

Italy

Italian Financial Transaction Tax Implications of the Evolving Regulatory Landscape: The Exemption for Market Makers

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This article outlines the interrelations between the exemption for market making activities under the Short Selling Regulation, as interpreted by the European Securities and Markets Authority (the ESMA), and the Italian financial transaction tax exemption available for market makers.

1. Introduction

The Italian financial transaction tax (the IFTT) was enacted by article 1, paragraphs 491-500 of Law 228 of 24 December 2012 (*Legge di Stabilità 2013*, the Stability Bill), published in Official Gazette 302 of 29 December 2012. The provisions of the Stability Bill only set out the main framework for the IFTT. The detailed operational rules are contained in the Decree enacted on 21 February 2013 by the Ministry of Economy and Finance (the Treasury Decree), as subsequently amended and restated.^{[1][2]}

The IFTT provisions rely in some circumstances on regulatory concepts and cross-reference for these purposes other pieces of legislation, such as the Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 (the Short Selling Regulation),^[3] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 (MiFID I)^[4] and Commission Regulation 1287/2006 of 10 August 2016 (MiFID I Implementing Regulation).^[5]

This is, in particular, the case of the IFTT exemption for market makers.^[6] Indeed, market making activities, as defined in article 2(1)(k) of the Short Selling Regulation and in the ESMA Guidelines on the exemption for market making activities and primary market operations under Regulation (EU) No. 236/2012 on short selling and certain aspects of credit default swaps (the ESMA Guidelines),^[7] are exempt from IFTT (the IFTT MM exemption).^[8]

The Short Selling Regulation requires market participants to provide information on significant net short positions in shares and poses restrictions on uncovered short selling of shares. Under article 17 of the regulation, however, the information requirements and the restrictions do not apply to transactions performed in the course of market making activities, as defined in article 2(1)(k) of the Short Selling Regulation.^[9]

The IFTT MM exemption is linked to the definition of market making activities in the Short Selling Regulation and to the interpretation adopted in the ESMA Guidelines on how the market making exemption in the Short Selling Regulation should be applied.

The national competent authorities of five EU Member States, however, are not following in full the ESMA Guidelines, as they are disagreeing on the narrow interpretation adopted by the ESMA on certain topics. As a consequence, the market making exemption under the Short Selling Regulation is not applied in a consistent manner across the European Union and this may have significant implications on the IFTT MM exemption as well.

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1. The Treasury Decree was slightly amended on 18 Mar. 2013. Further significant amendments were introduced by way of Decree of 16 Sept. 2013.
2. For a comprehensive overview of the IFTT rules, see R. Papotti & M. Gusmeroli, *Italian FTT in Practice: Issues and Solutions*, Derivs. & Fin. Instrums. (2017), Journals IBFD; V. Salvadori di Wiesenhoff, *Update on Financial Transaction Tax*, Derivs. & Fin. Instrums. (2013), Journals IBFD; and V. Salvadori di Wiesenhoff & R. Egori, *Italian Financial Transaction Tax*, Derivs. & Fin. Instrums. (2013), Journals IBFD.
3. 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.
4. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.
5. Commission Regulation 1287/2006 of 10 August 2016 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive.
6. See art. 16(3)(a) Treasury Decree.
7. ESMA/2013/74, published on 2 Apr. 2013: <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-74.pdf>.
8. See in this respect, [sec. 4](#).
9. See in this respect, [sec. 3](#).

2. The Role of Market Makers in Providing Liquidity

Market liquidity can be defined as the ability to rapidly execute large financial transactions with a limited price impact. It is a key feature of financial market efficiency and functioning.

Market makers provide intermediary services that play an important role for market liquidity and, as such, are critical to the development and orderly functioning of financial markets. At its heart, market making is liquidity provision through the ability to promptly absorb investors' demand or supply of a financial instrument. In essence, a market maker facilitates trades by standing ready to buy and sell financial securities at given prices. This is also known as "immediacy" – the ability to expedite the trading interests of independent counterparties in a timely and cost-effective way. Market makers do this by quoting buy and sell prices, as well as providing on-request quotes, to ensure a two-way market. They offer different prices to potential buyers and sellers, i.e. they sell at the announced ask price and they buy at the announced bid price, making a profit from the difference between the buying prices and the selling prices applied to transactions.

EU legislators have recognized that market making activities play a crucial role in providing liquidity to markets and that imposing undue requirements on such activities could severely inhibit their ability to play that role. This is, for example, clearly stated in recital 26 of the Short Selling Regulation which explicitly highlights the crucial importance and usefulness of market making activities in providing liquidity to markets within the European Union.

3. The Short Selling Regulation

3.1. General

The Short Selling Regulation^[10] requires information on significant net short positions in shares to be notified to the competent authorities or disclosed to the market and imposes restrictions on naked short selling in shares.^[11] In particular, market participants, whether domiciled or established within the European Union or in a third country,^[12] are required to privately report to the relevant competent authority or disclose to the public significant net short positions^[13] which they hold in relation to the issued share capital of a company whose shares are admitted to trading or traded on a trading venue (regulated market or multilateral trading facility) in the European Economic Area (EEA) (unless they are primarily traded on a third-country venue),^[14] when the position equals, exceeds or crosses downwards specified thresholds.^[15] ^[16] In addition, the Short Selling Regulation acknowledges that uncovered short selling may increase the potential risk of settlement failure and volatility and, as a consequence, imposes restrictions in that respect to reduce such risks, stating that a short sale of a share can be entered into only where certain conditions have been met.^[17]

