Guidelines on the exemption for market making activities and primary market operations under Regulation on Short Selling. March 2013.

ESMA has published, the 1st of February, the Guidelines on the exemption for market making activities and primary market operations under Regulation (EU) 236/2012, of the EP and the Council on short selling and certain aspects of Credit Default Swaps. Market makers and primary dealers (the latest only relating to sovereign debt) are exempted, according to articles 17.1 and 3 of the Regulation: a) from notification and publication of significant net short positions in shares and from notification of significant net short positions in sovereign debt; and b) from the application of the restrictions (locate rule) on uncovered short sales in shares and sovereign debt and on uncovered sovereign credit default swaps.
The Guidelines are aimed at providing market participants and national supervisors with clarity on the criteria to be met to benefit from a market maker and primary dealer exemption:

1. Scope of the exemption.

There are three preconditions for particular activities of an entity to be exempted from the Regulation´s provisions above mentioned: (a) being a member of the market on which it, (b) deals as principal, and (c) in the concrete financial instrument for which it notifies the exemption. Dealing as principal mentioned in (b) means dealing in any of the following capacities: (i) by posting firm simultaneous two-way quotes of comparable size and at competitive prices, (ii) as part of its usual business by fulfilling orders or (iii) by hedging positions arising from the fulfilment of tasks under (i) and (ii)

The exemption should, therefore, concern a particular financial instrument: (a) shares of an issuer or (b) a sovereign debt issuer. Other listed financial instruments -different from a share or a sovereign debt instrument- but that create long or short positions on shares and on sovereign debt that should be taken into account for the purpose of the exemption are the instruments (futures, swaps etc) listed in Annex I of the Commission Delegated Regulations 918/2012. (If you want to read the full list of instruments, please go the link at the end of the text).

2. Definition of the relevant competent authority for notification.

For entities authorised in the EU that will to make us of an exemption for market making activities, the relevant competent authority is the authority of the home Member State of the entity that notifies its intention to make use of the exemption, and for the exemption as authorised primary dealers, the relevant competent authority for notification is the authority of the Member State of the concerned sovereign debt.

Third country entities should notify their intention to make use of an exemption through a single entry point in the EU that is the relevant competent authority in this case defined as the authority of the Member State where is placed the main trading venues in which they trade.

3. Principles and qualifying criteria of eligilibity for the exemption.

Competent authorities shall take into account when assessing whether an entity notifying an exemption is entitled to benefit from the following principles:

In connection with the principles and qualifying criteria that should apply when 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, ESMA develops the presence, price and size requirements only for shares and equity derivatives traded on a trading venue. In particular, the document defines those criteria for two different types of shares: on one hand, shares qualifying as liquid shares under MiFID and, on the other hand, shares that do not qualify as liquid shares under the MiFID and equity derivatives. ESMA proposes a presumption that an entity notification should be accepted by the competent authority if it can demonstrate that it is party to a market making

or liquidity provision contract or programme with a trading venue or an issuer.

In reference to the principles and qualifying criteria that should apply when dealing as part of its usual business, by fulfilling orders initiated by clients or in response to clients ´s request to trade, ESMA understands that the dealing is part of the entity´s usual business when it undertakes regular provision of prices to clients or maintains the ability to provide a quite in response to client demand and stands ready to trade with clients upon request.

4. Process of notification.

It is not an authorisation or licensing process but a notification process between the notifying entity and the relevant competent authority. Notification should be made in electronic format (in accordance with the templates provided in Annex I and II of the Guidelines) and will be confirmed in writing if required under the legal and regulatory framework of the related Member State. The competent authority may formally respond that it does not object to the use of that exemption depending on the national law of the Member State involved.

ESMA details the information to be provided in the notification that will depend on type of exemption (authorised primary dealers or market maker) the entities intend. to use. The competent authority will assess the exemption´s conditions and may prohibit the use of it, either at the time of the notification or subsequently, if it considers that the conditions of the exemption are no longer fulfilled. Any competent authority ´s decision refusing the benefit of the exemption to a person should be justified and made in writing.

The Guidelines also include provisions on: (i) specific situation of emergency measures, in which competent authorities may decide not to apply those measures to market makers or primary dealers, and (ii) cooperation between competent authorities.

5. Transitional measures.

Notifications made before entry into force of the Guidelines shall be review and assessed within 6 months after application of the Guidelines.

The Guidelines will be translated into all the official EU languages and will be applicable two months after the translations have been published in ESMA´s webpage for those ESMA members who notify within that period that they intent to comply with the Guidelines. ESMA members who notify ESMA that they will not implement the Guidelines should detail the reasons for the non-compliance.

If you want to read the final report containing the Guidelines on the exemption for market making activities and primary market operations under Regulation (EU) 236/2012, of the EP and the Council on short selling and certain aspects of Credit Default Swaps, please, do click on : http://www.esma.europa.eu/system/files/2013-158.pdf

If you want to read the Commission Delegated Regulation (EU) 918/2012, of 5 July, that supplements the Regulation 236/2012, on short selling and certain aspects of credit default swaps, in some technical aspects, please, do click on:
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:274:0001:0015:EN:PDF