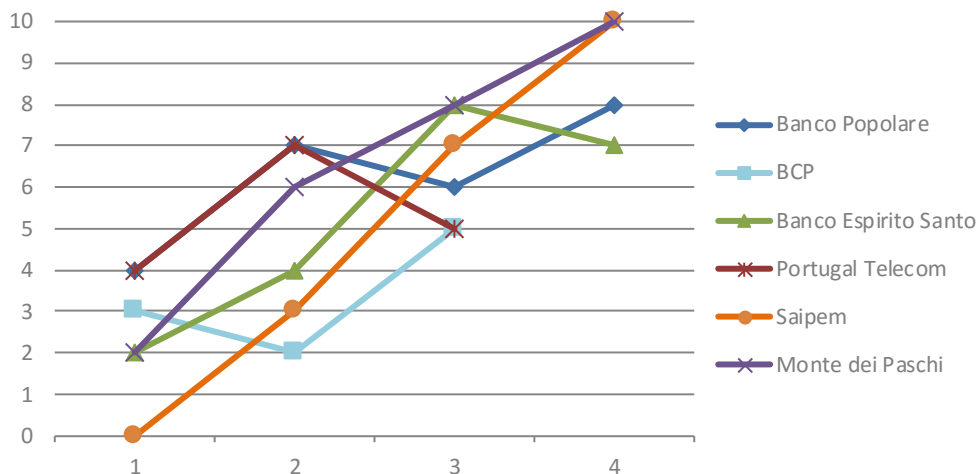
	Pre-ban	Ban	Post-ban
SSR net short positions			
Net short position notifications	152	26	126
Number of position decreases	62	19	49
Number of position increases	90	7	77
<i>Share of increases</i>	<i>59%</i>	<i>27%</i>	<i>61%</i>

Note: Number of net short position increases and decreases five days before and after short-selling bans. Ban= date where ban is in place during the full trading day.

Source: Markit Securities Finance, National Competent Authorities, ESMA.

The average number of short position holders is 4.7 per ban, and the median is 4. One noteworthy development is the growing number of notifications for shares on which authorities have imposed more than one ban (Banco Popolare, BCP, Banco Espírito Santo, Monte dei Paschi, Portugal Telecom and Saipem). This reflects increased short-selling activity and is largely due to the growing number of net short position holders active on these shares, which increases from 2.5 on average for the first ban to 6.5 for the third ban (Chart 4).

Chart 4: Number of active net short position holders for multiple bans, by company

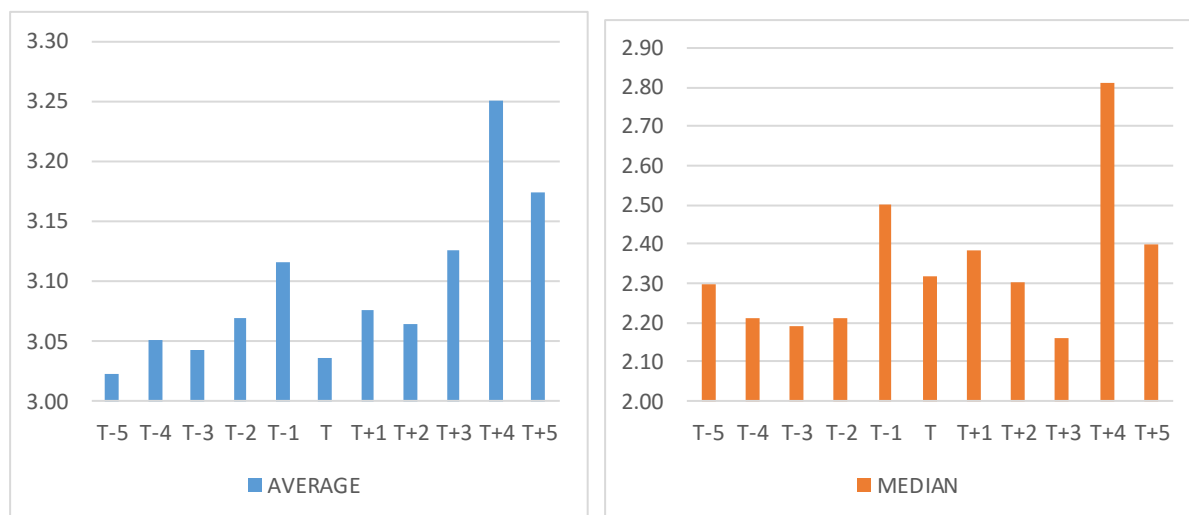


Note: Number of net short position holders changing their positions during the five days before and after short-selling bans. The companies displayed here are companies on which authorities have imposed more than one short-selling ban. The X-axis is the chronological order of the bans: 1= first ban; 2= second ban; etc. Given the larger number of bans on Monte dei Paschi, 27-28 October is used as first ban.

Source: National Competent Authorities, ESMA.

The ISIN-level aggregated data also shows that net short positions tend to decrease during bans. The mean position increases from 3.02% to 3.12% during the five days preceding the bans, decreases to 3.04% during the ban, and starts increasing again after the ban is lifted, from 3.08% on T+1 to reach a maximum of 3.25% on T+4 (Chart 5). Looking at the median, the introduction of a ban is similarly associated with a decline in net short positions, and the lifting of the ban with an increase (Chart 6)⁶.

Charts 5 and 6: Mean and median aggregated net short positions around bans (in %)



⁶ Some of the noise in the mean and median is due to observations removed in order to prevent overlap, but the main findings around the introduction and lifting of the bans are robust to the full exclusion of bans that are very close in time



Note: Mean and median net short position aggregated by ISIN around bans, in % of issued share capital. T= date where ban is in place during the full trading day.

Source: National Competent Authorities, ESMA.

Conclusions

Using an event study methodology, the analysis suggests that the SSR temporary short-selling restrictions do not have a statistically significant impact on share prices. Although the positive sign of mean abnormal returns during the short-selling bans is in line with findings in the economic literature, the mean is not significantly different from 0. This result holds across countries and benchmarks. Similarly, the effect on stock price returns of lifting the ban is non-statistically significant.

The volatility analysis based on two different measures shows that share price volatility declines when the ban is introduced and continues to do so after the ban is lifted. Despite further investigations, it is not possible to determine conclusively the existence of a causality link. The analysis of bid-ask spreads also suggests that the introduction and lifting of a temporary short-selling ban on share do not have a statistically significant impact on the liquidity of that share.

It is important to keep in mind that the analysis presents a few caveats, given the nature of the events tested using statistical methods that are usually better suited to long-term policy changes.

The results may also reflect the specificities of SSR bans. The constraint imposed on short-selling activities is a relatively weak one due to the short-term and temporary nature of the bans, the market making exemption, and the ability to take short positions in securities covered by the prohibition using derivative instruments, which may explain their limited effects. Short-selling bans also vary in their use and applications. Only two NCAs have made use so far of this instrument since the end of 2012, and bans are not systematically imposed when the relevant threshold for significant price falls is crossed.

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6.4 Annex IV: Analysis on the crossing of the thresholds

1. SSR thresholds: Overview

a. Empirical evidence

To assess “*whether the thresholds set to identify a significant drop in the price of financial instruments are appropriate for all instruments*”, ESMA carried out an empirical analysis based on 5 years of daily data. The analysis includes instruments as identified in the SSR, for which historical data from commercial databases were available¹.

The empirical evidence for each type of instrument, based on current SSR thresholds, is summarised in Table 1. The table displays the number of instruments and daily observations available, as well as the number and share of observations that have crossed the relevant threshold².

For example, using data on 966 liquid shares, percentage changes between the previous day’s closing price and the lowest price of the day were computed, resulting in more than 1.1 million observations over the period 2012 to 2016³. Around 3,500 observations (i.e. 0.3% of the total) are *below* the -10% SSR threshold, or on average 3 observations per day⁴.

¹ Money market instruments were not included in the analysis due to data limitations.

² The analysis is based on one observation per instrument per day.

³ ISINs for which no data is available are excluded from the analysis.

⁴ For simplicity, daily averages are calculated based on the number of week days over the entire period, rather than the number of trading days which differs from one country to another.

Table 1: Overview of SSR thresholds and significant price falls

Instrument type	Number of instruments	Number of observations	SSR threshold	Observations crossing the threshold	Share ^d	Daily average ^e
Liquid shares ^a	966	1,145,722	-10%	3,580	0.3%	3
Semi-liquid shares ^a	203	188,862	-10%	1,741	0.9%	1
Illiquid shares ^a	3,204	2,926,202	-20%	4,669	0.2%	4
Very illiquid shares ^a	890	654,150	-40%	3,809	0.6%	3
Sovereign bonds ^b	499	344,060	+7%	33,212	9.7%	28
Corporate bonds ^b	3,081	1,763,730	+10%	20,862	1.2%	18
Exchange-traded funds ^c	1,917	1,347,246	-10%	1,297	0.1%	1

Notes: Overview of price changes that crossed the SSR thresholds for significant price falls, by type of instrument. The calculations are based on one observation per instrument per day. Daily data from 1 January 2012 to 31 December 2016.

^a Daily observations for shares calculated as daily low price to previous day's closing price, in %. Liquid shares are shares trading on EU regulated markets (MiFID definition). Semi-liquid shares are non-liquid shares (MiFID definition) that were constituents of a main national equity index, as of January 2017; the sample may change over time due to shares being added to or dropped out of equity indices. Illiquid and very illiquid shares are non-liquid shares (MiFID definition) that are not constituents of a main national equity index; illiquid shares have a euro-equivalent price greater than or equal to EUR 0.5 per share as of end-2016; very illiquid shares have a euro-equivalent price smaller than EUR 0.5 per share as of end-2016.

^b Daily observations for bonds calculated as percent change in annual yields based on bid prices, in %, for EUR-denominated sovereign and corporate bonds that are constituents of the Markit iBoxx EUR sovereigns index and Markit iBoxx EUR corporates index. Sovereign bonds exclude sub-sovereign and local government issuers. Corporate bonds exclude covered bonds and collateralised bonds.

^c Daily observations for EU-domiciled exchange-traded funds calculated as daily low price to previous day's closing price, in %. Data including UCITS and non-UCITS exchange-traded funds.

^d Share of observations that have crossed the relevant SSR threshold during the sample period.

^e Average number of observations per day that have crossed the relevant SSR threshold during the sample period.

Sources: Shares: ESMA MiFID Register, Thomson Reuters Datastream; Sovereign and corporate bonds: Markit iBoxx; Exchange-traded funds: Thomson Reuters Eikon and Thomson Reuters Lipper; ESMA calculations.

b. Main findings

This sub-section describes the main findings based on the summary of empirical evidence. The details and problems identified for shares, bonds and exchange-traded funds are spelled out in the next sections.

Shares: The proportion of observations that crossed the relevant SSR thresholds is below 1% for each category of shares, i.e. an average 11 observations per day across all categories of shares and EU countries. The number of significant price falls amounts to only a small part of the returns distribution, suggesting that SSR thresholds for shares mainly cover unusual market events (i.e. the 99th percentile).

