European Commission
Rue de Spa 2
B-1049 Brussels
Belgium

26 October 2016

Dear Mr Dombrovskis

AIMA and MFA Letter on current industry concerns regarding the EU Short Selling Regulation in the context of the Capital Markets Union

The Alternative Investment Management Association (**AIMA**)[1] and the Managed Funds Association (**MFA**)[2] (together, **we**) are writing to the European Commission (**the Commission**) further to Regulation (EU) No.236/2012 on short selling and certain aspects of credit default swaps (**the SSR**)[3] in relation to the Commission's Capital Markets Union (**CMU**) initiative.

It has been almost four years since the SSR entered into effect, introducing harmonised rules for the: (i) notifications and disclosures of significant net short positions in shares, sovereign debt and uncovered sovereign CDSs; (ii) prohibition of uncovered short sales of shares and sovereign debt, and uncovered positions in sovereign CDS; and (iii) emergency powers to national competent authorities (**NCAs**) and ESMA to place further restrictions on short selling.

The intention of the SSR, as for other pieces of EU harmonising legislation, was to remove regulatory fragmentation and to improve the functioning of the internal market in financial services. Certain aspects of the regime have indeed proved beneficial, such as the prohibition on naked short sales and new buy-in rules for short sales which have failed to settle. However, we believe that certain of the SSR's obligations do not function efficiently, both from the perspectives of national competent authorities (**NCAs**) and market participants.

We are writing to highlight our concerns that that the SSR will be a significant obstacle to the successful implementation of the CMU and ought to be amended as a matter of priority.[4]

[1] Founded in 1990, the Alternative Investment Management Association (AIMA) is the global representative of the hedge fund industry. Our membership is corporate and comprises over 1,700 firms (with over 9,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than $1.5 trillion in assets. See www.aima.org.

[2] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[3] Available here: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:086:0001:0024:en:PDF

[4] To which we support the Commission's renewed commitment http://europa.eu/rapid/press-release_IP-16-3001_en.htm

We noted our concerns on the SSR in our respective responses to the Commission's Call for Evidence on the EU Regulatory Framework in January 2016.[5] The responses provide several examples of how the SSR's obligations could in fact detract from EU businesses' access to finance and market liquidity, in contradiction to the objectives of the CMU.

AIMA and MFA members represent significant participants in EU primary and secondary stock and bond markets, as well as OTC and exchange-traded derivative markets. They typically exercise the flexibility to take both long and short positions over various timeframes according to the particular investment strategy being pursued and the particular financial instrument being traded, undertaking intense fundamental and technical analysis to deduce what the fair price of an instrument should be. To this end, the ability to enter short positions is vital to the efficient pricing mechanisms of secondary markets - such that the true value of an instrument is reflected in its price as quickly as possible. This efficiency promotes confidence in secondary markets, which in turn encourages investors to participate in primary market issues and improves access to financing for corporate and sovereign issuers and the broader real economy.

The Annex, below, sets out our recommendations for the SSR Level 1 and 2 texts to be re-opened and for further ESMA guidance to promote greater harmonisation of implementation.

The Annex makes the following key recommendations:

- **Centralised notification and publication mechanism for significant net short positions in shares, sovereign debt –** we note the disparate array of mechanisms currently used by different Member States to receive notifications and disclosures of significant net short positions. We recommend that a single centralised EU mechanism be developed to harmonise net short position notifications and disclosures. If not possible, we would suggest that a harmonised template and mechanism to be used by each Member State;

- **Centralised EU source of issued share capital data –** we strongly recommend that the above platform also provide a centralised source of accurate and reliable figures for the issued share capital of a particular issuer to enable the accurate calculation of significant net short positions in shares for the purposes of Article 5 and 6 of the SSR;

- **Centralised list of in-scope instruments –** we also recommend that a centralised list of in-scope instruments be compiled for the purposes of the specific scope of the SSR;

- **Delay of significant net short position notifications from T+1 to T+2 –** we highlight the significant difficulties experienced by market participants in meeting the deadline for making notifications and disclosures of significant net short positions by 15:30 in the time zone of the relevant NCA on the following trading day. We note our belief that a T+2 obligation would facilitate more accurate notifications and disclosures by market participants, whilst mitigating the large costs associated with undertaking such complex reporting on a T+1 basis, especially for participants with operations spanning different time-zones;