10. The short selling framework is made up of the following EU legislation: (i) the Short Selling Regulation; (ii) Commission Delegated Regulation (EU) No. 826/2012 of 29 June 2012 supplementing the Short Selling Regulation with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to the ESMA in relation to net short positions and the method for calculating turnover to determine exempted shares (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0826>); (iii) Commission implementing Regulation (EU) No. 827/2012 of 29 June 2012 laying down implementing technical standards with regard to the means for public disclosure of net position in shares, the format of the information to be provided to the ESMA in relation to net short positions, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and period for the determination of the principal venue for a share according to the Short Selling Regulation (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0827>); (iv) Commission Delegated Regulation (EU) No. 918/2012 of 5 July 2012 supplementing the Short Selling Regulation with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0918>); and (v) Commission Delegated Regulation (EU) No. 919/2012 of 5 July 2012 supplementing the Short Selling Regulation with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments (<http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32012R0919>).
11. Similar requirements and restrictions also apply in respect of short sales of sovereign debt instruments.
12. Art. 10 Short Selling Regulation.
13. For the purposes of the Short Selling Regulation, short positions are those obtained through a short sale of a share or through entering into a transaction the effect of which is to confer a financial advantage on the position holder in the event of a decrease in the price or value of the share. In calculating net short positions, derivative positions in a share shall be "delta adjusted" (i.e. persons taking positions through derivatives need to adjust the nominal/notional value of these positions by the relevant "delta" in order to calculate net short positions in the underlying). Positions held through baskets and indices need also to be taken into account.
14. Based on art. 16 Short Selling Regulation, the requirements concerning the notification and disclosure of significant net short positions in shares and the restrictions on uncovered short sales in shares do not apply in respect of shares that are admitted to trading or are traded in the EEA where the principal trading venue is in a third country. The competent authorities are required to identify the shares having their principal trading venue located in a third country and shall notify the ESMA of such shares at least every two years. On the basis of these notifications, the ESMA publishes the compiled list of exempted shares to which provisions of the Short Selling Regulation relating to net short position transparency and the restriction of uncovered short sales do not apply. Such list is available at https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_shsex.
15. Based on art. 5 Short Selling Regulation, a holder of a net short position in relation to the issued share capital of a company shall notify the relevant competent authority when the position reaches or falls below 0.2% of the issued share capital of the company concerned and each 0.1% above that. Therefore, the holder of the net short position is required to make an initial private notification to the relevant competent authority when the position reaches 0.2% of the capital and to make subsequent disclosures for each incremental 0.1% threshold crossed (upwards or downwards) above 0.2%. A final notification is required once the position has fallen below 0.2%. Based on art. 6 Short Selling Regulation, a holder of a net short position in relation to the issued share capital of a company shall disclose details of that position to the public when the position reaches or falls below 0.5% of the issued share capital of the company concerned and each 0.1% above that. Therefore, the holder of the net short position is required to make an initial public disclosure when the position reaches 0.5% of the capital and to make subsequent disclosures for each incremental 0.1% threshold crossed (upwards or downwards) above 0.5%. A final disclosure is required once the position has fallen below 0.5%.
16. As stated in recital 10 of the Short Selling Regulation, the purpose of the transparency formalities concerning significant net short positions in shares is to benefit both regulators and market participants. Indeed, the notification to the competent authorities allows the regulators to monitor and, where necessary, investigate short selling that could create systemic risks, be abusive or create disorderly markets. Public disclosure is designed to provide useful information to other market participants about significant individual net short positions in shares.
17. The Short Selling Regulation provides that parties can only enter into a short sale of a share where certain conditions are met. Before conducting a short sale, the person needs either: (i) to have borrowed the share; (ii) to have entered into an agreement to borrow the share or have another absolutely enforceable claim so that settlement

However, under article 17 of the Short Selling Regulation, the requirements concerning notification or disclosure of significant net short positions in shares and the restrictions on uncovered short sales in shares do not apply when these transactions are performed in the course of market making activities. These activities play a crucial role in providing liquidity to financial markets within the European Union and market makers need to take short positions in performing their task. Imposing notification or disclosure formalities and restrictions in respect of short sales performed by market makers could severely inhibit their ability to provide liquidity and have a significant adverse impact on the efficiency of EU financial markets.^[18]

The exemption in article 17 of the Short Selling Regulation (the SSR exemption) allows market makers to build net short positions, without having to notify the relevant competent authorities and disclose to the public,^[19] and to enter into short sales without having coverage for them. The SSR exemption applies only to those transactions that are essential in order to perform market making activities as defined in article 2(1)(k) of the Short Selling Regulation. All other trading activities conducted by a market maker (and, in particular, proprietary trading) are subject in their entirety to the prohibitions and transparency requirements of the Short Selling Regulation.

Market makers wishing to take advantage of the SSR exemption must notify the relevant competent authority, as specified in article 17(5,8)^{[20] [21]} of the Short Selling Regulation, at least 30 calendar days before they first intend to use that exemption.^[22] The competent authorities can prohibit the use of the exemption at any time, either during the 30 calendar days from when they receive the notification, or subsequently where there have been changes in the circumstances of the notifying person so that it no longer satisfies the conditions of the exemption. This may result from an own assessment by the competent authorities or from a subsequent notification received from the notifying person indicating a change affecting its ability to use the exemption.

The SSR exemption is also available for market making activities in third countries, provided that the other conditions are met and that the EU Commission has decided that the legal and supervisory framework of the specific country complies with legally binding requirements equivalent to those laid down by MiFID I concerning regulated markets and by the Market Abuse and Transparency Directive.^[23] So far, however, the EU Commission has not adopted any such equivalency decisions.

Paragraphs 19-57 of the ESMA Guidelines address the interpretation of the market making definition in the Short Selling Regulation. The ESMA Guidelines were published in accordance with article 16(3) of the Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (the ESMA Regulation),^[24] in order to ensure a level playing field, consistency of market practices and convergence of supervisory practices across the EEA.

However, the ESMA's narrow interpretation of the market making exemption in the Short Selling Regulation prevents legitimate market making activities from taking advantage of the SSR exemption and this has led to a situation in which some Member States do not follow the ESMA Guidelines in full. Indeed, national competent authorities were required to notify the ESMA within two months from the publication of the guidelines, stating whether they would comply or intend to comply with them or not, with reasons for possible non-compliance. Five national competent authorities (among them BaFin^[25] and the FCA)^[26] reported that they were not going to comply with certain provisions of the guidelines as they disagreed with the interpretations set out by the ESMA. This is the case in particular for (i) the so-called "membership" requirement, i.e. the requirement that the exemption is granted for market making on financial instruments notified

can be effected when due; or (iii) to have an arrangement with a third party which has confirmed the share has been located and has taken measures so that the short seller has a reasonable expectation that settlement can be effected when due.

18. According to recital 26 Short Selling Regulation:

Market making activities play a crucial role in providing liquidity to markets within the Union and market makers need to take short positions to perform that role. Imposing requirements on such activities could severely inhibit their ability to provide liquidity and have significant adverse impact on the efficiency of the Union markets. Furthermore market makers would not be expected to take significant short positions except for very brief periods. It is therefore appropriate to exempt natural or legal persons involved in such activities from requirements which could impair their ability to perform such a function and therefore adversely affect the Union markets. In order for such requirements to capture equivalent third-country entities a procedure is necessary to assess the equivalence of third-country markets. The exemption should apply to the different types of market-making activity but not to proprietary trading... Competent authorities should be notified of the use of exemptions and should have the power to prohibit a natural or legal person from using an exemption if they do not fulfil the relevant criteria in the exemption. Competent authorities should also be able to request information from the natural or legal person to monitor their use of the exemption.