Exchange-traded funds (ETFs): Compared to shares, an even smaller part of the returns distribution (0.096%) crossed the relevant SSR threshold, suggesting that the threshold for ETFs mainly covers extreme market events (i.e. the 99.9th percentile). This may reflect the

index-tracking nature of ETFs, which can be prone to smaller price changes due to offsetting price movements of individual securities that their reference indices comprise.

Bonds: The large share of observations that crossed the relevant SSR thresholds, in particular for sovereign bonds, reflects the use of thresholds based on yields. Due to very low to negative interest rates, small nominal changes in basis points can result in large relative percentage changes. The definition and calibration of SSR thresholds for bonds likely needs to be revisited to adequately capture significant price falls.

Money market instruments: Money market instruments were not included in the analysis due to data limitations. These instruments include a variety of short-term assets, such as government T-bills, certificates of deposits and short-term corporate bonds. This makes the assessment and calibration of a single threshold based on prices a challenging exercise for public authorities.

2. Thresholds for shares

a. Empirical evidence

A sample of 966 Liquid shares⁵ was used for the analysis, with prices retrieved using ISINs. For each day, the percentage change between the previous day's closing price and the daily low price price is calculated, resulting in 1,145,722 observations from 2012 to 2016. Around 3,600 observations (0.3% of the total) crossed the -10% SSR threshold, or on average 3 observations per day (Table 2)⁶.

Using the same calculation method, a sample of 203 Semi-liquid shares was used, resulting in 188,862 observations. Semi-liquid shares are defined as non-liquid shares (MiFID definition) that were constituents of a main national equity index, as of January 2017⁷. More than 1,700 observations (0.9% of the total) crossed the -10% SSR threshold, or on average 1 observation per day (Table 2).

A sample of 3,204 Illiquid shares yielded 2,926,202 observations for the period 2012-2016. Illiquid shares are non-liquid shares (MiFID definition) that are not constituents of a main national equity index and have a euro-equivalent price greater than or equal to EUR 0.5 per share (as of end-2016). Around 4,700 observations (0.16% of the total) crossed the -20% SSR threshold, or on average 4 observations per day (Table 3).

Lastly, a sample of 890 Very illiquid shares resulted in 654,150 observations for the period 2012-2016. Very illiquid shares are non-liquid shares (MiFID definition) that are not constituents of a main national equity index and have a euro-equivalent price smaller than EUR 0.5 per share (as of end-2016). As shown in Table 3, around 3,800 observations (0.58% of the total) crossed the -40% SSR threshold, or on average 3 observations per day (Table 3).

⁵ Liquid and non-liquid shares were retrieved from the ESMA MiFID register:

https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_sha

⁶ Daily averages are calculated based on the number of trading days over the sample period.

⁷ In the SSR, Semi-liquid shares should also be the underlying of a listed derivative. For simplicity, ESMA focused exclusively on the requirement for shares to be part of a main equity index.

Table 2: Significant price falls for Liquid and Semi-liquid shares, by threshold

Liquid shares				Semi-liquid shares			
Threshold	Observations below threshold ^a	Share ^b	Daily average ^c	Threshold	Observations below threshold ^a	Share ^b	Daily average ^c
-10%	3,580	0.31%	3	-10%	1,741	0.92%	1
-9%	5,069	0.44%	4	-9%	2,588	1.37%	2
-8%	7,265	0.63%	6	-8%	3,492	1.85%	3
-7%	10,915	0.95%	8	-7%	4,881	2.58%	4
-6%	17,144	1.5%	13	-6%	6,884	3.64%	5
-5%	29,146	2.54%	22	-5%	10,103	5.35%	8
-4%	54,270	4.74%	42	-4%	15,911	8.42%	12
-3%	108,223	9.45%	83	-3%	26,260	13.90%	20
-2%	232,781	20.32%	178	-2%	45,032	23.84%	35

Notes: Number and share of observations above thresholds in 1% increments, and daily average, for Liquid and Semi-liquid shares. Current SSR thresholds in bold. Liquid shares are shares traded on EU regulated markets (MiFID definition). Semi-liquid shares are Non-liquid shares (MiFID definition) that are constituents of a main national equity index, as of January 2017; the sample may change over time due to shares being added to or dropped out of equity indices. The calculations are based on one observation per share per day (1,145,722 observations for 966 Liquid shares, and 188,862 observations for 203 Semi-liquid shares). Daily data from 1 January 2012 to 31 December 2016.

^a Daily observations for shares calculated as daily low price to previous day's closing price, in %.

^b Share of observations that have crossed the corresponding threshold during the sample period.

^c Average number of observations per day that have crossed the corresponding threshold during the sample period.

Sources: Thomson Reuters Datastream, ESMA Registers, ESMA calculations.

Table 3: Significant price falls for Illiquid and Very illiquid shares, by threshold

Illiquid shares				Very illiquid shares			
Threshold	Observations below threshold ^a	Share ^b	Daily average ^c	Threshold	Observations below threshold ^a	Share ^b	Daily average ^c
-45%	512	0.02%	0	-45%	3,365	0.51%	3
-35%	958	0.03%	1	-40%	3,809	0.58%	3
-25%	2,605	0.09%	2	-35%	4,636	0.71%	4
-20%	4,669	0.16%	4	-30%	6,674	1.02%	5
-15%	11,065	0.38%	8	-25%	9,123	1.39%	7
-10%	30,914	1.06%	24	-20%	14,291	2.18%	11
-5%	170,015	5.81%	134	-15%	26,425	4.04%	20

Notes: Number and share of observations above thresholds in 1% increments, and daily average, for Illiquid and Very illiquid shares. Current SSR thresholds in bold. Illiquid and very illiquid shares are Non-liquid shares (MiFID definition) that are not constituents of a main national equity index; illiquid shares have a euro-equivalent price greater than or equal to EUR 0.5 per share as of end-2016; very illiquid shares have a euro-equivalent price smaller than EUR 0.5 per share as of end-2016. The calculations are based on one observation per share per day (2,926,202 observations for 3,204 Illiquid shares, and 654,150 observations for 890 Very illiquid shares). Daily data from 1 January 2012 to 31 December 2016.

^a Daily observations for shares calculated as daily low price to previous day's closing price, in %.

^b Share of observations that have crossed the corresponding threshold during the sample period.

^c Average number of observations per day that have crossed the corresponding threshold during the sample period.

Sources: Thomson Reuters Datastream, ESMA Registers, ESMA calculations.

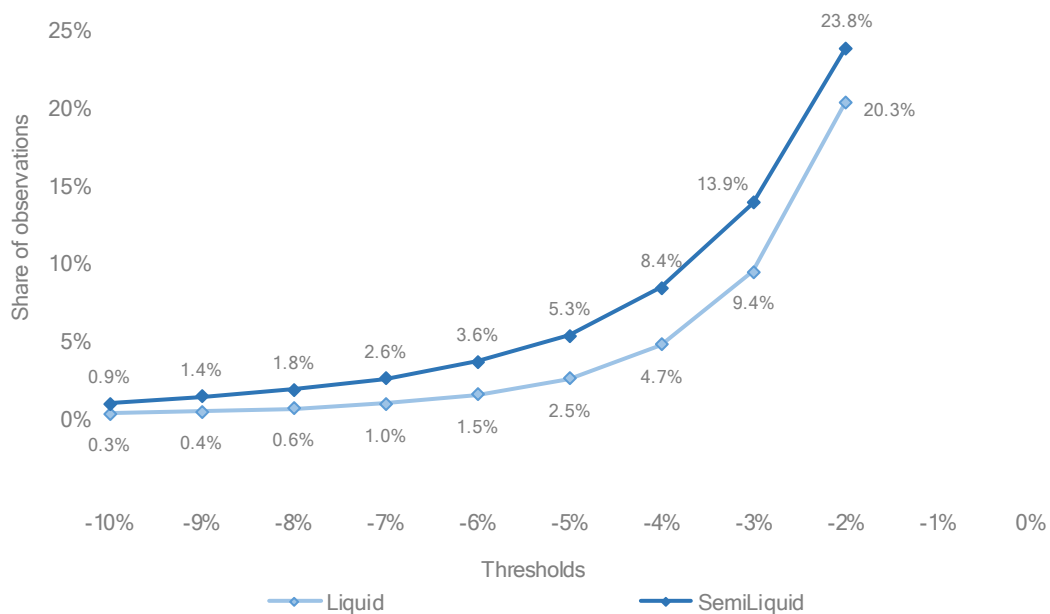
b. Findings

The number of significant price falls amounts to only a small part of the returns distribution, suggesting that SSR thresholds for shares mainly cover unusual market events (i.e. the 99th percentile).

Depending on the objectives, adjustments to the current thresholds may be warranted. If the objective is to set SSR thresholds that cover the same share of the returns distribution across the four categories of shares (e.g. closer to 0.5%), a decrease in the threshold for illiquid shares and an increase in threshold for semi-liquid shares would be appropriate. However, if the objective is to set SSR thresholds that would result in a similar daily average (i.e. average number of alerts received by NCAs) across the four categories of shares, then a decrease in the threshold for semi-liquid shares would be appropriate.

Charts 1 and 2 provide a graphical distribution of the left tail of the returns distributions for the four categories of shares, based on various thresholds.

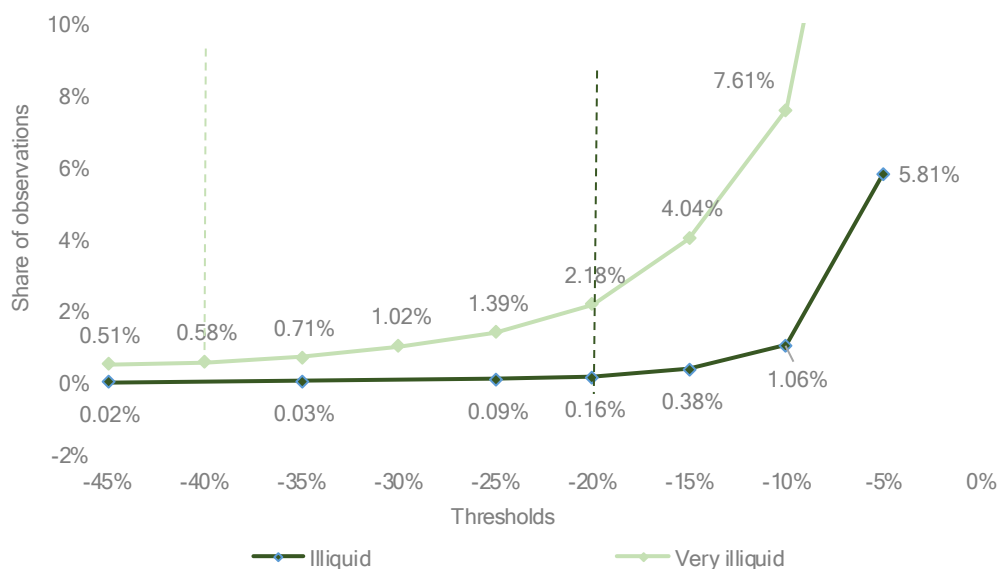
Chart 1: Portion of observations below thresholds for Liquid and Semi-liquid shares



Notes: Share of observations below thresholds in 1% increments, for liquid and semi-liquid shares. The dashed line indicates the current SSR threshold of -10% for both types of shares. Calculations are based on one observation per share per day (liquid shares: 1,145,722 observations for 966 securities; semi-liquid shares: 188,862 observations for 203 securities). Daily data from 1 January 2012 to 31 December 2016.