- **Amend incremental thresholds for additional private notifications for shares –** we suggest that, following the initial private notification threshold for shares at 0.2% of issued

[5] Available here: http://www.aima.org/objects_store/eu_cmu_-_call_for_evidence_on_eu_fs_framework_-_2015_-_response_to_consultation_85773.pdf and https://www.managedfunds.org/wp-content/uploads/2016/02/MFA-Response-to-CMU-Call-for-Evidence1.pdf.

share capital, the subsequent incremental thresholds at 0.3% and 0.4% of issued share capital do not provide commensurate benefits that match the significant costs of compliance, thus we recommend that those incremental thresholds be removed;

- **Harmonisation of NCA interpretation of the SSR** – we note certain areas where NCA interpretation and enforcement of the SSR has been inconsistent, leading to a great degree of uncertainty amongst market participants in aspects of the SSR including notifications of significant net short positions and the application of rules on uncovered short sales in shares. We propose that the SSR be amended and/or ESMA be encouraged to develop Q&A and other guidance aimed at providing NCAs and market participants with greater certainty on the meaning of the SSR's key obligations;

- **Duration adjustment for derivatives as well as for bonds when calculating net short positions –** we strongly recommend the Commission and ESMA explicitly clarify through a Level 2 amendment and Level 3 guidance that both duration and delta adjustment of derivative positions are permitted under the SSR for net short position calculations in sovereign debt. We believe that preventing a duration adjustment of derivatives positions can lead to inaccurate net position calculations that do not capture the true economic positions of participants and result in erroneous notifications;

- **Harmonisation of publication and wording of temporary short-selling bans** – we note that it can be difficult for market participants to immediately learn about the intraday introduction of a temporary prohibition on short selling introduced by an NCA. We recommend that NCAs inform ESMA, who would then formally publicise such bans on its website. This would remove the requirement for market participants to constantly monitor the websites of each NCA for such *ad hoc* announcements. We also recommend that the wording of emergency bans be harmonised to prohibit 'covered and uncovered short sales', rather than 'any trade that results in an increase of a net short position'.

We are grateful for your consideration of this letter. We would welcome the opportunity to discuss the content of this letter further during an in-person meeting between your team and a representative group of AIMA and MFA members.

If you have any other questions, please contact Oliver Robinson (orobinson@aima.org) of AIMA, or Matthew Newell (mnewell@managedfunds.org) of MFA.

Yours sincerely,

/s/

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Cc: European Securities and Markets Authority

Annex

1. Harmonised notification and disclosure mechanisms

Market participants currently experience significant cost and complexity when seeking to comply with the SSR notification and disclosure obligations due to the disparate methodologies and formats adopted by different NCAs. Each authority has implemented its own approach to receiving SSR short position notifications. Methodologies range from online platforms (as used by France, Germany and the Netherlands) – to email, fax and direct posting (used by other Member States such as the UK, Ireland, Sweden, Poland and Greece). Also, when required by Member States, the pre-approval processes to register with the relevant mechanism is often different across Member States.

Certain Member States even require the use of multiple mechanisms. For example, the German Federal Financial Supervisory Authority (**BaFin**) receives private notifications through a web-based portal, but public disclosures through an entirely separate system – the Bundesanzeiger (Federal Gazette). The latter system requires multiple operational processes and duplication on the part of market participants and takes up to several weeks for approval to be obtained, which can lead to delays if the disclosure threshold is crossed fairly quickly. Furthermore, the effective deadline for disclosures to the Bundesanzeiger is noon, which is earlier than the 15:30 deadline required by the SSR and can be impossible to meet if sign-off is required by US colleagues, for example.[6] The Bundesanzeiger also uses billing practices that are prone to errors and introduce unnecessary extra costs.[7]

AIMA and MFA suggest that a centralised notification and disclosure mechanism for shares, sovereign debt and uncovered sovereign CDS would improve compliance, reduce the burden on NCAs, and avoid the need for each market participant to make notifications to separate systems and newspapers.

To this end, we would encourage the Commission to work with NCAs and ESMA to establish a single reporting platform for all net short position notifications and disclosures, with the onward distribution of information to the relevant NCAs. We believe that this could be readily accomplished, for example, through the establishment of a single website for pan-European notifications allowing single-batch uploading of notifications using a single file format.

