Date: 17 March 2020
ESMA70-155-9556

OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY

of 17 March 2020

on a proposed emergency measure by Comision Nacional del Mercado de Valores under Section 1 of Chapter V of Regulation (EU) No 236/2012

In accordance with Article 44(1) of Regulation (EU) No 1095/2010, the **Board of Supervisors** has adopted the following opinion:

I. Legal basis

1. In accordance with Article 27(2) of 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[1] (the Regulation), the European Securities and Markets Authority (ESMA) shall within 24 hours of the notification made by a competent authority under Article 26 of that Regulation, issue an opinion on whether it considers the measure or proposed measure is necessary to address the exceptional circumstances as further specified in Article 24 of Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012.

2. In accordance with Article 44(1) of the ESMA Regulation the Board of Supervisors has adopted this opinion.

II. Background

3. On 16 March 2020, pursuant to Article 26 of Regulation (EU) No 236/2012, the Spanish Comisión Nacional del Mercado de Valores (CNMV) notified ESMA of its intention to make use of its powers of intervention in exceptional circumstances and to introduce an emergency measure under Article 20(2)(a) and (b) of that Regulation.

4. In particular, the concerned measure bans any legal or natural person from entering into transactions which might constitute or increase net short positions in shares admitted to trading to Spanish trading venues for which the CNMV is the competent authority (BOLSA DE MADRID, S.A., BOLSA DE BARCELONA, S.A., BOLSA DE VALENCIA, S.A., BOLSA DE BILBAO, S.A. and Mercado Alternativo Bursátil, S.A.), as well as to all

[1] OJ L 86, 24.3.2012, p. 1–24.

related instruments relevant for the calculation of the net short position as determined in Annex I, part 1, Articles 5 and 6 of Commission Delegated Regulation EU Nº 918/2012. The ban applies to transactions executed both on a trading venue or over the counter.

5. The measure applies to any natural or legal person domiciled or established within the Union or in a third country.

6. The measure does not apply to the following:

    a. Instruments: index-related instruments on indices not composed mainly by shares affected by the prohibition, and

    b. Transactions:

        i. The creation of, or increase of, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component.

        ii. The creation of, or increase of, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights.

        iii. The creation of, or increase in, net short positions through index-related instruments or baskets of financial instruments, not composed by a majority of shares included in the ban.

        iv. Transactions undertaken by market makers in that capacity as defined by Article 2(1)(k) of Regulation (EU) No 236/2012and according to Article 17 of the same Regulation.

7. The proposed measure is expected to enter into force on 17 March 2020 before the opening of the trading session and to expire after the close of the trading session on 17 April 2020. The proposed measure may also be lifted before the deadline, if the risks of a loss of market confidence is reduced, or extended depending on market conditions. Pursuant to Article 26(3) of Regulation (EU) No 236/2012, the CNMV notified ESMA less than 24 hours before the measure is intended to take effect.

8. The CNMV considers that the proposed measure is justified by the existence of extreme adverse circumstances that constitute a serious threat to market confidence and may result as a consequence in a threat to the financial stability not only for Spain but in all EU Member States.

9. The CNMV considers that as the COVID-19 pandemic spreads across populations and countries, the sharp price declines observed due to its outbreak may continue and its

final impact on markets is unforeseeable. Some European countries such as Spain have been more seriously hit by the virus and have shown the steepest curves of mortality in this pandemic. In Spain, the number of fatal casualties and of infected persons has doubled overnight, leading the Spanish Government to approve on Saturday 14 March 2020 the Royal Decree 463/2020, declaring the state of emergency on Saturday 14 March 2020. According to the CNMV, the state of emergency may imply the adoption of extraordinary restrictions on free movement of people, business activities, administrative powers and measures to align all the resources of Spanish economy towards the priority goal of addressing the health emergency provoked by COVID-19. Notwithstanding these measures (or in some cases due to them), the impact of COVID-19 may severely affect the income of listed companies, their profitability and the outlook of their business activity, as long as the situation remains as it is now.