Sources: Thomson Reuters Datastream, ESMA Registers, ESMA calculations.

Chart 2: Portion of observations below thresholds for Illiquid and Very illiquid shares



Notes: Share of observations below thresholds in 1% increments, for illiquid and very illiquid shares. The dashed lines indicate the current SSR thresholds of -20% and -40%, respectively, for illiquid and very illiquid shares. Calculations are based on one observation per share per day (illiquid shares: 2,926,000 for 3,204 securities; very illiquid shares: 654,150 observations for 890 securities). Daily data from 1 January 2012 to 31 December 2016.

Sources: Thomson Reuters Datastream, ESMA Registers, ESMA calculations.

3. Thresholds for bonds

a. Empirical evidence

SSR thresholds for sovereign and corporate bonds are based on yields. Daily percentage changes in annual yield were computed using bid prices (which are more frequently available than mid prices or ask prices)⁸.

Out of a sample of 499 sovereign bonds and 3,081 corporate bonds, respectively 9.7% and 1.2% of observations crossed the +7% (for sovereign bonds) and +10% (for corporate bonds) SSR thresholds, i.e. on average 28 and 18 observations per day (Table 4)⁹.

⁸ While daily low prices based on actual transaction prices were used for shares, the reliance on *bid* prices for bonds precludes a similar approach, due to the greater probability of outliers.

⁹ As yields and bond prices have an inverse relationship, SSR thresholds based on bond yields imply that significant price falls occur *above* the corresponding SSR threshold, not below.

Table 4: Significant price falls for bonds, by threshold

Sovereign bonds				Corporate bonds			
Threshold	Observations above threshold ^a	Share ^b	Daily average ^c	Threshold	Observations above threshold ^a	Share ^b	Daily average ^c
10%	23,897	6.9%	20	10%	20,862	1.2%	18
9%	26,332	7.7%	22	9%	24,929	1.4%	21
8%	29,443	8.6%	25	8%	30,364	1.7%	25
7%	33,212	9.7%	28	7%	38,172	2.2%	32
6%	37,995	11.0%	32	6%	50,009	2.8%	42
5%	44,295	12.9%	37	5%	68,667	3.9%	58
4%	52,838	15.4%	44	4%	98,426	5.6%	83
3%	64,925	18.9%	55	3%	150,476	8.5%	126
2%	82,663	24.0%	69	2%	249,936	14.2%	210

Notes: Number and share of observations above thresholds in 1% increments, and daily average, for sovereign bonds and corporate bonds. Current SSR thresholds in bold. The calculations are based on one observation per bond per day (344,460 observations for 499 sovereign bonds, and 1,763,370 observations for 3,081 corporate bonds). Daily data from 1 January 2012 to 31 December 2016.

^a Daily observations calculated as percent change in annual yields based on bid prices, in %, for EUR-denominated sovereign and corporate bonds that are constituents of the Markit iBoxx EUR sovereigns index and Markit iBoxx EUR corporates index. Sovereign bonds exclude sub-sovereign and local government issuers. Corporate bonds exclude covered bonds and collateralised bonds.

^b Share of observations that have crossed the corresponding threshold during the sample period.

^c Average number of observations per day that have crossed the corresponding threshold during the sample period.

Sources: Markit iBoxx, ESMA calculations.

b. Findings

The main finding is that the current SSR thresholds result in a very large number and share of observations that fall within the “significant price falls” category. This mainly reflects the reliance on yields, which creates two issues.

First, due to very low interest rates, small nominal changes in basis points result in large relative percentage changes. The issue gets worse as yields move closer to zero. As an illustration, more than 99% of observations for corporate bonds that are above the 10% SSR threshold were registered in 2015 and 2016, and less than 1% between 2012 and 2014.

Second, yield-based thresholds become even more problematic with negative yields. For example, a direct application of the formula used to calculate the returns of bond, for which the yield changes from -0.01% to 0.01% overnight, results in a 200% increase. Although absolute values might partially address this issue, the corresponding changes from negative to positive yields (or from positive to negative yields) would remain of limited information for the identification of significant price falls.

Given these issues, the current distribution of returns cannot be used to provide reliable alternative SSR thresholds, and consideration should be given to the use of different reference values, such as prices.

4. Thresholds for exchange-traded funds

a. Empirical evidence

A sample of 1,917 ETFs was used, and prices were retrieved using their ISINs, resulting in 1,347,246 observations from 2012 to 2016. As with shares, daily returns are calculated as daily low price to previous day's closing price.

The -10% SSR threshold yielded only 1,297 observations below the threshold (less than 0.1% of the total), i.e. on average one observation per day (Table 5).

Table 5: Significant price falls for ETFs, by threshold

Threshold	Observations above threshold ^a	Share ^b	Daily average ^c
-10%	1,297	0.1%	1
-9%	1,841	0.1%	1
-8%	2,857	0.2%	2
-7%	3,770	0.3%	3
-6%	5,523	0.4%	4
-5%	8,687	0.6%	7
-4%	15,359	1.1%	12
-3%	32,995	2.5%	26
-2%	82,772	6.1%	64

Notes: Number and share of observations below thresholds in 1% increments, and daily average, for exchange-traded funds (ETFs). Current SSR threshold in bold. The calculations are based on one observation per ETF per day (1,347,246 observations for 1,917 EU-domiciled ETFs). Daily data from 1 January 2012 to 31 December 2016.

^a Daily observations for EU-domiciled exchange-traded funds calculated as daily low price to previous day's closing price, in %. Data including UCITS and non-UCITS exchange-traded funds.

^b Share of observations that have crossed the corresponding threshold during the sample period.

^c Average number of observations per day that have crossed the corresponding threshold during the sample period.

Sources: Thomson Reuters Lipper, Thomson Reuters Eikon, ESMA calculations.

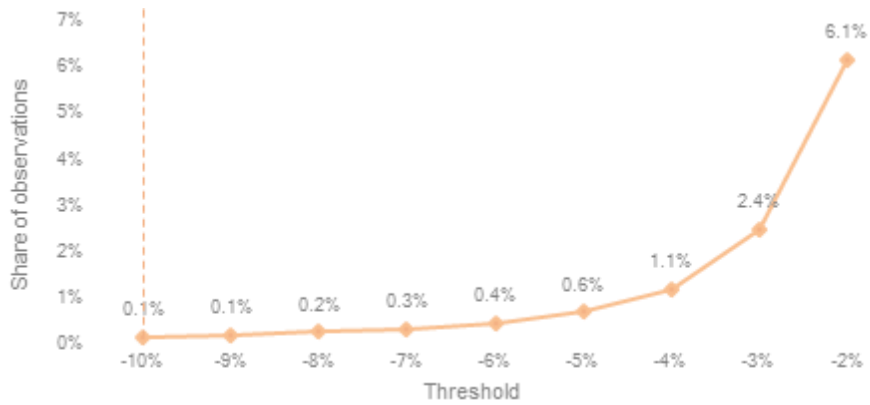
b. Findings

Compared to other SSR thresholds, only a very small share of the distribution of ETF price returns (0.096%) is below the ETF threshold. This may reflect the index-tracking nature of ETFs, which are possibly prone to smaller price changes due to offsetting price movements of individual securities that their reference indices comprise.

Most ETFs in the EU track equity benchmarks¹⁰. Alignment with the SSR threshold for e.g. liquid shares would require lowering the ETF threshold to -7% (Chart 3). However, the relative share of non-equity ETFs (mainly bond ETFs) has been growing in recent years. As ETF prices seek to reproduce the performance of the underlying benchmark, consideration may need to be given in the future to SSR thresholds based on the type of benchmark tracked by the ETF.

¹⁰ See ESMA Report on Trends, Risks and Vulnerabilities, No. 1, 2017.

Chart 3: Share of observations above thresholds for ETFs



Notes: Share of observations below thresholds in 1% increments, for exchange-traded funds. The dashed orange line indicates the current SSR threshold of -10%. The calculations are based on one observation per ETF per day (1,347,246 observations for 1,917 EU-domiciled ETFs). Daily data from 1 January 2012 to 31 December 2016.

Sources: Thomson Reuters Lipper, Thomson Reuters Eikon, ESMA calculations.

6.5 Annex V: Public disclosure of net short positions

1. Overview of SSR net short positions

a. Individual net short position in EU shares

In this section, descriptive statistics (number and distribution) on net short positions are presented using:

- ISINs, i.e. EU shares on which net short positions are held
- Position holders, i.e. investors that are holding net short positions
- Distinct net short positions, i.e. unique combinations of position holder and ISIN.

Since the entry into force of the SSR, NCAs have received notifications on 2,321 different ISINs¹. There are 26,636 distinct net short positions (NSP), which corresponds to an average 11.5 position holders per ISIN.

Table 1 shows the distribution of ISINs and distinct NSP by NCA domicile. NCAs with the largest number of ISINs (UK, Germany, Sweden, France and Italy) logically have the largest numbers of distinct NSP.

Table 1: Number of ISINs and net short positions in EU shares, by NCA domicile

NCA	Number of ISINs	Number of distinct NSP	Average number of position holders per ISIN
AT	29	324	11.2
BE	52	701	13.5
CZ	5	12	2.4
DE	359	4,185	11.7
DK	51	670	13.1
ES	96	1,498	15.6
FI	56	1,063	19.0
FR	223	2,934	13.2
GB	755	8,562	11.3
GR	13	33	2.5
HU	4	58	14.5
IE	57	146	2.6
IT	199	2,176	10.9
LU	2	6	3.0
NL	89	1,363	15.3
PL	43	286	6.7
PT	17	259	15.2

¹ All figures exclude short positions for which information on one of the main fields was missing: position value, position date, issuer ISIN, position holder name.