Should the Commission be unable to achieve this single pan-European mechanism, AIMA and MFA would suggest that a standardised template and communication method be developed in collaboration with ESMA and implemented by all NCAs. This standard notification form and mechanism could be in Excel format with certain information tailored to the relevant NCA - such as logo and contact details. The single communication method of these Excel files could be through email, which would permit our members to develop more automated solutions to the compilation and submission of notifications and disclosures to as great a degree as possible.

[6] See discussion on T+2 disclosures below.
[7] Members have often been served with duplicate invoices generated by Tesch Inkasso - the payment collection company for the Bundesanzeiger.

2. Centralised source of data for significant net short position calculations and in-scope instruments

Article 5 of the SSR requires legal and natural persons to notify the details of their significant net short positions in shares that are admitted to trading on an EU trading venue to the relevant NCA on each occasion that their position exceeds or falls below 0.2% of the issued share capital of an issuer, and every 0.1% above this threshold. Article 6 contains a public notification obligation for net short positions in shares exceeding 0.5% of issued share capital. Article 7 of the SSR contains the equivalent obligation for significant net short positions in sovereign debt, with notifications at either 0.1% or 0.5% of outstanding issued debt, depending upon the amount issued.

In order to make the abovementioned private and public notifications, market participants must first:

(i) evaluate whether their traded securities are in-scope of the SSR;
(ii) obtain the requisite data on the total issued share capital of an issuer (the denominator);
(iii) calculate their net short position in the share (the numerator); and
(iv) determine if a relevant threshold has been crossed.

However, our members have and continue to experience significant difficulties in seeking to comply with these obligations.

Data for making calculations for shares

Obtaining accurate data about the current issued share capital of each issuer is particularly challenging for AIMA and MFA members.

Market participants in the vast majority of cases will make every reasonable endeavour to obtain accurate and up-to-date information upon which to base their significant net short position calculations. However, there is currently no centralised source of issued share capital data, with market participants typically left to obtain the relevant information and to bear sole responsibility for any errors in that data.

Currently, AIMA and MFA members utilise a combination of regulatory data feeds, trading venue data and the issuer themselves to find out total issued share capital. However, despite their best endeavours, the figures given to them by each source often do not match up, often due to differences in how quickly data is updated. Such inconsistency leads to uncertainty, delay and regulatory risk being incurred by a market participant that may make an erroneous notification, or fail to notify at all, and thus incur NCA enforcement penalties.[8]

A key problem is that there is currently no obligation on issuers to provide an 'issued share capital' figure for the purposes of the SSR. While current EU transparency rules require issuers,

[8] Some national competent authorities are particularly strict in their enforcement, imposing strict liability fines in all circumstances of late or incorrect notifications.

for example, to publish total voting rights, there is no similar requirement under the SSR for issuers to publish total issued share capital.[9]

As there is no requirement on issuers to regularly publish their 'total issued share capital', market participants are not able to obtain reliable and accurate information from issuers. Issuers may report on 'share capital' generally in annual reports or on their website, but they may be using a very different definition of 'issued share capital' and furthermore it is completely within their discretion if or how frequently they publish this information.

'Issued share capital' for SSR purposes includes (a) all share classes; and (b) treasury shares, but such information is not systematically reported; accordingly it can be impossible to know if all share classes are being captured, how up to date this information is, and whether any shares have been subsequently cancelled.

Market data providers such as Bloomberg and Reuters can only disseminate information the issuers themselves publish – their figures are, therefore, inherently unreliable. We recommend that policy makers introduce a positive obligation requiring issuers to publish this information regularly.

Certain NCAs have themselves recognised the difficulties of obtaining reliable denominator data for SSR significant net short position calculations in shares. There have been numerous instances of NCAs actively flagging where regulatory data has been wrong, for example, the Comisión Nacional Del Mercado de Valores (**CNMV**) has taken such action in circumstances where securities have been included in an issuer's issued share capital before the effective date of the new shares.[10] The Autoriteit Financiële Markten (**AFM**) has gone a step further and established a register of share capital on its website for the purposes of both long and short position notifications - contacting firms that submit notifications based on erroneous regulatory data and directing them to instead use the share capital figures on the AFM website.[11]

Overall, we do not believe that the *status quo* ought to continue, as it leads to sub-optimal outcomes for both market participants and NCAs which have an interest in obtaining consistent and comparable data.

