European Securities and Markets Authority

Report

Preliminary findings on multiple withholding tax reclaim schemes

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1 Executive Summary

Reasons for publication

The European Securities and Markets Authority (ESMA) has prepared this report to respond to the European Parliament Resolution 2018/2900 (RSP) of 29 November 2018, whereby the European Parliament requested ESMA to conduct an inquiry into schemes such as Cum/Ex and Cum/Cum.

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Further to the European Parliament Resolution[1], ESMA has analysed multiple withholding tax reclaim schemes in order to assess how widespread they actually are across the EU, to what extent the schemes are connected with short selling and market abuse violations and any potential solution to prevent/detect the phenomena.

ESMA also analysed those schemes in light of requirements in the MiFID II framework and reviewed evidence from market data.

Additionally, ESMA has also analysed the possibility for National Competent Authorities to transmit to national tax authorities the information received by other National Competent Authorities in the form of Suspicious Transactions and Orders Report (STOR) under the Market Abuse Regulation and the MIFID Transaction Reporting Exchange Mechanism (TREM).

Next Steps

The ESMA Board of Supervisors has approved the launch of a formal inquiry under Article 22(4) of the ESMA Regulation. Should the results of this formal inquiry provide additional elements not already contained in this report, ESMA will report them to the EP accordingly.

[1] Resolution of the European Parliament 2018/2900 (RSP) of 29 November 2018 (http://www.europarl.europa.eu/doceo/document/TA-8-2018-0475_EN.pdf).

2 Background

1. At the end of October 2018, different media in the EU published the result of an investigation carried out by a consortium of investigative journalists that reported the existence in some EU Member States of an alleged large-scale tax fraud known as "Cum/Ex" scheme. Those schemes, aimed at pursuing multiple withholding tax reclaims, were known in Germany for some years including relevant media coverage and a parliamentary investigation committee publishing its results on this topic in June 2017. Such schemes however may also exist in other Member States and may have different structures.

2. To give further background, when German companies pay dividends, they withhold about a quarter to cover any taxes the shareholder might later owe. Subsequently, shareholders get certificates showing how much money was deducted, and the amount can be credited against their tax bill or, if they owe no additional taxes, refunded.

3. According to the journalistic investigation reported by the media in October 2018, the scheme involved short selling of shares around the date of dividend pay-outs and exploited an interpretation of the German tax code that apparently allowed multiple persons to claim ownership of the same shares and the corresponding right to receive a refund of the same amount as the taxes withheld from dividend payments. Two or more investors may have received certificates corresponding to taxes that were in fact withheld only once.

4. This practice, that is reported to have cost German taxpayers more than €55 billion according to EU media, is currently being investigated by German prosecutors, who are assessing the involvement of accountants, tax advisors, investment firms and law firms. At the same time, tax authorities in Germany are trying to recover the tax refunds that they consider as illegal.

5. At this stage no criminal court judgment has been made available to ESMA, declaring the above practice as fraudulent. However, while no comprehensive overview of all court cases is available, in Germany final tax court rulings, against which no legal remedies are admissible anymore, have denied repaying capital yield tax in the context of share transactions based on Cum/Ex-schemes.

6. Further to the media investigations, on 21 October 2018 ESMA received a request from MEP Sven Giegold asking ESMA to initiate on its own initiative an inquiry into the subject.

7. On 14 January 2019 ESMA received a letter from MEP Markus Winkler on behalf of the President of the European Parliament, transmitting the Resolution 2018/2900 (RSP) of 29 November 2018, whereby the European Parliament requested ESMA to conduct an inquiry into those schemes[2] in order to:

    — assess potential threats to the integrity of financial markets and to national budgets;

[2] The EP Resolution 2018/2900 (RSP) of 29 November 2018 requests ESMA "*to conduct an inquiry into dividend arbitrage trading schemes such as Cum/Ex and Cum/Cum*". Those trading schemes and their relevance to pursue multiple withholding tax reclaims is described in the next sections of this report.

— establish the nature and magnitude of actors in these schemes;

— assess whether there were breaches of either national or Union law;

— assess the actions taken by financial supervisors in Member States;

— make appropriate recommendations for reform and for action to the competent authorities concerned.

8. ESMA discussed the issue with relevant market experts (through its Market Integrity Standing Committee) in order to assess the magnitude of the practice and how widespread it actually is across the EU, to what extent the scheme is connected with short selling and market abuse practices and any potential solution to prevent/detect the phenomenon.

9. ESMA also analysed the phenomenon from the perspective of firms' obligations under the MiFID II legal framework. Furthermore, ESMA reviewed relevant EU-wide market data.

10. Additionally, ESMA has also analysed the legal framework to see whether the information that the National Competent Authorities receive within the MiFID II and the Market Abuse Regulation regimes could be shared with the national tax authorities. The findings of this analysis are included in section 5.2 of this report.