19. Id.

20. Art. 17(5) reads as follows: "the exemption referred to in paragraph 1 shall apply only where the natural or legal person concerned has notified the competent authority of its home Member State in writing that it intends to make use of the exemption. The notification shall be made not less than 30 calendar days before the natural or legal person first intends to use the exemption". Under art. 17(8), "a third-country entity that is not authorized in the Union shall send the notification referred to in paragraphs 5 and 6 to the competent authority of the main trading venue in the Union in which it trades".

21. A person wishing to use the SSR exemption must notify the competent authority of its home Member State, as defined in art. 2(1)(n) Short Selling Regulation. Third-country entities not authorized in the European Union must notify the competent authority of the main trading venue in the European Union in which they trade. The third-country entity is required to assess its activity in the course of the preceding year on the basis of the turnover (as defined in art. 2(9) MiFID I Implementing Regulation) per trading venue when performing market making activities in Europe and identify on which trading venue (i.e. regulated market or MTF) it is the most active.

22. The notification procedure is not an authorization or licensing process by the competent authority.

23. Art. 17(2) Short Selling Regulation: "The Commission may, ..., adopt decisions determining that the legal and supervisory framework of a third country ensures that a market authorised in that third country complies with legally binding requirements which are, for the purpose of the application of the exemption set out in paragraph 1, equivalent to the requirements under Title III of Directive 2004/39/EC, under Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) and under Directive 2004/109/EC of the European Parliament and of the Council 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, and which are subject to effective supervision and enforcement in that third country". Directive 2003/6/EC is no longer in force, having been replaced by Regulation (EU) No. 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse.

24. 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), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC.

25. *Bundesanstalt für Finanzdienstleistungsaufsicht* (Germany).

26. Financial Conduct Authority (United Kingdom).

only to the extent that the market maker is a member of the trading venue on which market making is (at least, partially) performed;^[27] and (ii) the “product scope” requirement, which does not allow to exempt instruments other than shares or instruments creating long positions in shares.^[28]

In addition to its guidelines, the ESMA published the following documents concerning the Short Selling Regulation and the SSR exemption: the Final Report on ESMA’s technical advice on the evaluation of the Short Selling Regulation (the SSR Final Report);^[29] the Final Report on the ESMA Guidelines (the Guidelines Final Report);^[30] a compliance table concerning the ESMA Guidelines (the Compliance Table);^[31] a peer review report concerning the compliance by a group of competent authorities with the Short Selling Regulation as regards market making activities (the Peer Review Report);^[32] and a consultation paper on the evaluation of certain elements of the Short Selling Regulation (the Consultation Paper).^[33]

3.2. The market making definition in the Short Selling Regulation

Market making activities are defined in article 2(1)(k) of the Short Selling Regulation as:

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:

- (i) 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;
- (ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients’ requests to trade;
- (iii) by hedging positions arising from the fulfilment of tasks under points (i) and (ii).

The SSR exemption only applies to transactions of a market maker carried out performing the above-mentioned activities (liquidity provision, client facilitation and related hedging) and on the condition that all relevant requirements are satisfied. The exemption does not cover the entire scope of activity of a market maker; in particular, as clearly stated in recital 26 of the Short Selling Regulation, it does not apply to proprietary trading.

Market making activities eligible for the SSR exemption are only those undertaken by the entities specifically listed in article 2(1)(k) of the Short Selling Regulation: investment firms, credit institutions or third country entities. Any such entity is entitled to avail itself of the SSR exemption provided that it is a member of a trading venue (or a market in a third country with declared equivalent regime) and it performs as principal, whether on or outside a trading venue, any of the quoting, client servicing and hedging activities listed in article 2(1)(k) in respect of the financial instruments for which it notifies the exemption.^[34]

27. See sec. 3.3.

28. See sec. 3.4.

29. ESMA/2013/614, published on 3 June 2013: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-614_final_report_on_ssr_evaluation.pdf.

30. ESMA/2013/158, published on 1 Feb. 2013: <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-158.pdf>.

31. ESMA/2013/765, published on 19 June 2013: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-765_guidelines_compliance_table_-_market_making_guidelines.pdf. According to para. 6 ESMA Guidelines, competent authorities were required to notify the ESMA whether they would comply or intend to comply with the guidelines, with reasons for non-compliance, within two months from their publication. Based on information supplied by the competent authorities, the ESMA published the Compliance Table. Five competent authorities indicated not to comply with the ESMA Guidelines and the ESMA decided to publish their reasons for non-compliance in the Compliance Table.

32. ESMA/2015/1791, published on 5 Jan. 2016: https://www.esma.europa.eu/sites/default/files/library/2015-1791_peer_review_report_compliance_with_ssr_as_regards_market.pdf. The Peer Review was aimed at assessing how national competent authorities apply the SSR exemption and focuses on those markets with the highest number of market makers benefiting from the exemption and the markets in which market makers have notified the highest number of instruments. The Peer Review was limited to the competent authorities of Germany (BaFin), Italy (CONSOB), the United Kingdom (FCA), Sweden (Finansinspektionen - FI) and Hungary (Magyar Nemzeti Bank). Three of them (BaFin, the FCA and FI) had reported in 2013 that they were not going to comply with certain provisions of the ESMA Guidelines, as they disagreed with the interpretation set out by the ESMA. And, indeed, the Peer Review confirms that these authorities do not comply in full with the guidelines.

33. ESMA/2015/145-127, published on 7 July 2017: https://www.esma.europa.eu/sites/default/files/library/esma70-145-127_consultation_paper_on_the_evaluation_of_certain_aspects_of_the_ssr.pdf.

34. As clarified in para. 19 ESMA Guidelines, to qualify for the exemption, therefore, market making activities must be undertaken, whether on or outside a trading venue, by the following entities:

- i. an investment firm which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k); or
- ii. a credit institution which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k); or
- iii. a third-country entity which is a member of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission under art. 17(2) where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k); or
- iv. a firm as referred to in point (l) of art. 2(1) MiFID I, which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k) (these are firms which provide investment services and/or perform investment activities consisting exclusively in dealing on own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of

3.3. The membership requirement

3.3.1. General

According to article 2(1)(k) of the Short Selling Regulation, a market maker must be “a member of a trading venue ... where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the” quoting, client servicing and hedging activities mentioned in the same article 2(1)(k).