AIMA and MFA members believe strongly that the solution is for the SSR to require that issuers provide the requisite issued share capital data and that ESMA assembles, maintains and publishes a single reliable data source for this data, rather than making it incumbent upon every market participant to check every data source to detect discrepancies. This source could be incorporated within the central notifications platform we propose above. Market participants are not able to know which data source is actually correct, thus we believe that it should be the issuer's responsibility to ensure that issued share capital data is accurate and is submitted to the centralised data source as quickly as possible as soon as any changes occur. We note the

[9] Article 15 of the Transparency Directive requires Issuers of shares on regulated markets to make disclosures of the total voting rights and any capital increases or decreases at the end of each calendar month during which a capital increase or decrease has occurred

[10] Earlier in 2016, the Comisión Nacional Del Mercado de Valores (**CNMV**) provided advice in relation to Banco Popular's capital increase due to data providers including those new securities in their issued share capital figures prior to the effective date of the issue. The CNMV distributed a circular being distributed informing participants that the new Banco Popular shares had been admitted to trading

[11] Available here: https://www.afm.nl/en/professionals/registers/alle-huidige-registers.aspx?type=%7BF25D2CA1-B93C-4331-B025-85DF328CD505%7D

positive example of the Netherlands that demonstrates that such a list is possible and suggest that ESMA could provide a vital service by serving as the central repository for this information.

If a centralised 'golden source' of data is not introduced, we would recommend as an alternative that the preamble of SSR be amended to clarify that compliance with Articles 5-8 of SSR is on a reasonable endeavours basis and that a participant will be held in compliance with the rules as long as they have acted on a reasonable basis by using an accredited data source to make the net short position calculation. These could include: (i) a regulatory data feed – such as Bloomberg or Reuters; (ii) data from the relevant stock exchange on which the security is traded; (iii) an NCA's centralised register; or (iv) the issuer's website itself. We suggest that this approach would be consistent with the SSR rules on when to include positions obtained through indices and baskets in a net position calculation. Article 3(3) of SSR makes clear that a market participant will not be held in breach of the rules if it has acted reasonably, having regard to the relevant available information, when making its calculation.

Even if amendments to the SSR are not introduced, we would urge the Commission to support the introduction of ESMA guidance to NCAs that checking one of these aforementioned data sources is sufficient for the purposes of the SSR significant net short position calculation in shares.

Scope of shares and sovereign debt for notifications

Our members also experience fundamental problems of identifying which shares and sovereign debt instruments are actually in scope of the SSR, which is likely only to increase for sovereign debt upon the introduction of MiFID II in 2018.

The SSR notification rules apply to all shares and sovereign debt instruments admitted to trading on an EU trading venue, including both regulated markets and multilateral trading facilities (**MTFs**). The rules will also apply to sovereign debt traded on an 'organised trading facility' (**OTF**) as of 2018 when MiFID II enters into effect. However, it is a consistent concern amongst market participants that there is currently no reliable list of in-scope share and sovereign debt instruments maintained at EU level.

AIMA and MFA members are concerned that the absence of a reliable centralised list for SSR currently results in unnecessary operational duplications, inefficiencies and regulatory risk. It is current market practice for each market participant to undertake its own process to check every EU trading venue, consulting various sources in order to reach a sufficient degree of satisfaction. This is both time consuming and expensive. We question whether this is a fair situation for participants.

There are already certain centralised EU resources presently available in relation to other legislative measures. For example, the ESMA list of shares admitted to trading on a regulated market under MiFID implementing Regulation No 1287/2006,[12] as well as the list under Article 4 of the Market Abuse Regulation (**MAR**) of financial instruments admitted to trading on a trading venue or for which a request for admission to trading has been made. However, these lists do

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

not match the scope of SSR, with the former list too narrow[13] and the latter MAR list too broad.[14] The latter list will also not become effective until MiFID II enters effect in January 2018.

We would strongly recommend that the SSR be amended to introduce a specialised publicly accessible ESMA list of shares and sovereign debt admitted to trading on a trading venue and against which market participants may check their short positions. We believe that such a list would be beneficial to both market participants and NCAs through reduced operational and supervisory costs respectively.

We note that a centralised list would enable the deletion of the current exempted third-country shares list under Article 16 of SSR,[15] which itself has not always worked effectively. Our members have noted cases of EU and third-country companies merging, with the new shares' primary trading venue subsequently in a third-country, but the exempted list not having been updated even three months after the merger.