11. On 29 March 2019 ESMA received another letter from MEPs Giegold, Berès, Karas and Klinz emphasising that the EP Resolution called upon "*EBA and ESMA to conduct an inquiry on the basis of Article 22(4) of the respective ESAs Regulation*", highlighting ESMA's insufficient response to the EP Resolution.

12. In the MEPs' view, threats to the integrity of a market "*go beyond questions of legality. Market integrity encompasses the fair and safe operation of markets, without misleading information or inside trades, so that investors can have confidence and be sufficiently protected. Integrity means more generally the adherence to strong moral and ethical principles and values*".

13. MEPs conclude stating that if "*no further action is taken, the European Parliament will of course reserve its right to initiate another resolution on the matter*".

14. Following an in depth discussion, the ESMA Board of Supervisors has agreed to submit to the European Parliament this Report and has also approved the launch of a formal inquiry under Article 22(4) of the ESMA Regulation. Should the results of this formal inquiry provide additional elements not already contained in this report, ESMA will report them to the European Parliament accordingly.

3 Dividend arbitrage and multiple WHT reclaim schemes

15. When issuers distribute dividends, the tax law of some Member States provides for a withholding tax (WHT) on the dividends distributed to be withheld by the issuer. At the same time, in some jurisdictions the tax law provides for a tax certificate to be issued (often by the shareholder's custodian bank) and, in all those cases where the shareholder is not a tax subject in the State of distribution of the dividend, it can be later claimed back in the form of a reimbursement from the tax authorities.

16. Dividend arbitrage strategies have existed for many years in EU financial markets and involve the placement of shares in alternative tax jurisdictions around dividend dates, with the aim of minimising the relevant tax on dividends.

17. Dividend arbitrage strategies therefore require the establishment of an equity position cum-dividend in a tax-favourable jurisdiction. That equity position needs to be later 'unwound', i.e. returned to their original less favourable jurisdiction.

18. Those strategies are often structured in a way that an investor lends or sells its shares to a borrower/buyer domiciled in a country that has a lower dividend tax rate, so as to minimise the taxes paid on such dividend. The borrower/buyer receives the dividend paid out by the issuer of the share and then returns it to the lender/seller, minus the dividend tax and a percentage – or "cut" – negotiated between the two counterparties.

19. Typologies vary and may involve various forms of Cum/Ex or Cum/Cum trading. It should be noted that, in the absence of a unique definition, semantically Cum/Cum and Cum/Ex merely refer to the dates of the trade which establishes a position (always cum-dividend) and the dates of eventual delivery, settlement, unwind or financing of that trade (either cum-dividend or ex-dividend). All the other elements of the scheme, including the instrument used (shares, stock loans, options/ forwards/ futures, ETFs, ADRs, etc.), the number of participants, the existence of shares, the jurisdiction of participants, and the legitimacy of requests to tax refunds may vary in each case. Given the breadth of potential typologies, the mechanics of such trading cannot be generalised, and an in-depth examination of the structure of each specific scheme is required.

20. However, in some schemes achieving a dividend arbitrage is not the main objective, as the real intention is to obtain multiple issuance of tax certificates and the consequent multiple refunds of taxes to multiple persons, with only one of them having actually received the dividend distributed and paid the relevant WHT[3].

21. Some of the schemes exposed by the journalistic investigation reported by the media in October 2018 were connected to the double issuance of tax certificates and double refunds of taxes to two holders of securities, with only one of them having actually received the dividend distributed. Other schemes had different characteristics but were also used to potentially commit fraud in relation to withholding taxes.

22. Even though ESMA's initial analysis mainly focused on the Cum/Ex scheme, its conclusions may cover any scheme which involves transactions (Cum/Ex or Cum/Cum[4]) aimed at creating the paperwork (incl. tax certificates) which allows persons to obtain tax refunds on dividend tax which was not paid, and which is likely to represent a fraud under national legislation. It is not, however, in the remit of ESMA to qualify these behaviours as illegal or fraudulent. In this respect ESMA has to rely on national legislation and national Courts' decisions.

[3] In some cases, potentially no persons have actually received any dividend, and both the trading and WHT reclaims are wholly based on fictitious shares.

[4] Some scheme typologies may combine a mixture of Cum/Cum and Cum/Ex trading and may even involve Ex/Ex financing.

23. Differently, one could argue that dividend arbitrage, in its most basic form, i.e. trading actual shares in such a way as to place these shares in a favourable tax jurisdiction (whether on a Cum/Ex or Cum/Cum basis), to then obtain a tax refund on tax which was actually paid, may well not be fraud. The wider and different discussion as to whether it is tax evasion or tax avoidance and whether this is an illegal practice under the tax law of each Member State will not be the subject of ESMA's assessment. Furthermore, it is not the subject of this report whether these types of practices, even if legally acceptable, is acceptable or not from a moral or ethical point of view.