RO	5	3	3.0
SE	266	2,357	8.9
Total	2,321	26,636	11.5

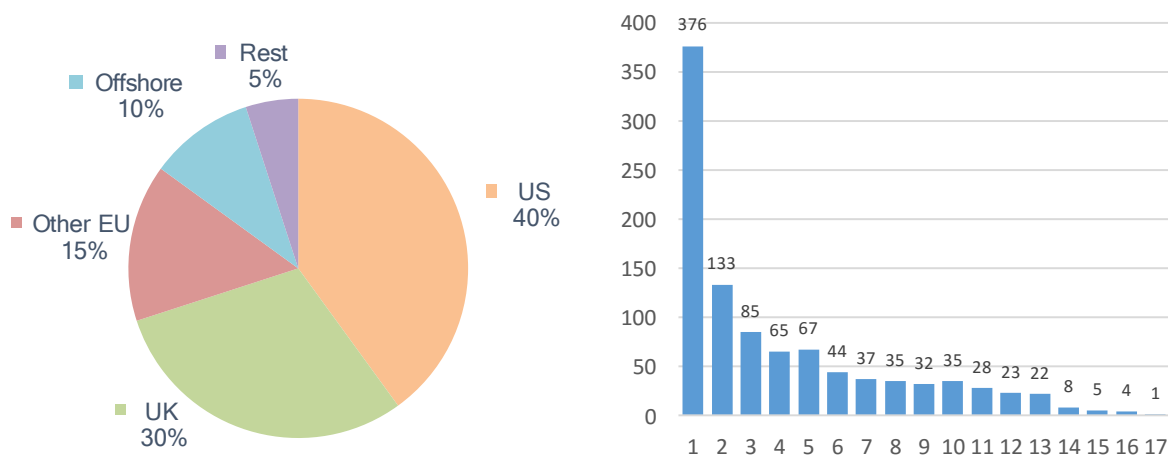
Note: Number of EU shares ISINs and distinct net short position notifications on EU shares received by NCAs, and average number of position holder per ISIN, by NCA domicile, from 1 January 2013 to 31 December 2016. A distinct net short position is defined as a unique pair between one position holder and one ISIN.

Sources: National Competent Authorities, ESMA.

Chart 1-2 and Table 2 provide information on the domicile and international short-selling activity of short position holders. Chart 1 shows the distribution of position holders by country, and Chart 2 the number of position holders that have reported to one or more NCAs. The latter reflects short-selling activities taking place in one or more country. Table 2 shows the distribution of distinct NSPs by domicile of the position holder.

There are around 1,000 position holders on EU shares. A large majority of position holders (around 70%) are domiciled in the US and UK, with less than 15% based in other EU countries (Chart 1)². Moreover, more than 80% of distinct NSP in EU shares were held by entities located in the US and in the UK. The average number of position holders by ISIN is 11.5, and the median is 5. The relatively large difference between the mean and the median indicates that a large number of shares are shorted by a small number of position holders.

Charts 1 and 2: Distribution of position holders by domicile and by number of reporting NCAs



Note: Left chart: Number of position holders by domicile. "Offshore" includes Bermuda, Guernsey, Isle of Man, Jersey, Cayman Islands and Virgin Islands. Right chart: Number of position holders (vertical axis) that have reported to 1 NCA, 2 NCAs, 3 NCAs, etc. (horizontal axis). Data from 1 January 2013 to 31 December 2016.

Sources: National Competent Authorities, ESMA.

² Due to inconsistent reporting and confidentiality issues, the exact number of position holders cannot be determined. The percentages displayed in Chart 1 are rounded, as percentages for the US and the UK vary by up to 5 percentage points based on the method used to reconcile the data on position holders from different NCAs. Regardless, these two countries remain the predominant origin of short position holders.

Table 2: Number of distinct net short positions in shares, by location of the position holder

Position holder country	Number of distinct NSPs	Share of total (in %)	Position holder country	Number of distinct NSPs	Share of total (in %)
AE	3	0.0%	IM	18	0.1%
AN	1	0.0%	IT	82	0.3%
AU	18	0.1%	JE	264	1.0%
BM	239	0.9%	JP	4	0.0%
BR	14	0.1%	KR	1	0.0%
BS	2	0.0%	KY	350	1.3%
CA	191	0.7%	LU	123	0.5%
CH	541	2.0%	MC	16	0.1%
CI	3	0.0%	MT	15	0.1%
CN	43	0.2%	NL	231	0.9%
CY	3	0.0%	NO	28	0.1%
DE	104	0.4%	PL	33	0.1%
DK	47	0.2%	PT	7	0.0%
ES	12	0.0%	QA	1	0.0%
FI	11	0.0%	SE	161	0.6%
FR	1,071	4.0%	SG	40	0.2%
GB	10,514	39.5%	SK	1	0.0%
GC	1	0.0%	US	11,230	42.2%
GG	244	0.9%	VG	141	0.5%
GI	3	0.0%	ZA	1	0.0%
HK	306	1.1%			
IE	178	0.7%	N/A	340	1.3%
			Total	26,636	100%

Note: Number of distinct net short positions in EU shares received by NCAs, by position holder country, from 1 January 2013 to 31 December 2016. A distinct net short position is defined as a unique pair between one position holder and one ISIN.

Sources: National Competent Authorities, ESMA.

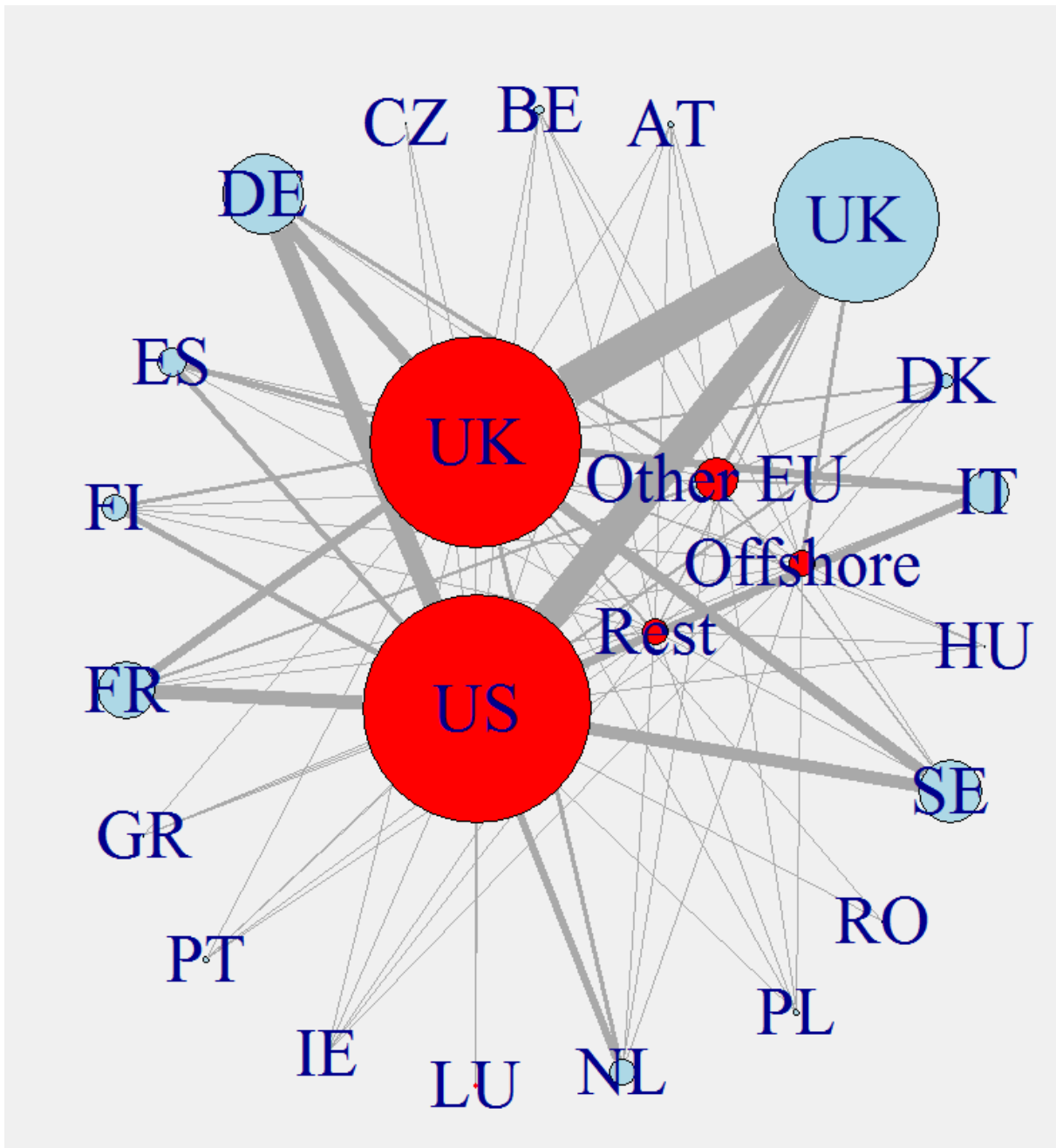
Investors reported net short positions in 26.6 different shares on average, with a median of five. The large difference between the mean and the median indicates that a small number of position holders short a large number of shares. Moreover, around 150 position holders account for more than 80% of net short position notifications received (Chart 3), covering three fourths of the ISINs in the dataset. Taken together, this suggests that short-selling activities in EU shares are highly concentrated.

Chart 3 displays the geographic concentration of net short positions, based on the number of distinct NSP. The red nodes correspond to the total number of distinct short positions by domicile of the position holder. The blue nodes correspond to the number of ISINs on which short positions were held, regrouped by issuance country. The size of the links shows the number of distinct NSP held by position holders from country A on ISINs from country B. For

example, the link between the red “UK” node and the blue “UK” node reflects the large number of short positions held by UK-based position holders on UK shares.

The predominance of US- and UK-based position holders is clear, most of whom hold net short positions in UK ISINs, followed by Germany, France and Sweden.

Chart 3: Geographic concentration of net short positions



Note: Number of distinct net short positions in EU shares received by NCAs, by position holder country (red nodes) and ISIN issuance country (blue nodes), from 1 January 2013 to 31 December 2016. A distinct net short position is defined as a unique

pair between one position holder and one ISIN. “Offshore” includes Bermuda, Guernsey, Isle of Man, Jersey, Cayman Islands and Virgin Islands.

Sources: National Competent Authorities, ESMA.

b. Consolidated net short positions in EU shares reported by NCAs to ESMA

This section is based on the daily data sent on a quarterly basis by NCAs to ESMA, which includes equities from the main national indices and is aggregated at ISIN level. This means that all net short positions in a particular ISIN reported to NCAs are summed, without any information on position holders. For example, two net short positions of 0.2% and 0.3% on a specific ISIN reported to NCAs on any given day will be reported to ESMA for that day as an aggregated position of 0.5% on that ISIN.

The average daily value of net short positions in shares reported to NCAs, aggregated by ISIN, has been relatively stable over time at 2% of issued share capital, with an average standard deviation of 2.5% and maximum values close to 20% on average (Table 3). The average value is also broadly stable over time within each country.