In whichever form this in-scope list is maintained, we would strongly recommend that it be updated on as close to a real-time basis as possible and that competent authorities are pushed to collect and submit the relevant data.

3. Incremental thresholds for private notifications of significant net short positions in shares

Our members recognise the supervisory benefit to NCAs of the 0.2% of issued share capital threshold for private notifications of significant net short positions in shares. We also accept the political decision to require public disclosure at 0.5% of issued share capital. However, our members do not agree that the additional notification and disclosure thresholds of each 0.1% above 0.2% is necessary or appropriate. We believe that such frequency of re-notification introduces disproportionate operational burdens when compared to the supervisory benefits obtained. We note that market participants with more dynamic positions incur significant operational costs due to the need to make repeat notifications as positions rise and fall below the incremental 0.1% thresholds between 0.2% and 0.5% of issued share capital.

From the perspective of NCAs, there is little benefit of knowing the precise net short position of a participant between 0.2% and 0.5% down to the nearest tenth of a percent. We would strongly recommend, therefore, that these be removed – leaving just thresholds at 0.2% and at 0.5% and above.

[13] It does not include shares admitted to trading on an MTF or sovereign debt instruments.

[14] Including instruments for which a request for admission to trading has been made, as well as numerous other equity and non-equity instruments beyond shares and sovereign debt instruments

[15] Article 16 of SSR provides an exemption for shares where the 'principal trading venue' is located in a third-country, with a list of exempted shares maintained by ESMA

4. Timings for private notifications of significant net short positions in shares and sovereign debt and public disclosures of shares

All of the above issues of complexity are exacerbated by the especially tight timescales of notifications and disclosures.

Article 9 of the SSR specifies that calculations must be made by midnight on the relevant trading day, and notifications/disclosures made on a T+1 basis by 15:30 on the following trading day. We appreciate that competent authorities wish for data to be provided as soon as is practicable, however, we would urge the Commission to reconsider this timeframe to allow market participants an extra day to make notifications and disclosures – with notifications instead falling due on a T+2 basis.

Many of our members' businesses are global in nature, with different units responsible for undertaking relevant calculations located in different continents and time-zones across the world. Making a report by 15:30 the following day can be extremely difficult, with any lack of connectivity between different locations as a result of a web or other IT issue, even for only a couple of hours, rendering such notifications impossible in the short timeframe. As noted, this requirement is a particular issue for public disclosures in the Bundesanzeiger**,** which in fact must be made by noon CET (12:00). For firms with operational headquarters in the Eastern US – 6 hours behind CET – this means that sign-off is required from US staff by 06:00 Eastern Time or earlier to enable submission. Furthermore, firms with headquarters in the Western US must approve a filing by 0300 Pacific Time.

Regardless of time-zone issues, SSR net short position calculations themselves can be complex and time consuming. The SSR applies to all financial instruments as defined under Annex 1 section C of Directive 2004/39/EC on markets in financial instruments (**MiFID**) that are admitted to trading on a trading venue and any derivatives referenced thereto. A 'short position', therefore, not only includes selling the relevant share or debt, but also any transaction creating or relating to another financial instrument that confers a financial advantage on the natural or legal person in the event of a decrease in the price or value of the share or debt instrument (e.g., options, derivatives). These calculations are more complicated than other typical reporting obligations and open to greater risk of error. Accordingly, we do not believe that such a tight timeframe is optimal for the purposes of NCA supervision, introducing a greater risk of errors that could be mitigated by an extra day for notifications and disclosure to be made.

We would urge the Commission to propose the amendment of the notification and disclosure obligations under the SSR to become at 15:30 on a T+2 basis.

5. Greater harmonisation of Member State interpretation

We highlight that use of a European Regulation as the relevant legislative instrument to introduce harmonised rules on short selling is predicated on the need 'to ensure that provisions directly imposing obligations…are applied in a uniform manner throughout the Union' in order to prevent obstacles to the proper functioning of the internal market.[16] The Preamble to the SSR also makes clear that a Regulation is '…necessary to confer powers on the European Supervisory

[16] Recital 2 and 3 of the Preamble to the SSR

Authority … (ESMA) … to coordinate measures taken by competent authorities or to take measures itself.'[17]

A key tool to assist in the harmonisation of obligations and coordination of NCA measures is the ESMA Question and Answers (**Q&A**) document. However, our members are concerned that the Q&A document for the SSR is not being used in an optimal way – with the most recent update occurring over three years ago in January 2013.[18]

We note two matters that would benefit significantly from further ESMA and/or Commission clarity to promote a greater degree of harmonisation across different Member States.