The first requirement that needs to be satisfied by a party that wishes to use the SSR exemption is, therefore, that it must be a member of a trading venue, which is either a regulated market within the meaning of point (14) of article 4(1) of MiFID I or a multilateral trading facility within the meaning of point (15) of article 4(1) of MiFID I.^{[35] [36]}

3.3.2. The ESMA’s narrow interpretation of the membership requirement

The ESMA interprets in a narrow manner the membership requirement in the market making definition, making it a condition for the exemption that the market maker is a member of a trading venue where the financial instrument in question is admitted to trading or traded and in which it conducts a market making activity in that instrument. The ESMA Guidelines unduly limit the scope of the exemption by setting out the pre-condition that no firm can qualify for the exemption unless it is a member of a trading venue on which its market makes the instrument for which the exemption is claimed.

In the feedback statement section contained in the Guidelines Final Report,^[37] it is explicitly stated that an entity intending to benefit from the exemption needs to be a member of a trading venue, where it conducts some market making activities, including hedging, on a specific financial instrument. In addition, it is also confirmed that the concerned instrument must be admitted to trading or traded on that trading venue.^[38] Thus, the SSR exemption would not apply to instruments that are not admitted to trading on a regulated market or traded on an MTF.

More in detail, according to the ESMA, the Short Selling Regulation requires (i) a market maker to be a member of the trading venue on which it conducts (at least partially) market making activities in the particular financial instrument(s) identified in the notification to the competent authority and (ii) the instrument(s) included in the notification to the competent authorities to be admitted to trading or traded on that venue of which that person is a member. Based on the ESMA Guidelines,^[39] there are indeed three preconditions for particular activities of an entity to be exempted from the SSR Regulation’s provisions. That entity (i) must be a member of the market on which it (ii) deals as principal in one of the capacities mentioned in the market making definition (iii) in the financial instrument for which it notifies the exemption.^{[40] [41]}

Even though a market maker is not required to conduct its market making activities solely on the venue or market of which it is a member,^[42] the narrow interpretation of the membership requirement adopted by the ESMA excludes from the SSR exemption all market making activities on instruments that are not admitted to trading or traded on any trading venue (as is the case for many non-listed derivatives) and limits the ability to offer OTC market making.

A considerable amount of market making activities, however, occurs away from trading venues and may relate to financial instruments which are either not traded on any trading venue (“pure OTC instruments”) or admitted to trading or traded on a trading venue (“exchange-traded instruments”). In the latter case, market making activities can take place either on a trading venue or OTC.

hedging positions on derivatives markets or which deal for the accounts of other members of those markets or make prices for them and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such firms is assumed by clearing members of the same markets).

35. See art. 2(1)(l) SSR.

36. Based on art. 2(1)(k) SSR, the SSR exemption is in principle also available to a third-country entity which is a member 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). However, the EU Commission has not published any equivalency declarations yet.

37. ESMA consulted on draft Guidelines in mid Sept. 2012 (see ESMA/2012/580: <https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-580.pdf>). The Guidelines Final Report includes a feedback statement on the most important issues raised during the consultation process.

38. See para. 5 of the feedback statement: “ESMA has taken considerable time to closely consider the Regulation and explore through a legal analysis whether there were ways to accommodate non-admitted/non-traded instruments for the purpose of the market making exemption in Article 17(1). Results of the analysis led to a negative conclusion”.

39. See para. 20.

40. The membership requirement is confirmed in various other parts of the ESMA Guidelines and, amongst others, in paras. 35, 36, and 43 which read as follows: “35. Any natural or legal person intending to make use of the exemption for market making activities and notifying the relevant competent authority of its intention should be a member of a trading venue (i.e. a regulated market or a MTF as defined in Article 4(14) and 4(15) of MiFID) or of an ‘equivalent’ market in a third country where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(1)(k). 36. In either case, the instrument which is the subject of the notification should be admitted to trading or traded on that venue or market of which that person is a member. For financial instruments referred to in paragraph 30 [i.e. financial instruments, other than shares and sovereign debt, that create long or short positions in shares or sovereign debt], it is not required to be a member of the venue where the corresponding share or sovereign debt is admitted to trading or traded. 43. A person ... that intends to use the exemption ... must be a member of a trading venue where the financial instrument in question is admitted to trading or traded and in which it conducts a market making activity on that instrument...”.

41. In the ESMA Guidelines (see para. 22), it is also stated that the Commission services have expressed in writing their legal analysis of the market making definition contained in art. 2(1)(k) SSR, which makes clear that the assessment of the membership requirement for the qualification of market making activities has to be done with respect to each individual financial instrument and that, accordingly, market making activities on instruments that are not admitted to trading or traded in any trading venue cannot qualify for the SSR exemption as the membership requirement cannot be met.

42. See para. 21 ESMA Guidelines.

Based on the ESMA Guidelines, the SSR exemption is not available for market making activities in relation to pure OTC instruments. On the other hand, market making in exchange-traded instruments may be exempted under article 17 of the Short Selling Regulation also where the activity is conducted OTC on condition, however, that some market making activities take place on the trading venue of which the market maker is a member (i.e. market making cannot take place OTC only).[43]

The reading of the ESMA Guidelines and of other documents published by the ESMA on the topic, suggests that the membership requirement should also be satisfied in respect of hedging activities (i.e. no hedging in pure OTC instruments).[44]

It follows from the ESMA's interpretation that market makers are not permitted to hedge their liquidity provisions or client facilitation transactions in shares using OTC derivatives. In addition, a transaction in an OTC derivative, even where it relates to a share admitted to trading on a trading venue, which is entered in response to client order or request to trade, does not qualify as a market making activity (as the derivative itself is not an exchange-traded instrument); the hedging of such derivative transaction by entering into a trade in the underlying shares (which are exchange-traded instruments) would also not qualify as market (that transaction would not be hedging a market making activity falling under limb (i) and (ii) of the definition).

Under the ESMA Guidelines, certain legitimate market making activities have, therefore, been excluded from the scope of the SSR exemption by virtue of a narrow interpretation of the membership requirement and this has a damaging effect on liquidity and efficiency in the cash equity markets and in markets where market makers rely on these instruments to hedge their risk positions. This is one of the main reasons why some Member States have declared non-compliance with some parts of the guidelines on market making activities and, in particular, with the membership requirement.