Table 3: Aggregated net short positions in EU shares

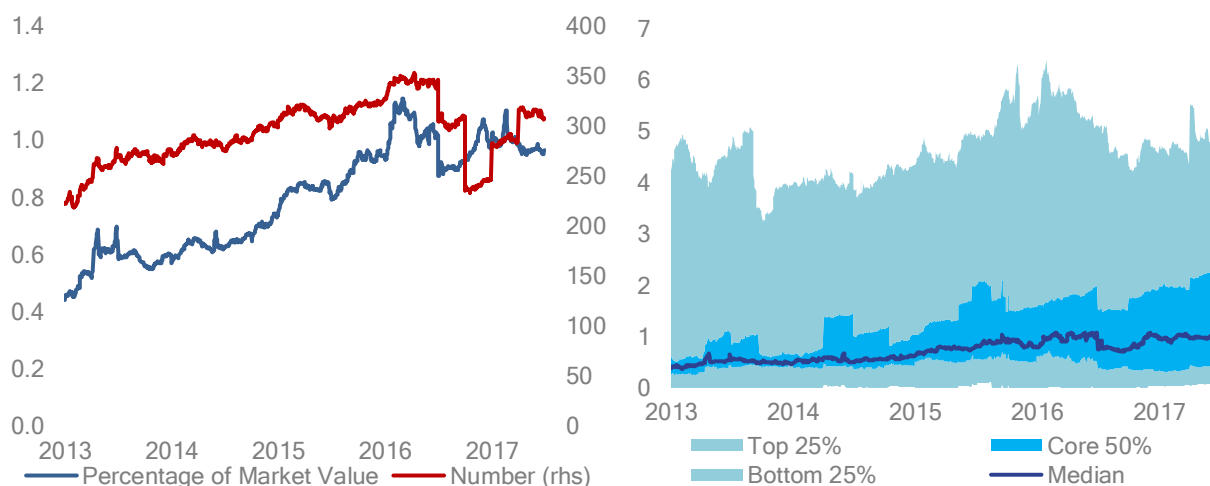
Reporting period		Daily net short position values (in %)		
		Mean	Standard deviation	Max
2013	Q1	1.9	2.6	20.3
	Q2	2.0	2.6	17.4
	Q3	1.9	2.5	26.4
	Q4	1.8	2.3	19.6
2014	Q1	1.8	2.3	16.1
	Q2	1.8	2.3	31.0
	Q3	1.8	2.3	17.2
	Q4	2.0	2.5	17.1
2015	Q1	2.2	2.8	18.7
	Q3	2.1	2.7	18.2
	Q2	2.3	2.8	19.8
	Q4	2.4	2.9	19.2
2016	Q1	2.4	2.9	21.0
	Q2	2.3	2.7	20.3
	Q3	2.2	2.7	21.6
	Q4	2.1	2.6	20.7
2017	Q1	1.9	2.3	18.6
	Q2	2.2	2.8	23.4

Note: Mean value, standard deviation and maximum value of daily net short positions in EU shares aggregated by ISIN, by quarter, in % of issued share capital.

Sources: National Competent Authorities, ESMA.

As a percentage of total market value of EU shares, the aggregated value of net short positions in EU shares reported to NCAs has been steadily rising, reaching 1% of EU market value for the first time in 2016 (Chart 4). The maximum number of ISINs reported to ESMA for a single day was 354, in April 2016. The dispersion of average net short positions between EU countries is high, reflecting to some extent the varying number of ISINs reported by each NCA (Chart 5). Moreover, dispersion in the core 50% has increased for the third quartile, highlighting that the aggregated value of net short positions has increased for a growing number of countries.

Charts 4 and 5: Value, number and dispersion of consolidated net short positions in EU shares



Note: Left chart = Market value of consolidated net short positions in EU shares, as percentage of total market value in the EU (left axis). Number of listed shares on which net short positions were reported (right axis). Right chart = Dispersion of consolidated net short positions by EU country, as a percentage of market value of those positions relative to each country's blue chip index market value.

Sources: National Competent Authorities, ESMA.

c. Consolidated net short positions in EU sovereign debts reported by NCAs to ESMA

The average value of net short positions in EU sovereign debts reported to NCAs has increased over time, from around EUR 25bn in 2013 to EUR 120bn in the first half of 2017 (Table 4). The standard deviation and sum of net short positions has increased in line, with the latter reaching an all-time high of EUR 1,312bn on 14 June 2017.

Due to the reporting thresholds and the method of calculation used for NSP on sovereign debts, it is not possible to infer whether this corresponds to increased short-selling activity on EU sovereign debts. Therefore, NSP data on sovereign debt is currently of limited use for financial stability monitoring.

Table 4: Consolidated net short positions in EU sovereign debts

Reporting period	Daily net short position value (in EUR bn)		
	Mean	Standard deviation	Sum

2013	Q1	20.4	56.2	184.7
	Q2	21.6	61.0	195.0
	Q3	29.4	73.2	285.8
	Q4	26.6	68.9	285.6
2014	Q1	29.5	77.1	318.0
	Q2	29.4	76.6	325.9
	Q3	25.1	70.5	331.4
	Q4	27.8	71.5	306.9
2015	Q1	34.1	74.8	400.3
	Q2	53.0	123.2	691.9
	Q3	42.8	92.0	569.0
	Q4	41.7	88.8	515.3
2016	Q1	50.1	98.6	512.4
	Q2	56.5	117.6	569.1
	Q3	71.3	152.7	648.8
	Q4	79.1	178.0	641.0
2017	Q1	107.5	221.7	903.1
	Q2	129.8	224.1	1,168.1

Note: Mean value, standard deviation and sum of daily of net short positions in EU sovereign debt. Quarterly averages, in billion euros.

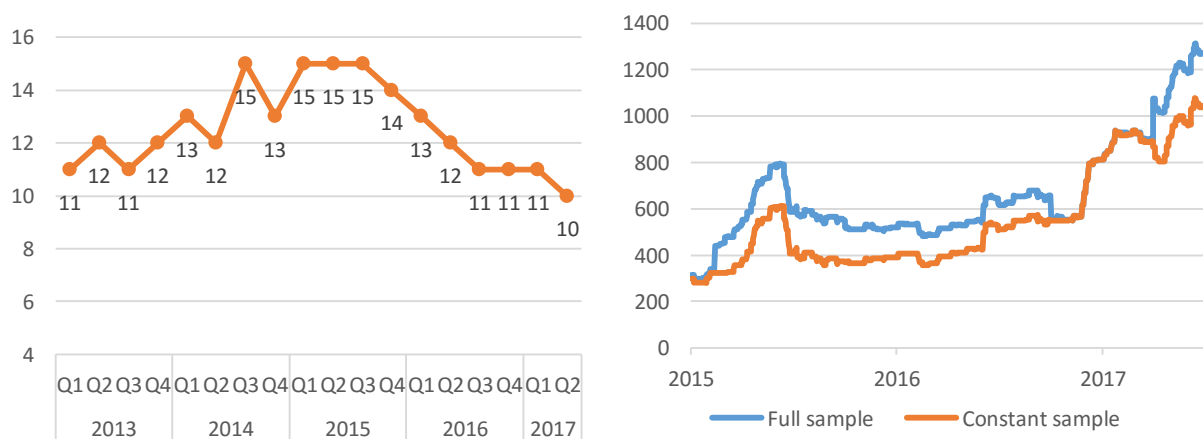
Sources: National Competent Authorities, ESMA.

Since the beginning, ESMA has received NSP data from 16 NCAs out of 28. The number of NCAs reporting NSPs on sovereign debt during a single quarter has never exceeded 15 and changes almost every quarter (Chart 6)³. This reflects the irregular NSP notifications received as market participants cross the reporting threshold. The absence of data from several NCAs since the entry into force of the SSR is likely due to the reporting threshold being too high in several countries.

To illustrate the challenge this creates for analysing EU-level data, Chart 7 provides a comparison of the full set of NSP data received on EU sovereign debt, versus a sample that includes NSP from the 6 NCAs that have reported data every quarter since 2015Q1. Changes in the sum of net short positions based on the full sample may be misinterpreted as EU-wide market developments, when the changes may actually be driven by the number and composition of reporting NCAs.

Charts 6 and 7: Number of NCAs reporting and sum of net short positions in EU sovereign debts

³ The decreasing number of NCAs in recent quarters may reflect technical issues related to the submission of quarterly reports by NCAs.



Note: Left chart = Number of NCAs from which reported net short position data on sovereign debt to ESMA, by quarter. Right chart = Sum of daily of net short positions in EU sovereign debts, in billion euros; Full sample=all net short position data received; Constant sample=net short position data received from NCAs that have reported data every quarter from 2015Q1 to 2017Q2.

Sources: National Competent Authorities, ESMA.

Moreover, NSP on sovereign debt are calculated as the net sum of duration-adjusted cash positions and delta-adjusted nominal derivatives position. All other things equal, a change in net short cash positions from a 2-year security to a 10-year security will automatically result in a higher NSP values. The trend in Chart 7 may for example reflect the longer average duration of shorted debt, rather than an actual increase in short-selling activity on this debt.

While information about the average maturity of debt shorted by market participants might be useful to authorities when provided separately, the monitoring of short-selling activities for financial stability purposes requires the ability to monitor changes in the total value of net short positions driven by economic reasons, without duration effect.

2. Impact of the public disclosure threshold on net short positions

a. Literature review

The economic literature on the public disclosure of short positions is sparse, mainly owing to the recent adoption of such measures in a limited set of countries. Public disclosure is generally understood as an alternative policy tool to short-selling bans, with the similar aim of introducing a constraint on short-selling activity. However, where bans are a blunt tool intended for emergency situations, public disclosure rules are different in at least two regards:

- i) The disclosure rule is permanent and therefore intended to durably change the behaviour of investors;
- ii) The threshold does not constitute a hard ceiling on short selling activities; its effects are more nuanced and may not have a symmetric impact on all investors.

The second point is a fundamental one, in that a differentiated impact on investors would have different implications for trading activity and financial stability.

In Europe, Jones, Reed and Waller (2016) investigated the public disclosure of short positions by focusing on the regimes adopted in the UK, France and Spain that pre-dated the SSR. Noting that the literature generally argues that short sellers improve market efficiency and help to stabilise share prices, they analyse the effects of disclosure on share prices and on the behaviour of short sellers based on public data from these three countries. They find that public disclosure has a limited overall impact on share prices, outside of rights issues. They also conclude that public disclosure discourages informed trading, and that share prices become less informative as a result. Lastly, the authors document the existence of herding behaviour with the presence of a short position disclosure significantly increasing the probability of another disclosure, but find no evidence that disclosure is used for share price manipulation.