10. Such situation has posed, according to CNMV, three different specific threats to market confidence:

    a. First, the CNMV considers that as opposed to a deterioration affecting just one issuer, based on fundamental economic facors, in the current context investors do not have accurate and public information on the impact of the public health crisis on each listed company, since events develop quickly and restrictions adopted by the Government might come with little or no advance notice. Hence, price formation may take place in an environment of partial information.

    b. Second, the CNMV has observed cases of disinformation, rumours and false news in media and social networks regarding activities that could be affected by decisions of the Government or by the evolution of the crisis. Such rumours may affect listed companies and damage the confidence of investors in an efficient market, where prices should be formed with public, reliable information.

    c. Third, the CNMV considers that, although Regulations (EU) No 236/2012 and Article 24 of Regulation (EU) No 918/2012 were drafted without considering the scenario of a pandemic, when identifying situations that could be considered a threat to market confidence, they refer to “natural disasters” that may damage financial institutions, market infrastructures, clearing and settlement systems and supervisors. The effect of the restrictions within the state of emergency on the availability of resources (including human and IT) could be similar to some natural disasters. The CNMV considers that the restrictions to the movement of workers and the fact that key personnel of infrastructures may be affected and unable to continue working, puts the market infrastructures, clearing and settlement systems at enormous strain to monitor, supervise and manage markets. The stock market is the most sensitive to this situation or distress. At the same time, the CNMV has not observed any disruption of clearing and settlement systems yet.

11. In this context, the CNMV considers that a growth of short positions betting on negative news (be them real or ill-based) affecting Spanish and EU companies could destabilize markets in a way that could be self-reinforcing, with downward price spirals as serious as that observed in the session of 12 March 2020, in which the IBEX 35 index lost 14,61%.

12. The CNMV also declares that, as a consequence of the above, a negative effect on the financial stability of the system cannot be discarded. According to the CNMV, the bulk of the sales has come from long positions being unwound and, specifically in the Spanish banking sector, the amount of short positions has been moderate. However, the CNMV also notes that in the current context the price of the shares of Spanish credit institutions could be heavily influenced by short positions taken in coming weeks, that may lead to threats to financial stability.

III. Opinion

13. ESMA considered the information provided by CNMV and is adopting the following opinion on the notified measure, on the basis of Article 27(2) of the Regulation:

On the adverse events or developments

14. First, ESMA agrees that the outbreak of the COVID-19 pandemic is having serious adverse effects on the real economy and on the financial markets of the Union. As regards the latter, since 20 February 2020 the stock markets in the EU lost up to or more than 30% in value, and all sectors and types of issuers were affected by severe share price falls (details in the Annex).

15. ESMA considers that the adverse situation linked to the COVID-19 has greatly increased the vulnerability of EU financial markets, and there is a concrete risk that the observed downward trend will continue in the coming days and weeks, with the consequent adoption by EU Member States of restrictive measures which impact all economic sectors.

16. Pursuant to Article 20 (1)(a), the measure under Article 20(2) of Regulation (EU) No 236/2012 requires the presence of adverse events or developments which constitute a serious threat to financial stability or to market confidence in the Member State concerned.

17. The notification of the CNMV considers that the serious threats to market confidence are already existing. Namely, the CNMV considers that the current context is not compatible with the availability of accurate information, with the consequence that price formation may take place in an environment of partial information. Second, rumours of false news

linked to the pandemic may have the effect of impacting listed companies and damage the confidence of investors in the markets. A third source of threat to market confidence is that the COVID-19 pandemic is at the origin of restrictions on the availability of human resources at issuers.

18. ESMA agrees with the CNMV that the severe losses observed, the incertitude as regards the spreading of the COVID-19 contagion and the possible consequent further volatility and downward price spirals have the effect of prejudicing market confidence. ESMA also agrees that the emergency situation linked to the pandemic may cause a general state of alert which seriously threatens market confidence. Furthermore, ESMA agrees that such circumstances impact market confidence in general, with consequences for all listed issuers.

19. As regard financial stability[2], ESMA recently stated (see the paragraph below) that substantial selling pressure and unusual volatility in the price of shares of financial institutions is already ongoing and could continue to occur, as the contingency linked to the COVID-19 pandemic may result in market participants taking new short positions in order to profit from further price falls, which may in turn exacerbate the falls already experienced in the past weeks. ESMA therefore agrees that, as indicated by the CNMV, given the current market circumstances, an evolution towards substantial threats to the financial stability is possible.

20. In line with that, ESMA deems that the prohibition to open or increase net short positions would eliminate a factor that may play a significant role in exacerbating the fall of prices of shares admitted to trading on EU trading venues and therefore threaten financial stability.

21. With reference to the broader EU-markets scenario, ESMA has assessed that there are existing threats to market integrity, orderly functioning of markets and to financial stability. On that basis, on 16 March 2020 ESMA has adopted a decision to temporarily lower the notification thresholds of net short positions to national competent authorities in accordance with point (a) of Article 28(1) of Regulation (EU) No 236/2012 (ESMA70-155-9546). ESMA considers that its decision will enable national competent authorities to better monitor the existing threats.