Interpretation and enforcement practices for notifications and disclosures of net short positions

AIMA and MFA members have noted the currently disparate interpretation and enforcement practices applied by NCAs regarding any delays or errors in market participants making notifications and public disclosures of significant net short positions under Articles 5, 6 and 7 of the SSR.

Certain NCAs, such as the Swedish Finansinspektionen, take a largely strict liability approach and fine market participants in all cases of notification errors, even when these errors have not been in the control of the relevant market participant. Technical problems that can lead to failed or erroneous notifications range from regulatory or issuer-provided data being wrong, as well as online connectivity issues that are not within the control of the individual participant.

As we describe above in relation to erroneous regulatory data used as the denominator for significant net short position calculations, we would be grateful if the Commission could encourage ESMA to provide a Q&A that a notification or disclosure failure under the SSR should *not* constitute a breach of the SSR when that participant has made reasonable endeavours to ensure that it complies, but has been unable to do so due to an error or issue falling outside of the participant's control.

Interpretation of Article 12 of the SSR – uncovered short sales in shares

Article 12 of the SSR restricts a person from entering a short sale of a share admitted to trading on a trading venue unless it has: (a) borrowed the share; (b) entered an enforceable agreement to borrow the share; or (c) an arrangement with a third-party under which it has confirmed a share 'locate' and the person has taken measures that give a reasonable expectation that settlement can be effected when it is due. Article 13 contains the equivalent restriction on uncovered short sales of sovereign debt.

AIMA and MFA members support this prohibition on uncovered short-sales, requiring persons entering such short sales to have in place a locate arrangement that gives them a reasonable expectation that they will be able to settle the transaction when due. We agree that avoiding unnecessary settlement failures is an important objective of the SSR for which it has been successful.

[17] Recital 3

[18] Implementation of the Regulation on short selling and certain aspects of credit default swaps (2nd UPDATE) https://www.esma.europa.eu/system/files_force/library/2015/11/2013-159.pdf

Nonetheless, AIMA has significant concerns that a disparate approach to the application and interpretation of these provisions is being taken by different NCAs across the EU and that this is undermining the objective of the SSR to ensure that rules for 'uncovered short selling are applied in a uniform manner throughout the Union' in order to prevent obstacles to the proper functioning of the internal market.[19]

In a letter to the European Securities and Markets Authority (**ESMA**) on 16 July 2015, AIMA raised concerns on the interpretation by the Hellenic Capital Market Commission (**HCMC**) of Article 12 of the SSR, in particular, relating to the point of the sale of a long position gained in the course of a rights issue. In this letter we stressed the need for consistency of national implementation of the SSR and the difficulties facing market participants arising as a consequence of divergent approaches of Member States and NCAs, actively damaging the confidence of investors to participate in the relevant primary and secondary markets.

The letter also called for ESMA to offer its own view to promote harmonisation and legal certainty in the context of the application of Article 12 of the SSR. AIMA still awaits any formal output from ESMA in the form of Q&As or other guidance on the matter.

AIMA would be especially grateful for Q&As, Level 3 guidelines or an amendment of the SSR that provides clarity on the application of the application of Article 12 of the SSR Level 1 text and the relevant Level 2 measures in the context of selling allocations obtained in a rights issue. In particular, we would hope that it is confirmed that enforceable claims to be transferred shares in a rights issues are deemed to be 'holding' a share, thus meeting the definition of a long position. AIMA would be happy to elaborate upon this issue separately, if necessary.

6. Duration adjustment possibility for derivatives and bonds when calculating net short positions

Article 3(5) of the SSR, together with the relevant Commission Delegated Regulation (**DR 918/2012**)[20] and ESMA's Questions & Answers on the implementation of the SSR,[21] provide rules for the calculation and notification of significant net short positions in sovereign debt. Market participants report interpretation difficulties coupled with a lack of economic logic in these calculation and notification provisions – namely that the two different methodologies for calculating cash versus derivative positions produces net position figures that can differ significantly from the economic reality.

