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16 November 2012

Verena Ross  
Executive Director  
European Securities and Markets Authority  
103 Rue de Grenelle  
75007 Paris  
France

Dear Ms Ross

**Issue 170: The Short Selling Regulation: ESMA's consultation paper of 17 September 2012**

The remit of the Financial Markets Law Committee (the "FMLC" or the "Committee"), established by the Bank of England, is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

The FMLC notes that the European Securities and Markets Authority ("ESMA") published a consultation paper on 17 September 2012 on the exemption for market making activities and primary market operations (the "Consultation")<sup>1</sup> under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps (the "Regulation"). The Consultation contains draft guidelines on market making and the application of exemptions for market making activities and primary market operations under the Regulation.

The Committee is of the opinion that there are a number of legal uncertainties in respect of the Consultation when it is read in conjunction with the Regulation.

Article 17(1) of the Regulation provides that Articles 5, 6, 7, 12, 13 and 14 shall not apply to transactions performed due to market making activities. The Consultation explains further that the exemption under Article 17(1) relates to the market making activities of a person that has properly notified the relevant competent authority and it is not an exemption of the person in question for all its activities.

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<sup>1</sup> ESMA Consultation Paper. Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps. 17 September 2012/ESMA/2012/580

## **Interpretation by the Consultation of the requirement in Article 2(1)(k) of the Regulation concerning trading on a trading venue**

Article 2(1)(k) of the Regulation provides a definition of market making activities which reads as follows:

*'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*

Paragraphs 12 to 20 of the Consultation require that a market maker in a particular instrument be a member of a trading venue on which that instrument is traded in order to make use of the exemption under Article 17 of the Regulation. Paragraph 14 establishes that

*As illustrated by the above, the market making activities of an entity as defined above in paragraph 5(a)–(c) are exempted if:*

- a. the entity is a member of a trading venue (or a market in a third country with declared equivalent regime) where*
- b. it deals (whether on the trading venue or OTC) as principal in*
- c. a financial instrument for which it claims the exemption.*

The FMLC considers that the Consultation does not properly reflect Article 2(1)(k) of the Regulation. On a strict reading of Article 2(1)(k) of the Regulation, there is no requirement for a link between the trading venue of which the market maker is a member, and the financial instruments in which that legal entity undertakes market making activities. Conversely, the Consultation appears to have interpreted the wording to mean that the person relying on the exemption must be a member of a trading venue on which it deals as principal in the financial instrument for which it is seeking to rely on the exemption.

The FMLC notes that the Consultation's interpretation of the exemption as a whole may rely, to some extent, on its interpretation of the word "where" in Article 2(1)(k) of the Regulation. "Where" could be read as having two meanings: (i) a situation in which an organisation deals as principal in a financial instrument or (ii) the place in which a financial instrument is being dealt with by an organisation as principal. The Consultation seems to have relied on the second meaning. The FMLC considers that it is wrong to do so. This is because the French and Spanish linguistic versions of the Regulation support the first meaning. Moreover, the words "whether traded on or outside a trading venue", also found in Article 2(1)(k), appear to be rendered superfluous if the second meaning prevails.

### **Paragraph 13(c) of the Consultation: market making exemption for third country firms**

Paragraph 13(c) of the Consultation states that a third country firm may only rely on the market making exemption where it is a member of an equivalent third country market, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2).

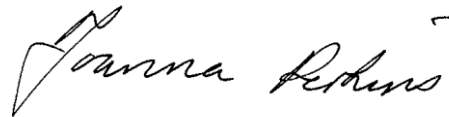
Article 2(1)(k) of the Regulation, however, indicates that an investment firm, credit institution, third country entity or a firm may rely on the exemption where they are a member of a trading venue or equivalent third country market.

The effect of the Consultation would be to prevent a third country firm from relying on the market making exemption where it is a member of a trading venue.

The FMLC considers that these divergences in interpretation between the Regulation and the Consultation concerning the application of the exemption under Article 17 of the Regulation create legal uncertainty for the wholesale financial markets and hence need to be addressed.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely

A handwritten signature in black ink that reads "Joanna Perkins". The signature is written in a cursive style with a large, stylized initial 'J'.

**Joanna Perkins**  
**FMLC Director**