22. At the same time, ESMA agrees with the CNMV that the economic impact of the COVID-19 pandemic has been harder in Spain than in other EU Member States, and therefore considers that the circumstances described above are adverse events or developments which constitute a serious threat to market confidence in Spain and are consistent with the adoption of the measure of Article 20(1)(a) of Regulation (EU) No 236/2012,

[2] In its Financial Stability Review, the ECB considers financial stability as a condition in which the financial system – which comprises financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unravelling of financial imbalances, see https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr201911~facad0251f.en.html.

considering also the conditions further specified in Article 24 of the Commission Delegated Regulation No 918/2012.

On the appropriateness and proportionality of the measure

23. In order to assess whether the measure would be appropriate and proportionate in relation to the threat, ESMA has analysed how and the degree to which sharp price declines pose a risk to the orderly functioning, integrity and stability of the Spanish market as a whole, looking not only at the range of shares affected by the latest market developments but also at the build-up of net short positions of shares within the scope of the measure.

24. From the analysis of the shares impacted by these sharp price declines, it becomes evident that the downfall spiral spreads across the Spanish markets and across different sectors, including systemically important institutions (cf. the Annex). Such widespread impact is consistent with the global nature of the outbreak of a global pandemic (COVID-19), as announced by the World Health Organisation[3], that has proven to be very serious in Spain .

25. From that perspective, ESMA understands that limiting the scope of its measure to one or several sectors or to a subset of the issuers may not achieve the desired outcome. Without this broad scope applied by this measure the CNMV may have to adopt additional restrictive measures in the near future at a time when their effectiveness may be limited.

26. As also indicated by the data submitted to ESMA by the CNMV, the latest developments in relation to COVID-19, have put an extremely wide range of Spanish shares in a situation of vulnerability. In case short-selling strategies start targeting those shares, the prices may drop further potentially triggering downward spirals and further 'runs' on the market.

27. ESMA considers that suspending the capacity of market participants in the Spanish market to enter into short sales or into transactions with equivalent effect in relation to shares admitted to trading on regulated markets would not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to its benefits. ESMA rather deems this measure suitable and adequate to provide an appropriate and uniform level of protection to all Spanish issuers and investors and the wider Spanish market as a whole.

28. ESMA considers that the measure is the least stringent of all the measures that could adequately address the threat to confidence in the Spanish market. A temporary restriction on short selling according to Article 23 of the Regulation (EU) No 236/2012 would not address the threat to market confidence as it would remain applicable for a

[3] https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200310-sitrep-50-covid-19.pdf?sfvrsn=55e904fb_2

few days only and would be limited to short selling without covering any opening or increasing of net short positions.

29. Additionally, ESMA notes that the proposed measure does not extend the prohibition to index-related instruments or baskets of financial instruments not composed by a majority of shares, to market making activity and to short positions entered into to hedge positions on convertible bonds or subscription rights. This is with a view to limit the measure to the strictly necessary scope and not to be overly restrictive to trading strategies of market participants, with particular reference to those ones that provide an important service in terms of increasing liquidity and reducing volatility, particularly relevant in the current situation.

30. For the above reasons, ESMA considers that the emergency measure proposed by the CNMV under Article 20(2)(a) and (b) of Regulation (EU) No 236/2012 and Article 24(1)(c) of Commission Delegated Regulation (EU) No 918/2012 in relation to Spanish shares is appropriate and proportionate to address the existing threat to market confidence in the Spanis market.

On the duration of the measure

31. In terms of duration of the measure, ESMA considers that maintaining the prohibition for one month is justified considering the information publicly available at the moment. While the CNMV expressed it intention to lift the ban as soon as the evolution of the situation allows, it does not discard the possibility of extending the measure if the situation so requires.

Conclusion: on the necessity of the measure

32. Having considered the adverse situation linked to the COVID-19, the appropriateness, proportionality and justified duration, ESMA considers necessary the emergency measure proposed by the CNMV under Article 20(2)(a) and (b) of Regulation (EU) No 236/2012 and Article 24(1)(c) of Commission Delegated Regulation (EU) No 918/2012 in relation to Spanish shares.

This opinion will be published on ESMA’s website.

Done at Paris, 17 March 2020

[Signed]

For the Board of Supervisors

Steven Maijoor

Chair

ANNEX

FIGURE 1 – MAIN SPANISH INDICES

Index	Date of reference	% since previous	% since 31/12/19
Ibex 35	16/3/20	-8%	-36%
Ibex medium cap	16/3/20	-6.7%	-34%
Ibex small cap	16/3/20	-6.8%	-33.2%
Ibex banks	16/3/20	-11.03%	-46.24%
Ibex energy	16/3/20	-4.15%	-26.25%
Ibex construction	16/3/20	-10.09%	-37.54%