The ESMA's interpretation of the membership requirement, which significantly restricts the scope of application of the SSR exemption, seems to be going beyond what is required in the SSR Regulation, for the following reasons:

- first, based on Recital (2)6 of the Short Selling Regulation, the broad purpose of the SSR exemption is to enable firms to provide liquidity to the EU “markets”. The Recital uses the broad term “markets” and is not restricted to the provision of liquidity to regulated markets and MTFs. As such, the Recital seems to be suggesting that the provision of liquidity to all markets, whether conducted via trading venues or OTC, is an important function performed by market makers;
- second, although the first limb of article 2(1)(k) of the SSR Regulation states that a market maker must be a member of a trading venue or third country equivalent market, it does not say in the second limb that the financial instrument for which the SSR exemption is sought must be traded on that market; and
- third, the ESMA's reading of the membership requirement relies on a specific meaning attributed to the adverb “where” contained in the English text of the market making definition in the Short Selling Regulation, which is not supported by other equally authentic language versions of the Short Selling Regulation and is in conflict with the meaning that same word has in other places of the same regulation. Indeed, the ESMA has allegedly interpreted that adverb as a geographical reference that establishes a link between the trading venue and the financial instrument(s) (i.e. the membership requirement is considered in relation to the trading venue on which the financial instrument of the exemption is traded).[45] Other language versions of the market making definition do not establish any link between the trading venue of which the relevant party is a member and the financial instrument in which it deals and for which it claims the SSR exemption. These other language versions clearly state that the requirement for membership of a trading venue and the requirement to deal as principal in the financial instruments are two separate and unconnected tests.[46] The word “where” in the English version should therefore be interpreted as “in the circumstances in which” or “when/if”. That is indeed the meaning the word clearly has in other places of the Short Selling Regulation[47] and there is nothing to indicate that a different meaning of “where” is intended in article 2(1)(k). Accordingly, the preconditions for the SSR exemption to apply should be that (i) the relevant party is

43. See para. 30 Consultation Paper: “In the case of exchange-traded instruments, market making activities can take place on a trading venue or OTC, as for instance in the activity of fulfilling orders initiated by clients or in response to clients’ request to trade under article 2(1)(k)(ii) of the SSR. The SSR regime in case of exchange-traded instruments requires that market making activities benefiting from the exemption should in any case take place on the trading venue of which the market maker is a member and, in addition, could also take place OTC, but cannot take place OTC only”.

44. Para. 36 ESMA Guidelines indicates that the instrument to which the market making exemption relates must be admitted to trading or traded on a trading venue of which the firm is a member. Where the market making occurs in a financial instrument other than shares (e.g. derivatives), the firm does not have to be a member of the trading venue where the related share is admitted to trading or traded, but it seems clear that the ESMA expects the firm to be a member of the trading venue where the derivative is admitted to trading or traded. In the Guidelines Final Report (see para. 5), the ESMA confirms that the membership requirement needs to be satisfied for hedging activities as well: “an entity intending to benefit from the exemption needs to be a member of a trading venue, where it conducts some market making activities, including hedging, on a specific financial instrument. In addition, it is also confirmed that the concerned instrument must be admitted to trading or traded on that trading venue. Thus, the exemption cannot apply to instruments that are not admitted to trading on a regulated market or traded on an MTF”. In the SSR Final Report (para. 152), the ESMA acknowledges that “market makers in OTC equity derivatives may hedge their risk by taking a short position in the corresponding underlying equity” and states that “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 ... 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 wording of Article 2(1)(k), it is not clear that this different treatment of market makers in OTC products is justified”.

45. See para. 16 Consultation Paper: “... In the ESMA Guidelines it was clarified that membership should be considered in relation to the trading venue on which the financial instrument of the exemption is traded”.

46. In French, the term “et” (meaning “and”) is used. In German, the term “wenn” (meaning “when”) is used. In Spanish, the term “si” (meaning “if”) is used. In Italian, the term “quando” (meaning “when”) is used. In Polish, the wording “w przypadku gdy” (meaning “in the case where”) is used.

47. See, for instance, Recitals (15) and (21) and arts. 2(1)(b), 2(1)(e), 3(1)(b) and 4(1).

a member of a trading venue; and (ii) it deals as principal in the relevant financial instrument. It should be irrelevant whether the instrument is dealt on that venue (or any other venue) or not.

The ESMA has acknowledged in various documents^[48] that, in principle, the reasons for granting the SSR exemption apply irrespective of whether the market maker is dealing in a pure OTC instrument or in an exchange-traded instrument and that the difference in treatment between market makers in OTC products and market makers in exchange-traded instruments, although in line with the wording of the Short Selling Regulation (as interpreted by the ESMA), does not seem to be justified. As such, the ESMA has suggested that the requirement for the market maker to be a member of the trading venue where the product in which it is market making is admitted to trading or traded should be reconsidered by the legislator (i.e. that the definition of market making activities in the Short Selling Regulation should be revisited).

3.4. The product scope requirement

Under the ESMA Guidelines, equity market making activities may only be carried out in relation to shares and financial instruments that create long or short positions in shares as defined in article 3 of the Short Selling Regulations.^[49] These are “those listed financial instruments the position of which must be taken into account when calculating the net short positions”, as listed in Part 1 of Annex I of the Commission Delegated Regulation (EU) No. 918/2012: options, covered warrants, futures, index-related instruments, contracts for difference, shares/units of ETF, swaps, spread bets, packaged retail or professional investment products, complex derivatives, certificates linked to shares, and global depository receipts.

The ESMA Guidelines seem to be unduly restricting the scope of products that are eligible for the SSR exemption and this has again the effect of excluding legitimate market making activities from the exemption (e.g. market making activities in convertible bonds and subscription rights may not be eligible for the SSR exemption). Indeed, article 2(1)(k) of the Short Selling Regulation defines market making activities as those activities where the person deals as principal in a financial instrument (whether traded on or outside a trading venue) and article 2(1)(a) of the Short Selling Regulation contains a straightforward definition of “financial instrument”, referring to the instruments listed in section C of Annex I of MiFID I. There seems to be no reason to depart from that definition for the purposes of the SSR exemption, which should therefore be eligible in respect of any MiFID financial instrument. The ESMA restricts the instruments eligible for the SSR exemption to those instruments that are listed in part 1 (and part 2, as far as sovereign debt is concerned) of Annex 1 of Commission Delegated Regulation (EU) No. 918/2012. However, those lists are made for different and specific purposes (i.e. to catalogue the instruments that must be taken into account when calculating a net short position in shares or sovereign debt) and are not deemed to set out a general limitation on the types of financial instruments which may benefit from the SSR exemption.