Using SSR data on German shares, Jank, Roling and Smajlbegovic (2016) investigate the behaviour of investors around the public disclosure threshold. They find that a considerable fraction of position holders is reluctant to cross the threshold. The decision to cross appears to be persistent as some investors follow a policy not to disclose their positions. The authors also find stronger negative returns for the shares shorted by secretive investors, suggesting that these investors possess superior information. As a result, secretive investors are prevented by the threshold from fully acting on their information and beliefs due to the constraint imposed on short selling, resulting in less informational efficiency.

b. Distribution and analysis of net short positions

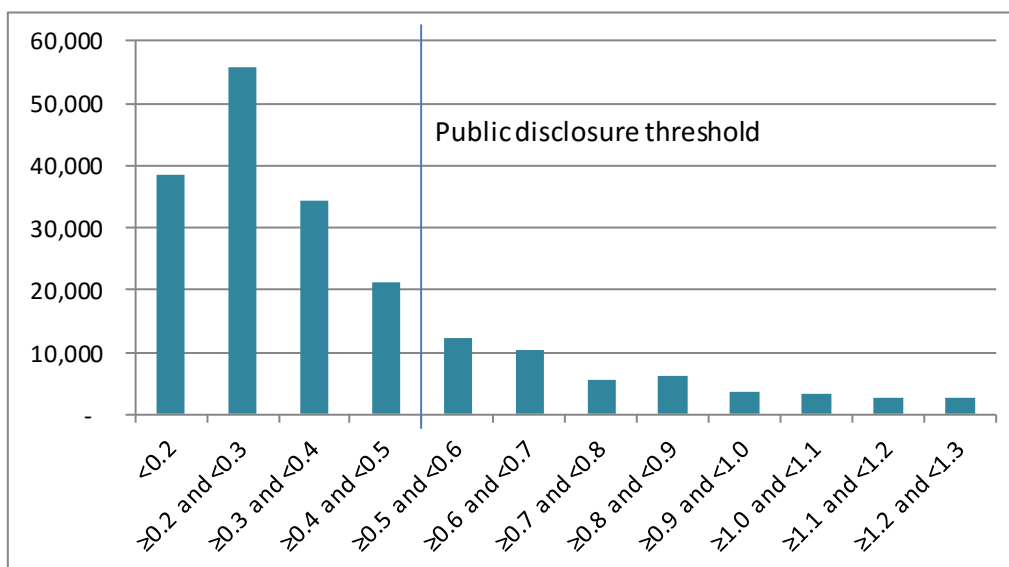
To investigate the impact of public disclosure on investor behaviour *below* the threshold, we reproduced the methodology used by Jank et al. (2016), applied to the ESMA EU-wide sample described above. We also looked into the impact of public disclosure *above* the threshold, confirming the existence of herding behaviour documented in Jones et al. (2016).

The sample includes a total 210,341 observations. Given the notification thresholds (every 0.1% starting at 0.2% of issued share capital), NSPs are regrouped into bins of 10 basis-point increments, as in Jank et al. (2016). For example, the ≥ 0.2 and < 0.3 bin includes all positions greater than or equal to 0.2% and smaller than 0.3%; the ≥ 0.3 and < 0.4 bin includes all positions greater than or equal to 0.3% and smaller than 0.4%; etc. This notation is used throughout this section.

Chart 8 shows the distribution of net short positions by reporting bin. The data are truncated at 1.3% (i.e. positions greater than or equal to 1.2% are not included) for readability but covers 93% of the sample nonetheless. The blue line marks the public disclosure threshold: to the left are all net short positions reported to NCAs not publicly disclosed; and to the right all net short positions publicly disclosed.

Most net short positions are below the public disclosure threshold of 0.5% (71%). The number of short positions in each bin gradually decreases from 0.2% (the reporting threshold) as the size of short positions increase, with no obvious clustering around the public threshold. This also holds with higher data granularity, e.g. when splitting the sample into bins of five basis points or smaller.

Chart 8: Distribution of net short position values by bin



Note: Number of net short positions in EU shares received by NCAs, regrouped into bins of 10 basis point increments, from 1 January 2013 to 31 December 2016. For example, ≥ 0.2 and < 0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed.

Sources: National Competent Authorities, ESMA.

To determine the impact of the public disclosure threshold on the behaviour of investors, we investigate the frequency of net short position increases and the duration of positions, as in Jank et al. (2016). Each unique combination of position holder and ISIN is considered as a distinct short position which may increase and decrease over time.

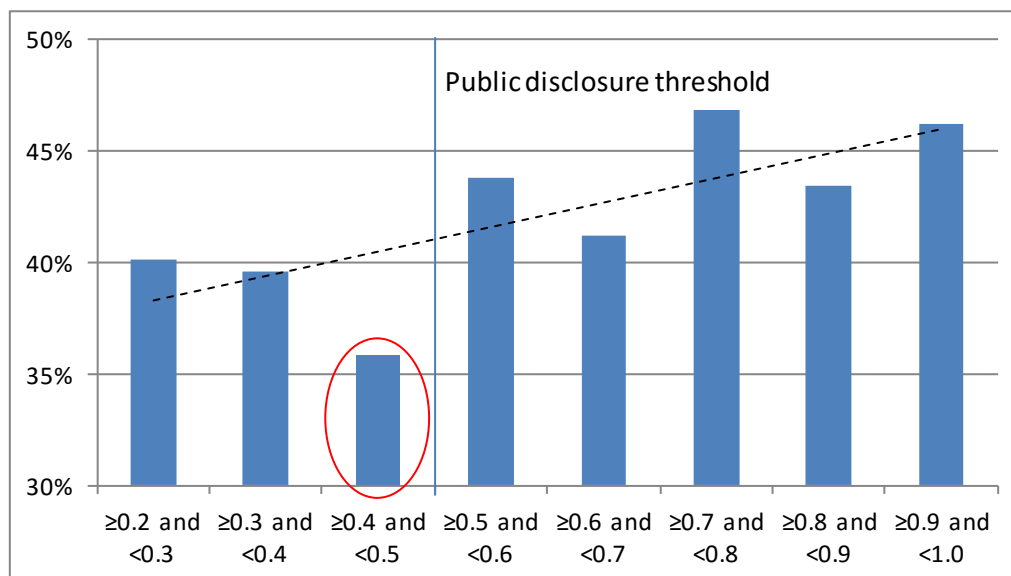
To investigate the frequency of short position increases, net short positions are split within each bin based on whether the next notification is in a higher or lower bin, i.e. whether the short position increases or decreases. We look in particular the ≥ 0.4 and < 0.5 bin, which is just below the public disclosure threshold and where positions are the most likely to be influenced by the constraint.

Around 36% of net short positions in the ≥ 0.4 and < 0.5 bin increase, the smallest percentage of all reporting bins (Chart 9). In contrast, 40% of positions in the bin just above increase. Moreover, the trend suggests that the frequency of net short position increases tends to grow with the size of net short positions, whereas the ≥ 0.4 and < 0.5 bin marks a drop in frequency of increases relative to smaller positions. The differences in frequencies relative to ≥ 0.4 and < 0.5 bin are all statistically significant at the 1% level⁴.

⁴ As a robustness check, the analysis was also performed using a logit regression to account for the non-normality of the net short positions distribution. The odds-ratios obtained for each bin showed a virtually identical picture.

The abnormality observed highlights that the public disclosure threshold has a material impact on the market outcome of net short positions. This outcome is likely driven by the behaviour of some position holders that avoid crossing the public disclosure threshold.

Chart 9: Frequency of net short position increases by bin



Note: Frequency of net short position increases in EU shares received by NCAs, regrouped into bins of 10 basis point increments, from 1 January 2013 to 31 December 2016, with linear trend (dotted line). For example, ≥ 0.2 and < 0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed. The red circle highlights positions that are in the reporting bin just below the public threshold.

Sources: National Competent Authorities, ESMA.

The abnormality observed highlights that the public disclosure threshold has a material impact on the market outcome of net short positions. This outcome is likely driven by the behaviour of some position holders that avoid crossing the public disclosure threshold.

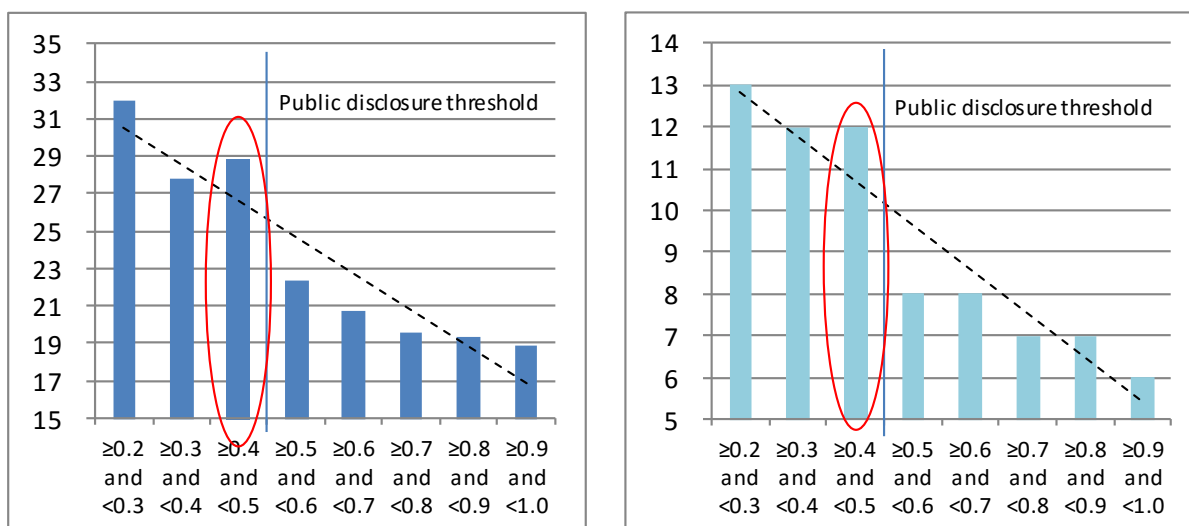
Next, we investigate the duration of net short positions by observing the number of days spent in each bin (i.e. between two short position notifications). Stale positions with a duration greater than 300 days are excluded to avoid introducing a bias. Indeed, after the first notification, positions that fall below the 0.2% reporting threshold should be notified to the relevant authority one last time until the threshold is crossed again. However, it appears that position holders sometimes omit to notify the competent authority, leaving a large number of stale positions between 0.2% and 0.3%.

The duration of short positions in the ≥ 0.4 and < 0.5 bin is the second highest, with an average of 29 days (Chart 10). Differences between positions in bins with a lower duration (i.e. all bins except the lowest reporting bin) relative to the ≥ 0.4 and < 0.5 bin are all statistically significant at the 1% level. Moreover, the decreasing trend suggests that the duration of positions in the ≥ 0.4 and < 0.5 bin is an outlier. When using median instead of mean (Chart 11), the duration in

the 0.4% bin is still the second highest, equal to the duration in the 0.3% bin (12 days), but the gap with the 0.5% bin is much larger in relative terms (8 days).

This abnormality reinforces the view that the public disclosure threshold seems to influence the market outcome of net short positions, which is likely driven by the behaviour of some investors that avoid crossing the public threshold and tend to “overstay” in the reporting bin just below the threshold.

Charts 10 and 11: Mean and median duration (in days) spent in each reporting bin



Note: Mean and median duration of net short positions in EU shares received by NCAs, in days, regrouped into bins of 10 basis point increments, from 1 January 2013 to 31 December 2016, with linear trend (dotted line). For example, ≥0.2 and <0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed. The red circles highlight positions that are in the reporting bin just below the public threshold.

Sources: National Competent Authorities, ESMA.

The evidence presented, in line with the literature, confirms the relevance of the SSR net short position public threshold: some investors avoid crossing the 0.5% threshold, as reflected in the lower frequency of short position increases and relatively longer duration of positions just below the threshold.

c. Public disclosure avoidance

To identify the type of investors that are influenced by the disclosure threshold, the sample is further divided between net short positions at their record high and position below their record high, as in Jank et al. (2016). The objective is to determine whether the public disclosure threshold impacts investors asymmetrically.