Netting of long and short positions

Pursuant to Art. 3(5) of the SSR, a net short position in relation to the issued sovereign debt of the sovereign issuer concerned is calculated by "deducting any long position that a [person] holds in relation to issued sovereign debt and any long position in debt instruments of a sovereign issuer the pricing of which is highly correlated to the pricing of the given sovereign debt from any short position which that [person] holds in relation to the same sovereign debt".

[19] Recitals 2 and 3 of the Preamble to the SSR

[20] Article 11(1) and Annex II Part 2 of Commission Delegated Regulation (EU) No. 918/2012 ("DR 918/2012") http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:274:0001:0015:en:PDF,

[21] Section 4b and 4e; ESMA/2013/159 of January 2013 https://www.esma.europa.eu/system/files_force/library/2015/11/2013-159.pdf

Calculation of net short positions in sovereign debt

Pursuant to Art. 11 of DR 918/2012, for the purposes of Art. 3(5) of the SSR, "net short positions in sovereign debt shall be calculated by taking into account transactions in all financial instruments that confer a financial advantage in the event of a change in the price or yield of the sovereign debt" (e.g. derivatives). For the calculation, it is suggested that the delta-adjusted model for sovereign debt set out in Annex II of DR 918/2012 shall be used.

Annex II of DR 918/2012 stipulates in Part 2, Art. 11(1) that "any cash positions" (which would include cash sovereign debt positions) "shall be taken into account using their nominal value duration adjusted." However, for the purpose of the calculation of positions in options and other derivative instruments it stipulates that they "shall be adjusted by their delta which shall be calculated in accordance with [Annex II,] Part 1." Annex II is, however, silent as to whether such positions can or should also be adjusted by the relevant duration of the underlying bond positions. The text of ESMA's Q&A 4e provides little assistance, with ESMA stating that "Part 2 of Annex II … suggests that … derivatives … should be delta-adjusted". We note that the verb "suggest" generally means to put forward a possibility for consideration. It does not stipulate a definite instruction.

Accordingly a person seeking to interpret the above might conclude that, while the notification provisions refer to delta adjustment for derivative positions, a duration adjustment for derivative positions is not ruled out. However, we understand that several NCAs are applying the rules to prevent such derivatives positions from being adjusted by the relevant duration of the underlying bond positions. We are, therefore, concerned that the methodologies for calculating a net short position have become materially different between cash debt and derivatives – with sovereign debt requiring a participant to multiply the duration of each individual issued debt instrument in which the investor has an overnight long or short position by the nominal value of each of those positions and to add up all the products, as per section 4b of the ESMA Q&A; and derivatives positions requiring the nominal value of the contracts to be delta adjusted as per section 4e of the ESMA Q&A.

Consequences arising from an inconsistent methodology of delta v duration adjustment

The interpretation described above can lead to situations which are, from an economic perspective, incorrect and depict a wrong risk position. By way of clarification, please consider the following examples:

Example A:

A market participant holds a long position in UK sovereign bonds of £10m, with a modified duration of 10. The participant also holds a short position in 10-year UK government bond futures contracts of £100m. According to the ESMA Q&A, the net short position would be zero. That is: (£10m x 10) - £100m = 0.

Using this calculation methodology, the market participant would not have a net short position at all; whereas, economically, he would hold a short position in UK sovereign debt of £90m.

Example B:

A market participant holds a long position in UK sovereign debt of £10m, with a modified duration of 10. The participant also holds CDS on UK sovereign debt of £100m. According to the ESMA Q&A, the net short position would be zero. That is: (£10m x 10) – £100m = 0.

Using this methodology of calculation, the market participant again would not have a net short position; whereas, economically, he would hold a short position in UK sovereign debt of £90m. This position also conflicts with other provisions of the SSR, with the latter economic position captured pursuant to Art. 4 as a prohibited position in uncovered sovereign CDS of £90m.

Example C:

An investment manager following a relative value trading strategy may frequently trade both sovereign bonds and sovereign bond futures in the same sovereign, but with no intention of engaging in net directional short-selling of any such sovereign instruments.

A typical relative value trade in Country A's sovereign debt might involve a firm taking a short position in Country A's government bonds, but simultaneously taking an offsetting long position in Country A's bond futures (or vice versa). Economically, such trades net out the firm's risk so that the firm is neither short nor long Country A's sovereign debt on a duration-weighted basis.