3.5. The Italian regulators’ full compliance with the ESMA Guidelines

On 5 June 2013, Bank of Italy and CONSOB published a joint communication, stating their intention to comply in full with the ESMA Guidelines.^[50]

Differently from the FCA and other non-compliant authorities, CONSOB and Bank of Italy clearly make reference, in their joint communication, to paragraph 20 of the ESMA Guidelines, where it is stated that an entity can benefit from the SSR exemption provided that it is a member of the market on which it deals as principal in one of the relevant capacities (liquidity provision, client facilitation and related hedging) in the financial instrument for which it notifies the exemption.

The clarifications contained in the joint communication are consistent with the ESMA Guidelines. Indeed, CONSOB and Bank of Italy plainly state, quoting paragraphs 20 and 43 of the ESMA Guidelines, that the market making activity must be conducted at least in part in a trading venue of which the market maker is a member and where the financial instrument for which the SSR exemption is sought is traded or admitted to trading. As indicated in paragraph 21 of the ESMA Guidelines, the Italian regulators also clarify that not all of the market making activity must be conducted on that trading venue or market. Last but not least, it is also stated that the instrument pertaining to the market making activity must be admitted for trading in the venue or market and that, accordingly, as indicated in paragraph 22 of the ESMA Guidelines, market making activities related to financial instruments that are not admitted for trading on any trading venue or market cannot benefit from the SSR exemption.

Strangely enough, the Italian text of the Short Selling Regulation is not consistent with the narrow interpretation of the “membership requirement” adopted by the ESMA, which relies on the “locational” meaning attributed to the adverb “where” contained in the market making definition. Indeed, the Italian text states that market making means the activity of a person that “is a member of a trading venue ... when it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the”^[51] quoting, client servicing and hedging activities mentioned in article 2(1)(K) of the Short Selling Regulation. However, even though the Italian version of the SSR would not support the ESMA’s narrow interpretation, the Italian regulators have decided to comply in full with the ESMA Guidelines and, in particular, with the membership requirement as interpreted therein.

48. See the SSR Final Report (para. 152) and the Consultation Paper (para. 26).

49. Paras. 30 and 32 ESMA Guidelines.

50. See Bank of Italy/CONSOB joint communication concerning the transposition of the Guidelines issued by AESFEM (ESMA), concerning the exemption for market making activities and primary market operations under Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swap: <https://www.bancaditalia.it/compiti/sispaga-mercati/short-selling/normativa/2013-06-Comunicazione-congiunta-BI-Consob.pdf> (the document is available in Italian only). The communication highlights some of the main issues in the ESMA Guidelines and provides operational guidance on the procedure to be followed for their application in Italy.

51. Emphasis added.

3.6. BaFin and the FCA stated non-compliance with the ESMA Guidelines

Both BaFin and the FCA have stated that they will comply with the ESMA Guidelines with the exception of the provisions concerning the requirement for the market maker to be a member of the trading venue where the relevant financial instrument is traded and the scope of the products eligible for the SSR exemption.

In particular, BaFin and the FCA^[52] only require a notifying entity to be a member of a trading venue in the European Union. They do not require, as the ESMA Guidelines request,^[53] that membership must be of the trading venue where the instruments are listed and where market making is performed (paragraph 20-22 of the Guidelines). As noted by the ESMA in the Peer Review Report, “the extent of the non-compliance with” the membership requirement, as interpreted in the ESMA Guidelines, “is mainly limited to market making activities in OTC financial instruments, for which the criterion could not be met by definition”.^[54] Indeed, BaFin, the FCA and FI also permit the SSR exemption for market making on pure OTC derivatives (i.e. entities that have notified the intention to carry out market making activities in these instruments will not be objected to by those competent authorities), while CONSOB and the MNB^[55] do not permit such notifications as compliance with the ESMA Guidelines, and the strict membership requirement stated therein means that SSR exempted market making on pure OTC derivatives is not possible. This divergence is a consequence of the different interpretations of the definition of market making activities in the Short Selling Regulation. On the other hand, “for listed financial instruments, such as shares traded in Regulated Markets or MTFs, the trading venue membership is met in the vast majority of cases in Germany, Sweden and the UK”.^[56]

BaFin and the FCA also declared non-compliance with the “product scope” of the ESMA Guidelines,^[57] arguing that the SSR exemption should be available in respect of market making activities on all MiFID financial instruments (as suggested in the first draft of the ESMA Guidelines), while the Guidelines limit the exemption to shares and instruments that must be taken into account when calculating a net short position in shares.

In the Peer Review Report, the ESMA emphasizes the point about the different technical approaches amongst the reviewed regulators (e.g. on the membership requirement or on the scope of instruments eligible for the SSR exemption) and encourages the EU Commission to look at this in its forthcoming review of the Short Selling Regulation.

3.7. The Consultation Paper

3.7.1. Background

The ESMA received a formal mandate from the European Commission on 19 January 2017 seeking technical advice on the evaluation of certain elements of the Short Selling Regulation (including the SSR exemption). This advice by the ESMA, to be delivered by 31 December 2017, should contribute to the follow-up 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.

On 7 July 2017, the ESMA published the Consultation Paper regarding its future technical advice to the Commission,^[58] seeking the views of market participants on three specific topics: (i) the exemption for market making activities under article 17 of the Short Selling Regulation, (ii) the short-term restrictions on short selling in case of a significant decline in prices based on article 23 of the Short Selling Regulation, and (iii) the transparency of net short positions and reporting requirements. Responses to the Consultation Paper were requested to be submitted to the ESMA by 4 September 2017.

With specific reference to market making and the SSR exemption, the ESMA was asked by the European Commission to analyse the following elements:

- whether the exemption for market making activities and the definition of market making activities is adequately clear, in view of current practices;
- 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, the ESMA was 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 Short Selling Regulation and that of “market maker” in article 4(1)(7) of MiFID II.

52. The Swedish regulator (FI) is also not compliant with the membership requirement as interpreted by ESMA.

53. Paras. 20-22 ESMA Guidelines.

54. Para. 63 Peer Review Report.

55. The Hungarian competent authority.

56. Para. 63 Peer Review Report.

57. Paras. 30-32 ESMA Guidelines.

58. 2.9 <https://www.esma.europa.eu/document/consultation-paper-evaluation-short-selling-regulation>.

In carrying out its analysis of the issues covered by the mandate, the ESMA was encouraged to seek the views of competent authorities and market participants.

3.7.2. Absence of alignment between the Short Selling Regulation and MiFID II

As requested by the Commission, the ESMA is gathering the opinion of market participants on the absence of alignment between the definition of “market making activities” in article 2(1)(k) of the Short Selling Regulation and the definition of “market maker” in article 4(1) (7) of MiFID II.

According to article 4(1)(7) of MiFID II, a “market maker” is:

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.