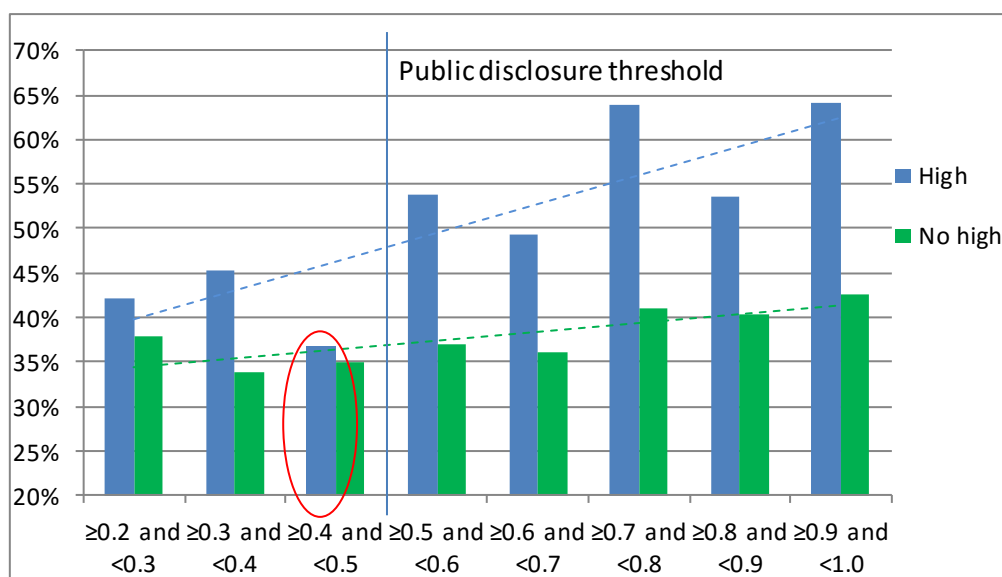
In each bin, a net short position is at its record high if, for each unique pair of position holder and ISIN, the position has never been in a higher bin in the past. For example, a position of 0.2% reported for the first time will be in the record-high sample of the ≥0.2 and <0.3 bin. If this position increases to 0.3%, it is then part of the record-high sample of the ≥0.3 and <0.4 bin. If the position decreases to 0.2% again, it will now be part of the non-record high sample of positions in the ≥0.2 and <0.3 bin. Net short positions below 0.5% that are at their record high

have never been made public, allowing us to focus on the behaviour of investors that avoid public disclosure and aim to keep their strategy secret from other investors.

We observe in Chart 12 that the impact of the public disclosure threshold is concentrated on net short positions that are at their record high in the bin immediately below the threshold. This is visible from both the difference in frequency with the adjacent bins, and the break compared with the overall trend.

For the non-record high sample, the frequency of increases for positions in the bin just below the 0.5% threshold is in line with the overall trend, and comparable to the adjacent bins. This suggests that the behaviour of investors that have already publicised a short position in a specific share (i.e. investors that have publicly expressed a bear view on an issuer in the past) is not influenced by the public disclosure threshold. Jank et al. (2016) show that the decision to cross or not the disclosure threshold appears to be persistent, with investors sticking to their behaviour over time. This may reflect concerns about protecting private information, or proprietary investment strategies.

Chart 12: Frequency of net short position increases, split between positions at their record high and below their record high



Note: Frequency of net short position increases in EU shares received by NCAs, regrouped into bins of 10 basis point increments, from 1 January 2013 to 31 December 2016, with linear trends (dotted lines). For example, ≥ 0.2 and < 0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed. The red circle highlights positions that are in the reporting bin just below the public threshold. A net short position is at its record high if, for each pair of position holder and ISIN, the position has never been in a higher bin in the past.

Sources: National Competent Authorities, ESMA.

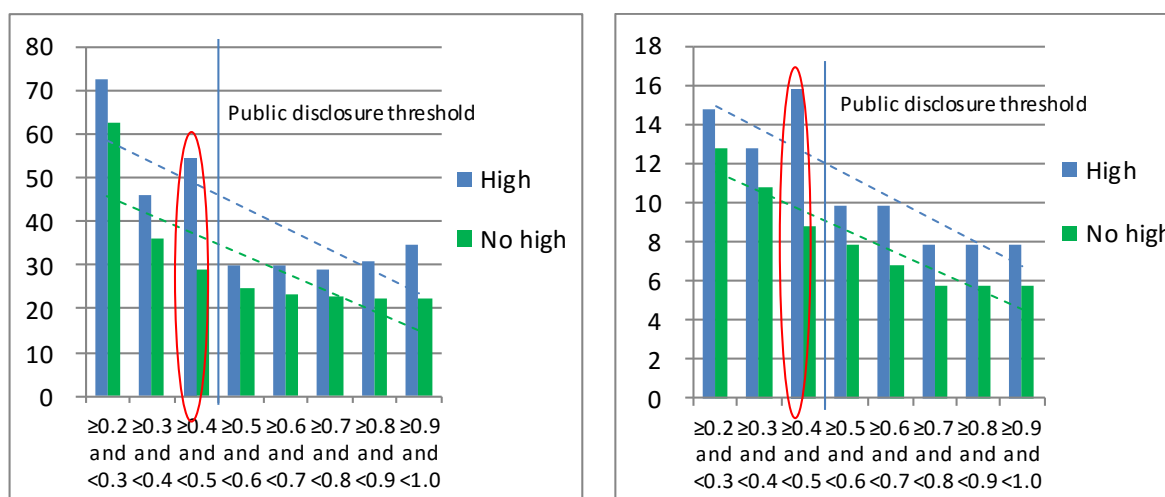
The average duration of net short positions confirms that the public disclosure threshold only impacts record-high positions that are in the bin just below the threshold (Charts 13 and 14). Investors that hold record-high short positions in the ≥ 0.4 and < 0.5 bin stay on average 35 days in this reporting bin, compared to 30 and 25 days in the adjacent bins. Moreover, the average duration of net short positions tends to decrease as the size of the positions increases,

but the duration of record-high positions in the bin just below the threshold marks a clear break from the overall trend.

In contrast, the average duration of net short positions in the ≥ 0.4 and < 0.5 bin that are below their record high is 22 days, i.e. 13 days shorter than record-high positions in the same reporting bin. This is comparable to the duration of short positions in the adjacent bins and in line with the overall decreasing trend.

These observations confirm the view that the public disclosure threshold seems to influence the behaviour of investors, who avoid crossing the threshold and are reluctant to disclose their strategy. Investors that have disclosed their position in the past do not seem to be influenced anymore by the threshold.

Charts 13 and 14: Mean and median duration (in days) spent in each reporting bin, split between positions at their record high and below their record high



Note: Mean and median duration of net short positions in EU shares received by NCAs, in days, regrouped into bins of 10 basis point increments, from 1 January 2013 to 31 December 2016. For example, ≥ 0.2 and < 0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed. The red circles highlight positions that are in the reporting bin just below the public threshold. A net short position is at its record high if, for each pair of position holder and ISIN, the position has never been in a higher bin in the past.

Sources: National Competent Authorities, ESMA.

Lastly, the sample is divided between Liquid and Non-liquid shares, per the ESMA MiFID Register on shares admitted to trading on EU regulated markets⁵. The objective is to analyse whether the public disclosure threshold affects liquid and non-liquid shares asymmetrically, i.e. whether investors behave differently around the threshold depending on the underlying liquidity of the share.

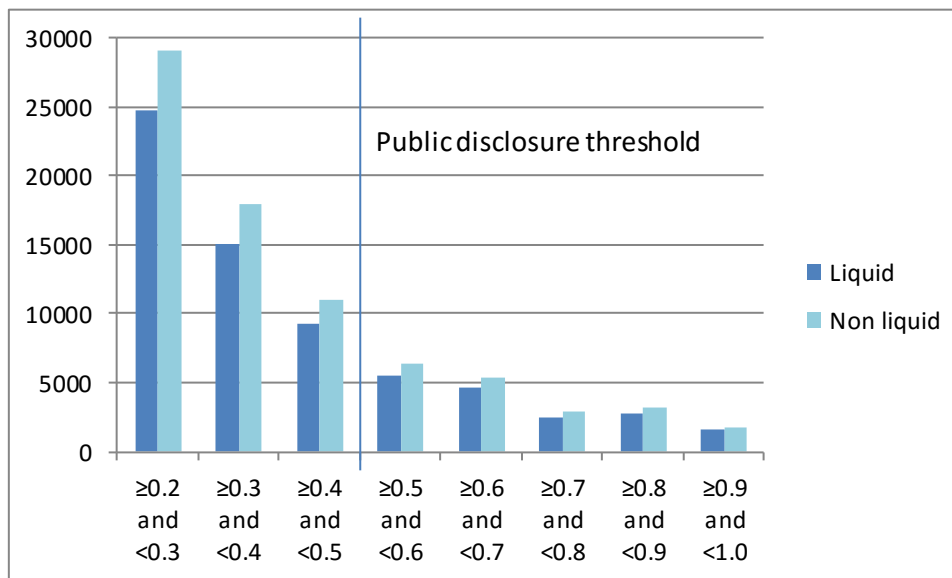
Based on data from the Register, there were 739 liquid shares and 1,218 non-liquid shares in the data (364 shares not included in the Register). The mean and median number of position

⁵ https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_sha

holders per ISIN is broadly similar, with an average of 15 liquid shares and 16.7 non-liquid shares per position holder. The respective median values are 3 liquid shares and 4 non-liquid shares. In contrast, the average number of position holders per ISIN is higher for liquid shares (15.7) than non-liquid shares (11.4), also reflected in the respective median values (10 versus 5).

The distribution of net short positions does not reveal any significant differences between the two sub-samples, aside from the larger number of non-liquid shares in each bin, as illustrated in Chart 15.

Chart 15: Distribution of net short position values on liquid and non-liquid shares by bin

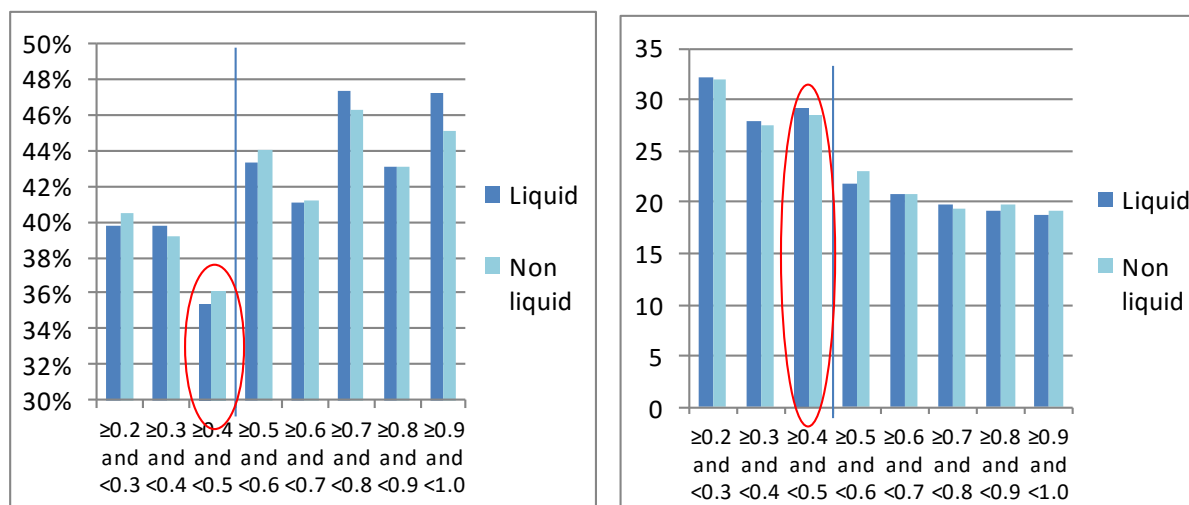


Note: Number of net short positions in EU shares received by NCAs, regrouped into bins of 10 basis point increments, split between liquid and non-liquid shares per the ESMA Register on shares admitted to trading on EU regulated markets, from 1 January 2013 to 31 December 2016. For example, ≥0.2 and <0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed. The red circle highlights positions that are in the reporting bin just below the public threshold.

