Association française des marchés financiers

FINANCIAL MARKET PROFESSIONALS

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ESMA CONSULTATION PAPER

Draft ESMA's draft technical advice on possible Delegated Acts concerning the regulation on short selling and certain aspects of credit default swaps ((EC) N° XX/2012)

Comments by AMAFI

Association française des marchés financiers (AMAFI) has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on the Consultation paper (hereafter referred as to the "CP") on *"ESMA's draft technical advice on possible Delegated Acts concerning the regulation on short selling and certain aspects of credit default swaps ((EC) No XX/2012*" issued by the European Securities and Market Authority.

Before answering the questions posed by ESMA in the "CP", AMAFI wishes to draw attention to the following.

The time given by the Commission at ESMA to prepare technical standards is far too short. The result is that ESMA does not have sufficient time to complete consult and analyze in depth the comments sent by the respondents. The short delay imposed to and by ESMA is especially damaging because the subjects dealt with are complex and cover a variety of fields. In addition, a short time is even more disadvantageous for professional associations because they must consult their members and meet validation rules associated with their corporate governance. Therefore we are not able to provide a constructive input with all the desirable quality and with alternative solutions. Therefore the risk for Europe is to put in place inappropriate rules.

In the specific context of this consultation, AMAFI has chosen not to respond to all the questions of the "CP" given the lack of time to deeply assess all the issues. This is particularly the case for all matters relating to the treatment of CDS and partly for Sovereign debt issues. This does not means that AMAFI supports or does not support the content of the propositions made by ESMA.

Regarding specifically CDS, AMAFI wishes to highlight the following considerations.

- AMAFI supports the objective of the regulation to ban naked CDS.

- That said, defining a naked CDS is a difficult task that cannot be done only through the development of technical standards and without taking into account other considerations, including prudential ones.

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- Therefore it is essential to achieve consistency between the market rules and the banking rules of the Bale III/CRDIV framework.

  In the first analyse it seems that this is not always the case. As example, the geographic limitation seems contradictory to art 375 of CRDIV, with regard to the use of cross-country proxy hedging for counterparty credit risk. CRDIV neither prohibits the use of proxy hedging nor prohibits cross-country hedging. Art 375 states that '*For all counterparties for which a proxy is used, an institution shall use reasonable basis time series out of a representative group of similar names for which a spread is available.'*

ESMA questions and draft technical advice

On Ownership

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

As the concept of ownership in the Member States concerning securities is not harmonized, AMAFI generally agrees with ESMA's proposal. Anyway, to bring more clarity, we consider that the technical advice should precise that without prejudice to the applicable civil law or securities law, a short (or a long position) is calculated on the economic "trade date" position.

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

Not at this stage.

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

Not at this stage.

On holding

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

We agree with the proposal.

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

Not at this stage.

Having a net short position and method of calculation

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

We agree with the proposal for shares.

For Sovereign debt, we consider that Debt instruments from issuers outside the EU should also be included. Furthermore, we believe that debt instruments for sovereign issuers within the same Member State should be assumed to be highly correlated, without the need for a correlation test. Finally, we believe that in Box 3, paragraph 18, the reference to "referenced sovereign debt" should be to "deliverable obligations" instead. ("*If a sovereign CDS position is hedging a risk other than the referenced sovereign debt, the value of the hedged risk cannot be treated as a long position for the purposes of calculating whether a person has a net short position in the issued sovereign debt of a sovereign issuer.")*

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

If however a quantitative threshold is applied, it seems that it should be significantly lower than 80/90%.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We fully agree with the "delta adjusted method" for the calculation of short position for shares. It is already put in place in France and consistent with the "Technical details of the pan-European short selling regime" (*CESR/10-453*).

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

We regret that ESMA has not taken the opportunity to amend Technical details of the pan-European short selling regime" (*CESR/10-453*) in order to take into account convertible debt securities in the calculation of the position in share. Given the disclosing obligation to the market, it could give misleading information on the actual position of the firm.

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

Not at this stage.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

Netting and aggregation

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

Within investment firms and banks groups, the tracking of individual desks and "decision makers" is an unnecessarily complicated approach, a point which duly ESMA recognises in paragraph 75, p.30. This approach is fundamentally inconsistent with the proposal in the first consultation paper which states that reporting should be done on a legal entity basis. It is furthermore inconsistent with the Level 1 text since the Regulation aims at disclosure of short positions so as to be able to assess the economic exposure of an entity as a whole, which would intuitively imply taking all relevant holdings in the legal entity into account for the calculation of the short position.

For fund management activities, we agree that the position should be calculated at the "decision maker" level but we have not assessed ESMA's proposal in detail.

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

We would privilege alternative 2 which is consistent with the transparency directive.

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

Not at this stage

Uncovered CDS

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

Levels of the notification thresholds for sovereign debt position

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

Liquidity thresholds

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

We do not have any comment on this question

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

We do not have any comment on this question.

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

We do not have any comment on this question.

Significant fall in value

Illiquid shares

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

We agree with ESMA's proposal to set up three categories.

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

We do not have a strong opinion on this proposal.

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

We do not have a strong opinion on this proposal but it seems appropriate.

Sovereign bonds

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

Corporate bonds

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

We have chosen not to answer this question.

Money market instruments

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

We have chosen not to answer this question.

UCITS

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

ETF

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

We have chosen not to answer this question.

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

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

We have chosen not to answer this question.

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

We have chosen not to answer this question.

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

On the method for calculating the fall

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

We have chosen not to answer this question.

Adverse events and threats

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

We agree with the proposal.

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

Not at this stage.

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