The ESMA points out that some similarities between MiFID II and the Short Selling Regulation exist. Indeed, under MiFID II, a market maker should be acting on a “continuous basis” and the buying and selling activity should take place against the market maker’s proprietary capital; these conditions are similar to what is required in the Short Selling Regulation definition, where the market maker must deal as principal.

There are, however, some significant differences between the two definitions. Indeed, MiFID II does not incorporate either a membership requirement or the three market making capacities specified in article 2(1)(k) of the Short Selling Regulation.

Market participants are therefore requested to express their views as to whether the differences between the two definitions can have a negative effect on the simultaneous application of MiFID II and the Short Selling Regulation to market makers and whether the definition in article 2(1)(k) of the Short Selling Regulation should make reference to the MiFID II definition with possibly additional requirements, where appropriate.

3.7.3. Membership requirement in respect of pure OTC instruments

As already discussed, the current wording of the market making definition of the Short Selling Regulation, as interpreted by the ESMA, implies that the market making activities in pure OTC instruments cannot benefit from the SSR exemption. The ESMA, however, acknowledges that, in principle, the rationale for granting the SSR exemption applies irrespective of whether a market maker is dealing in a pure OTC instrument or in an exchange-traded instrument. Accordingly, the ESMA is of the view that “the extent of the membership requirement should be better clarified in the definition of market making activities set out in article 2(1)(k) of the SSR”.^[59]

Under the new MiFID II/MiFIR regulatory framework, the universe of pure OTC instruments may shrink in the future and, accordingly, meeting the membership requirement to benefit from the SSR exemption may be less problematic.

Against this background, the ESMA is gathering input from market participants on whether or not the membership requirement in article 2(1)(k) of the Short Selling Regulation should be reconsidered and possibly waived in respect of those instruments that will remain pure OTC instruments despite the MiFID II/MiFIR framework.

In the ESMA’s view, reconsidering the membership requirement would imply an amendment to the Short Selling Regulation. However, the exclusion of market making in pure OTC instruments from the SSR exemption actually stems from the narrow interpretation adopted in the ESMA Guidelines. It can therefore be argued that the Guidelines, rather than the Short Selling Regulation, should be subject to revision.

3.7.4. Market making on exchange-traded instruments

Market making on exchange-traded instruments can take place on a trading venue and/or OTC. The membership requirement, as interpreted by the ESMA, implies, however, that market making activities on these instruments are not eligible for the SSR exemption if they take place OTC only (i.e. some market making needs to take place on the trading venue of which the market maker is a member).

The ESMA is seeking the views of market participants regarding (i) the possibility of extending the SSR exemption also to market making activities on exchange-traded instruments that take place OTC only, and (ii) the possibility of deleting the membership requirement altogether for exchange-traded instruments, irrespective of whether the market making activity is carried out on or outside a trading venue.

3.7.5. Product scope requirement

In relation to the financial instruments for which the SSR exemption can be claimed, the ESMA considers it opportune to clarify in the relevant legislation (i.e. either in the Short Selling Regulation or in the Commission Delegated Regulation) which financial instruments are comprised in the exemption.

At present, according to the ESMA, the exemption can only be used for shares (and sovereign debt) and instruments that create long or short positions in shares (and sovereign debt). “Activities 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”.^[60]

59. Para. 26 Consultation Paper.

60. Para. 35 Consultation Paper, which confirms the approach adopted in the ESMA Guidelines.

However, the ESMA also recognizes that, in certain instances, shares (and sovereign debt) are used for hedging products other than equity (and sovereign debt) derivatives. Indeed, “it is a common strategy for market makers in corporate bonds to hedge their market making risk via trades in the relevant sovereign debt. Without a clear exemption, the corporate bond market maker would face additional costs and problems in doing so. Similar arguments apply to market making in convertible bonds and subscription rights. Denying the exemption can inhibit market makers’ ability to provide liquidity in those financial instruments”.^[61]

Against that background, the ESMA is of the view that the scope of the financial instruments eligible for the SSR exemption should be carefully reanalysed in order to see whether it would be beneficial to extend the list of eligible products. However, the ESMA also believes that, to provide clarity and certainty to the competent authorities, the financial instruments for which the SSR exemption can be sought should be explicitly listed (i.e. if a broader set of instruments would be eligible for the exemption, it should be added to the lists in parts 1 and 2 of Annex I of the Commission Delegated Regulation (EU) No. 918/2012).

4. The IFTT Rules

4.1. The IFTT exemption for market makers in light of the divergence between competent authorities

Based on article 16(3)(a), first paragraph, of the Treasury Decree, transactions in chargeable equities and chargeable derivatives executed in the exercise of market making activities, as defined in article 2(1)(k) of the Short Selling Regulation and in the ESMA Guidelines, are exempt from IFTT (the IFTT MM exemption).^[62]

In the author’s opinion, for the purposes of the IFTT MM exemption, the Italian tax authorities will follow the guidance on the scope of market making activity contained in the ESMA Guidelines. Indeed, article 16(3)(a) of the Treasury Decree, as mentioned above, does not contain any independent tax definition of market making and specifically references for these purposes the Short Selling Regulation and the ESMA Guidelines. In addition, the Italian competent regulatory authorities (CONSOB and Bank of Italy)^[63] notified the ESMA that they intend to comply with the Guidelines.^[64] Last but not least, the Italian tax authorities have informally stated that indeed reference will be made to the ESMA Guidelines for the purposes of the IFTT MM exemption.^[65]

As a consequence, the analysis of the approach to the ESMA Guidelines adopted by the non-compliant regulatory authorities is probably largely moot in relation to the IFTT MM exemption as the principles set out in the ESMA Guidelines will most likely drive the Italian tax authorities’ views on the matter.

This does leave open the possibility that a foreign competent authority could, because of its different interpretations, accept that the SSR exemption is available to a notifier in respect to a specific financial instrument in circumstances in which the exemption would be denied by CONSOB. This will be the case where a market maker is established in a jurisdiction which does not follow the ESMA Guidelines (such as Germany and the United Kingdom). In these circumstances, it is likely to be the case that the market maker would look at its home member state regulator to determine the scope of the SSR exemption, although it should look at the position of the Italian authorities in determining the scope of the IFTT MM exemption. For example, a UK or German market maker that is trading pure OTC derivatives on Italian equities may consider that those trades (and related hedging) are covered by the SSR exemption (and thus it is not necessary to comply with the restrictions on uncovered short sales, etc.) because the United Kingdom and Germany do not follow the ESMA Guidelines in respect of the membership requirement, but those trades would not benefit from the IFTT MM exemption because the Treasury Decree references the ESMA Guidelines and CONSOB has accepted them.