Sources: National Competent Authorities, ESMA.

The same methodology as above is applied to the liquid and non-liquid sub-samples. Charts 16 and 17 show again that there are no major differences between liquid and non-liquid shares, suggesting that the public threshold has a symmetric impact on shares, regardless of their underlying liquidity.

Charts 16 and 17: Frequency of net short position increases and mean duration (in days) spent in each reporting bin, split between liquid and non-liquid shares



Note: Mean and median duration of net short positions in EU shares received by NCAs, in days, regrouped into bins of 10 basis point increments, split between Liquid and Non-liquid shares per the ESMA Register on shares admitted to trading on EU regulated markets, from 1 January 2013 to 31 December 2016. For example, ≥ 0.2 and < 0.3 includes all positions greater than or equal to 0.2% and smaller than 0.3% of issued share capital. The blue line marks the public disclosure threshold of 0.5%: to the left are net short positions reported to NCAs that are not publicly disclosed, and to the right positions that are publicly disclosed. The red circles highlight positions that are in the reporting bin just below the public threshold.

Sources: National Competent Authorities, ESMA.

d. Herding

We rely on the definition of herd behaviour first developed by Banerjee (1992), applied in this context: Investors follow the actions of other investors even when their private information suggests doing something different, which inflicts a negative externality on the rest of the market. To assess herding, we concentrate on instances where multiple investors short the same share over a limited period of time, or where short position holders contemporaneously change the size of their position.

To do so, we investigate the time between net short position notifications and measure the time concentration of net short positions. More specifically, we calculate the number of days between each notification on the same share and across investors, provided that the notifications are at least one day apart⁶. Net short positions are then regrouped into buckets, based on the number of days that have passed in the four weeks following the most recent notification.

First, we focus on net short position notifications received after a private notification (i.e. a net short position below 0.5%). Since private notifications are by definition not publicly available, they should not influence the behaviour of other investors.

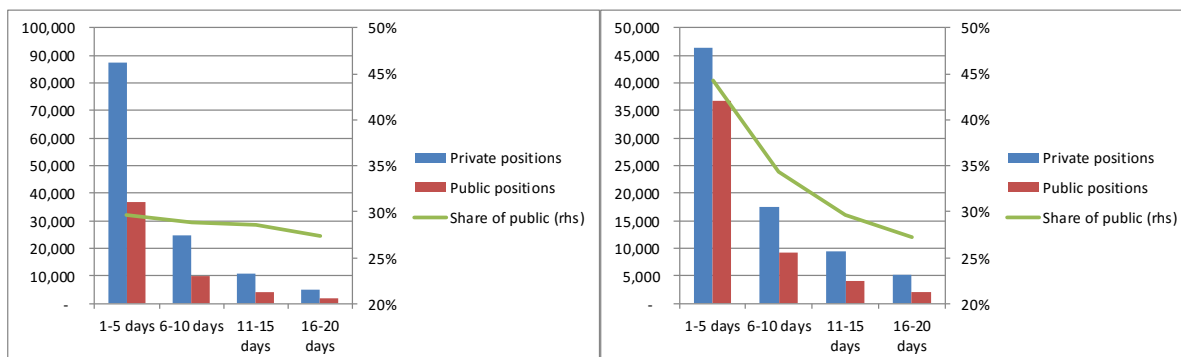
⁶ This one-day difference is necessary given that public disclosure occurs one day after the short position notification. As a result, the time between net short position changes is possibly biased upward when multiple notifications are received on the same day.

Time concentration appears to be very high, with 60% of all notifications received within five days of another private notification on the same share, including 27% within one day (Chart 18). This degree of concentration suggests the existence of herd behaviour amongst short sellers, reflecting group reaction to public information (e.g. company news, market developments), and individual investors likely anticipating the reaction of other investors. The share of publicly disclosed positions (i.e. net short positions above 0.5%) is broadly stable and in line with the full-sample average of 29%. This confirms that private notifications do not influence the decision of other investors to go public⁷.

Next, we compare these results with the number of net short position notifications received after a public disclosure⁸. Unlike private notifications, publicly disclosed positions in a security can be expected to influence the behaviour of other investors vis-à-vis that security, for two reasons. First, investors may assume that those who go public are likely to be better informed, and decide to replicate their competitor’s strategy. Second, investors may be less concerned with keeping their strategy secret once another investor has gone public, and decide to take a larger position.

Time concentration appears again to be very high after public disclosure (Chart 19). This is particularly the case for publicly disclosed positions in the five days that follow another public disclosure on the same ISIN. Indeed, the share of public notifications received within one week is much higher after another public disclosure has taken place (44%), and converges over time towards the full-sample average of 29%.

Charts 18 and 19: Net short position notifications received in the weeks following a private notification (left) and a public disclosure (right) on the same share



Note: Number of private and public net short position changes in four weeks following a private notification (left chart) or a public disclosure (right chart) of a net short position on the same ISIN, and share of public positions (right axis) in % of total. Private positions are net short below the public disclosure threshold.

Sources: National Competent Authorities, ESMA.

⁷ To confirm that public disclosure does not influence these findings, we followed the same procedure excluding all notifications received within ten and twenty days of a public disclosure. The share of publicly disclosed positions remains stable as in the main results (albeit lower due to the large number of public positions removed) and time concentration remains very high with most position changes received within five days of the previous notification.

⁸ The total number of net short position notifications received in the weeks that follow public disclosures is smaller than the number of notifications received in the weeks that follow private notifications. This is by construction, since publicly disclosed notifications constitute less than one third of the sample.

The higher share of publicly disclosed notifications is confirmed using a logit regression inspired from Jones et al. (2016)⁹. We define the dummy variable *Public* as dependent variable, and use lagged dummy variables indicating recent short position disclosures as explanatory variables. The estimation results show that the odds of a net short position notification being public (i.e. above 0.5%) are six times higher when another disclosure has taken place in the past week on the same share (Table 5).

Table 5: Odds ratio of a public disclosure after a recent disclosure

Time since previous disclosure	Odds ratio*	Standard error
1 week	6.3	0.8
2 weeks	4.2	0.7
3 weeks	3.3	0.7
4 weeks	3.0	0.8

Note: Odds ratio and standard errors from a logit regression, where the dependent variable is a dummy variable indicating whether a position is public or not, and the explanatory variables are lagged dummy variables indicating whether a short position disclosure has taken place in the last one, two, three or four weeks.

* All estimates statistically significant at the 1% level.

Sources: National Competent Authorities, ESMA.

The larger share of publicly disclosed notifications reflects a combination of follow-on disclosures by other investors, and subsequent changes to an already disclosed position (e.g. from 0.5% to 0.6%): Around half of the public notifications received within four weeks of a previous disclosure came from a different investor¹⁰.

To further inform the analysis, we look at the number of different investors that reported a position within five days of another notification. The average number of investors per share who reported a position after a private notification is very similar to the average following a public disclosure (around 12 investors), while the median is the same (six investors). This suggests that herding from new investors “piling in” immediately after a public disclosure, i.e. investors who previously did not hold a short position in a share and just seek to replicate other investors’ strategies, is limited.

As highlighted in Jones et al. (2016), it is possible that follow-on disclosures simply reflect independent investor reactions to exogenous public information. Indeed, the higher share of public notifications might reflect different investor behaviour above the disclosure threshold unrelated to previous public disclosures. However, the elements presented above strongly suggest that investors react to public disclosure by increasing the size of their position, thereby reinforcing herd behaviour. However, this hypothesis was not specifically tested.

⁹ The setup is different here given the nature of the data: the logit calculates the odds that a net short position notification is public rather than private, while Jones et al. (2016) estimate the probability of a public disclosure (compared to no disclosure) on any given day.

¹⁰ The methodology used possibly overestimates the share of public disclosures from new investors.

Conclusions

The conclusions that can be drawn regarding the reporting of SSR data on net short positions reflect the diversity of SSR data, which cover different instruments and level of aggregation.

The analysis of individual net short positions in EU shares shows a large concentration of short selling activities. A substantial majority of investors that have reported net short positions in EU shares are based in the US and UK. These investors are mainly active in a relatively limited number of EU countries. Despite some data quality issues, net short positions in EU shares aggregated by ISIN (reported to ESMA by NCAs) show a broadly increasing trend and dispersion in short selling activity over time at the EU level.

For EU sovereign debt, the available SSR net short positions data is inadequate for financial stability purposes. The absence of data from several NCAs since the entry into force of the SSR, and irregular reporting from other NCAs, are likely due to the reporting threshold being too high in several countries. In addition, the use of duration-adjusted cash positions implies that changes in net short positions may reflect changes in the duration of EU sovereign debt shorted, rather than the amount of short-selling activity taking place, which is economically less meaningful for financial stability risk monitoring. Changes in the threshold and methodology would help to improve the relevance of SSR data for sovereign debt market monitoring and financial stability.

The analysis of net short positions in EU shares shows that public disclosure influences the market outcome of short positions below and above the 0.5% disclosure threshold. First, the threshold imposes a constraint on short selling that is binding for investors that avoid publicly disclosing a net short position in a particular share, i.e. investors who aim to keep their strategy secret from other investors. Jank et al. (2016) documented stronger negative returns for German stocks shorted by these secretive investors, suggesting that the concealment of short position is associated with superior information. A possible implication, which was not tested here, is that the threshold might prevent informed investors from acting on their beliefs, leading to temporary overpricing and lower pricing efficiency.

Public disclosure can increase pricing efficiency by bringing transparency when positions are disclosed by informed investors. However, it also seems to reinforce herd behaviour, with disclosure leading to follow-on disclosures by other investors. One question raised in the literature but not addressed here is whether short sellers might use public disclosure to manipulate share prices by influencing others and profit from large price declines (so-called "bear raids"). Using public SSR data from three countries, Jones et al. (2016) find no evidence of this.

The current notification and public disclosure thresholds provide meaningful information to both regulators for supervisory purposes and the market for transparency purposes. Nonetheless, further research on the potential externalities of the public disclosure threshold would be needed to increase public understanding of the impact of the threshold.



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