A firm's purpose in doing such a trade may be to benefit from the movements in spread between the bonds and the futures, that is, the relative value between the two. Such a firm would carefully monitor for risk purposes the net duration-weighted risk arising as the prices of the two instruments change. Such net risk would calculate out as a small fraction of bonds traded.

Despite a fundamental objective of the strategy being to remain as economically flat as possible in relation to the directional price fluctuations of the instruments of a particular sovereign issuer, it is currently possible for a firm to find that they have a notifiable 'net short' position for the purposes of the SSR notification regime. An amendment of the Level 2 Regulation and clear Level 3 guidance confirming the permissibility of a duration adjustment of both bond and derivative positions would correct this issue.

The practical examples demonstrate how prohibiting the duration adjustment of derivatives can herald inaccurate notifications. AIMA and MFA members who have analysed the calculation and notification provisions believe strongly that a duration adjustment for derivative positions held in sovereign debt should be possible to prevent these inaccurate notifications.[22]

The Commission will likely already be aware from ESMA's technical advice following the SSR Review in 2013 (**ESMA's Final Report**)[23] that the current rules on net short positions in sovereign

[22] This would be calculated by netting the cash position (which has a delta equal to 1) with the delta-adjusted derivative position held in sovereign debt, and by multiplying the result by the modified duration of the sovereign debt.
[23] ESMA's technical advice on the evaluation of the Regulation (EU) 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps" (ESMA/2013/614) (**the Final Report**) available here:

debt could lead to inaccuracies, with many participants of the opinion that positions in cash and derivatives instruments should be treated in a consistent way (either nominal or duration adjusted).[24] ESMA's Final Report, in particular, noted that *"ESMA shares the concerns regarding the inconsistent treatment of positions in cash (which are duration adjusted) and positions in derivatives (which are not)"* and that, *"should the duration method be maintained, then positions in cash and derivatives should be treated in the same way, with positions in derivatives to be adjusted both by their delta and duration."* [25]

The Commission Report on the evaluation of the SSR acknowledged certain elements of the ESMA technical advice, however it did not provide explicit confirmation of ESMA's recommendation to treat cash and derivatives in the same way if a duration adjustment is maintained for sovereign debt. [26]

We urge the Commission to work with ESMA and the NCAs to reconsider this part of the position calculation and notification provisions, with a view providing a clear Level 2 amendment and Level 3 guidance confirming the ability to duration adjust derivatives as well as the underlying cash bonds.

7. Uniform approach to short selling bans

The emergency powers for NCAs established under Articles 20 and 23 of the SSR to restrict short selling upon a significant fall in the price of a financial instrument have been used by various competent authorities since 2012, for example, in Spain, Italy, Greece and Portugal. Nonetheless, AIMA and MFA would suggest that their use could be made more harmonised and efficient.[27]

Centralised publication and tracking mechanism for bans

We would see great benefit in creating a reliable way in which short-selling bans can be publicised and, most importantly, tracked by market participants on a real-time basis. This could be done, for example, by the relevant NCA alerting ESMA and ESMA sending an alert on as close to a real-time basis as possible.

Wording of bans

Our members have also noted that the disparate manner in which short selling bans have been drafted has created difficulties when seeking to comply - especially when bans are introduced intraday.

Certain bans have prohibited all 'short sales' of the relevant share, as defined by the SSR, whereas other bans have prohibited any 'increase in a net short position' in a particular share,

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https://www.esma.europa.eu/system/files_force/library/2015/11/2013-614_final_report_on_ssr_evaluation.pdf?download=1

[24] Para.53 of the Final Report

[25] Para. 57 of the Final Report

[26] European Commission report on the evaluation of the Regulation (EU) No.236/2012 on short selling and certain aspects of credit default swaps, available here: http://ec.europa.eu/finance/securities/docs/short_selling/131213_report_en.pdf

[27] See also the joint AIMA-MFA Response to the Call for Evidence by ESMA regarding the evaluation of the SSR, available here: https://www.aima.org/en/document-summary/index.cfm/docid/D760E2AC-1405-4FAE-AD824507DD7569FF

sometimes including or excluding specific instruments such as indexes. To minimise complexity of the SSR emergency bans we would propose amending Article 20 of SSR to provide a uniform approach to short-selling bans in relevant shares 'prohibiting any covered short sale' and deleting the reference to the broader instruments test under sub-paragraph (2)(b).