The scenario may change in the future, based on the outcome of the ESMA’s consultation on certain aspects of the Short Selling Regulation^[66] and subsequent follow-up legislative actions by the Commission, which may result in changes to the definition of market making activities in the Short Selling Regulation as regards in particular the membership requirement.

61. Para. 38 Consultation Paper.

62. According to art. 16(4) Treasury Decree, the IFTT MM exemption is only granted to market makers and limited to the transactions executed in the exercise of market making activities. Art 16(4) seems somehow equivalent to para. 13 ESMA Guidelines, where it is stated that “the exemption applies only to the transactions carried out in performance of market making activities as defined above [...]”; it does not apply to the entire scope of activity of the notifying entity. As recital 26 [of the Short Selling Regulation] clearly states, such an exemption does not cover the proprietary trading of those persons”. Accordingly, the purpose of art. 16(4) quoted should be to make it clear that the IFTT MM exemption (i) only applies to transactions that are genuinely executed in the capacity of market making; and (ii) does not apply to the entire scope of activity of the market maker (and, in particular, it does not cover proprietary trading of that person).

63. Art. 4-ter (2) Legislative Decree 24 February 1998, n. 58 (the Italian Finance Code) designates CONSOB as the national competent authority for receiving the notifications, implementing the measures and exercising the functions and powers provided for in the Short Selling Regulation in relation to shares and financial instruments other than sovereign debt and sovereign credit default swaps. Para. 3 of the same article designates Bank of Italy and CONSOB as the competent authorities for exercising the ordinary functions and powers provided for in the Short Selling Regulation in relation to sovereign debt and sovereign credit default swaps.

64. See sec. 3.5.

65. References to the ESMA Guidelines are contained in an unofficial draft Q&A on the scope of the IFTT MM exemption, which however has never been finalized and published by the Italian authorities.

66. See sec. 3.7. ESMA’s advice, to be delivered by 31 Dec. 2017, should contribute to the follow-up actions announced by the Commission in its Communication on the Call for Evidence on the EU regulatory framework for financial services published on 23 Nov. 2016 (<https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-855-F1-EN-MAIN.PDF>). In that Communication, the Commission announced its intention to assess the definition of the exemption for “market making activities” in the Short Selling Regulation.

4.2. The formalities for the purposes of the IFTT MM exemption

According to the Treasury Decree, the IFTT MM exemption applies provided that the person acting as market maker has been granted the exemption under article 17(1) of the Short Selling Regulation by the competent authority. The wording of the Treasury Decree is not entirely accurate, since the competent authority in article 17(5,8) of the Short Selling Regulation is not formally granting the SSR exemption. Rather, that exemption is available to entities that have notified in writing the competent authority that they intend to make use of it, on condition that the competent authority has not prohibited the use of such exemption. Indeed, as stated in paragraph 58 of the ESMA Guidelines, “the use of the exemption is based on the requirement for notification of the intent. It is not an authorization or a licensing process.”

4.3. The IFTT MM exemption for third country market makers

A specific procedure is contemplated for those countries to which the Short Selling Regulation is not directly applicable and, hence, the “authorization” under article 17(1) of the Short Selling Regulation is not available. Indeed, article 16(3) of the Treasury Decree states that in these instances:

the person acting in the course of market-making activities is entitled to the exemption, provided that such person has submitted a specific request to CONSOB according to the procedures that will be set out in a regulation to be issued by this public authority; the applicant shall in any case prove to comply with the same requirements and conditions provided for in the above [Short-Selling] Regulation and [ESMA] Guidelines. CONSOB, on the basis of the information that it has received, confirms the satisfaction of the prescribed requisites [i.e. compliance with the requirements and conditions under the Short-Selling Regulation and the ESMA Guidelines], within the deadline that will be set out in a forthcoming regulation issued by this same authority. CONSOB shall retain the right to request additional documentation; in this case, the statutory deadline period starts again from the reception of the above documentation.

CONSOB adopted the required regulation with Resolution 13 March 2013, n. 18494.^[67] That regulation governs the application for the purposes of the IFTT MM exemption that needs to be made by market makers established in non-EU/EEA jurisdictions and also includes the form to be filed with CONSOB for that purpose.

In addition, the IFTT Decree has addressed the fact that under article 2(1)(k) of the Short Selling Regulation, market making activities can also be undertaken by third-country entities which are members of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission under article 17(2) of the Short Selling Regulation. The Commission has not yet issued the equivalence declaration referred to by article 2(1)(k) of the Short Selling Regulation. Therefore, the Treasury Decree includes a specific tax rule on the equivalence of third country venues, which applies pending the issuance, by the European Commission, of the above-mentioned equivalence declaration. Indeed, for purposes of the IFTT MM exemption, regulated markets and multilateral trading facilities are deemed to be equivalent, provided that they are:

- authorized and supervised by a national public authority with which CONSOB has concluded a bilateral cooperation agreement, as identified in the specific section of the CONSOB website;^[68]
- authorized and supervised by a national public authority with which CONSOB has concluded a multilateral cooperation agreement, as identified in the specific section of the IOSCO website,^[69] provided that they are established in states and territories with an adequate exchange of information with Italy;^[70] or
- recognized by CONSOB under article 67(2) of the Italian Finance Code, based on the list published on the CONSOB website.^[71]

67. See [http://www.consob.it/web/area-pubblica/bollettino/documenti/bollettino2013/d18494.htm?hkeywords="imposta+sulle+transazioni+finanziarie"+18494&docid=1&page=0&hits=2&nav=true](http://www.consob.it/web/area-pubblica/bollettino/documenti/bollettino2013/d18494.htm?hkeywords=).

68. See http://www.consob.it/main/consob/cosa_fa/impegni_internazionali/accordi.html.

69. See http://www.iosco.org/library/index.cfm?section=mou_siglist, Annex A.

70. The jurisdictions that allow an adequate exchange of information with Italy for tax purposes are listed in the Decree of 4 Sept. 1996. The list was significantly broadened by the Ministerial Decree of 9 Aug. 2016 (published in the Official Gazette of 22 Aug. 2016) which added 50 additional jurisdictions (including Bermuda, the Cayman Islands, Hong Kong, Liechtenstein, Saudi Arabia and Switzerland) and grants the Italian authorities the right to remove from the list those countries that repeatedly do not comply with their exchange of information obligations.

71. See http://www.consob.it/main/mercati/regolamentati/mercati_accordi.html.