4 Analysis of multiple WHT reclaim schemes

4.1 The Experience of the National Competent Authorities

24. ESMA's initial analysis indicates that multiple WHT reclaim schemes have been reported and are being investigated in three Member States; Germany, Denmark and Austria. The Ministry of Finance of Luxembourg has declared that it cannot be excluded that Luxembourg may have also been the target of those schemes. In the Netherlands and in the UK multiple WHT reclaim schemes have been reported but only as a potential tax fraud to the detriment of other Member States.

25. In particular, it is clear that a multiple WHT reclaim scheme can by nature be perpetrated only to the detriment of those countries where the tax law provides for WHT on the dividends distributed, in some cases associated with the issuance of tax certificates that can be later on claimed back in the form of a reimbursement from the tax authorities.

26. The main problem in those cases that involve the issuance of tax certificates is that they do not contain any reference that allows to directly and automatically link a given tax certificate to the underlying distribution of a dividend, and therefore multiple issuance of certificates and multiple refunds for a given distribution of dividend are possible.

27. In Germany, for example, until 2012 the WHT was collected by the issuer, whereas the tax certificate was issued by the shareholder's custodian bank. This system allowed for two or more tax certificates to be issued and thus enabled two or more investors to claim WHT refunds even though only one of them actually received the dividend distributed and paid the WHT. From 2012 on, since the custodian banks are responsible both for collecting the WHT and issuing the tax certificates, it should be no longer possible to issue multiple tax certificates for a single WHT paid. It is currently under discussion whether other schemes have been used after 2012 (e.g. issuing American Depository Receipts).

28. A simplified description of one of the multiple WHT tax schemes that took place in Germany is contained in Appendix I.

29. According to the analysis carried out by ESMA on the multiple WHT reclaim scheme, it emerged that:

    A. the scheme can be perpetrated through a <u>wide range of trading typologies</u> deployed by different entities;

B. it is characterised by a high level of sophistication and complexity to give the impression that a series of genuine claims have taken place;

C. it involves both supervised entities and non-supervised entities across jurisdictions and involves orchestrated and pre-ordained trading strategies, centrally coordinated by a limited number of sophisticated persons who have the full picture of the scheme.

D. the trading behaviour is fragmented, often split across multiple clients, firms and jurisdictions;

E. it shows circular trading patterns undertaken for the purpose of eventually netting positions (potentially unfolding and unwinding even months later) and hedging risks in the meantime. In that sense, at a glance the scheme resembles wash trades carried out to increase the volumes and attract investors leveraging on the fictitious increased liquidity (while no actual transfer of ownership takes place), but a deeper analysis shows a substantial difference in their nature and that none of those elements found in wash trades are actually present in the multiple WHT reclaim schemes;

F. it involves high volumes of trading in percentage of the outstanding shares in relation to large capitalisation EU index stocks. The only way for rendering the scheme profitable is to engage in unlawful multiple claims of tax refunds, making it more profitable if carried out in large scale;

G. the scheme involves transactions carried out on venue but also over the counter (OTC). OTC volumes may not be clearly obvious to other market participants. It should be highlighted that even though the OTC volumes connected to the scheme are usually large, in some cases they may appear lower than they actually are, due to the fact that some of the entities involved may not have to report all/any trades to financial regulators;

H. given that the scheme is highly profitable per se, it is designed not to interfere with the price formation and not to commit market abuse. Therefore, often it is not detected by the National Competent Authorities' market surveillance systems, expressly conceived to detect insider dealing and market manipulation;

I. given its high level of complexity and that it does not seem to involve violations of the market abuse regime, it is unlikely to be reported to the National Competent Authorities as part of the Suspicious Transactions and Orders Report obligations under the Market Abuse Regulation;

J. for the scheme to be successfully completed, short selling transactions are in many cases conducted. In theory, the scheme does not necessarily involve violations of the short selling obligations. However, given the high volumes of trades, short sales are often not covered as requested by the Short Selling Regulation, while in some instances violations of the obligations to report net short positions to National Competent Authorities have been identified, allegedly in order not to raise the authorities' attention to the scheme;

K. when investigated, it emerged that there is no or limited evidence of existence of share ownership (firms and individuals purporting to own shares do not appear on central securities depositories registers or custodians on the record date), nor is there a link with the actual receipt of the net dividend distributed;

L. there seems to be a mixture of legitimate and potentially illegitimate conduct at firm level;

M. in the execution of the scheme, entities often make use of legal advice or opinion to provide an appearance of legitimacy.

30. The formal inquiry launched by ESMA will aim at gathering additional information on the nature of the entities involved, and to assess the potential involvement of other vehicles or funds set up through shells in other jurisdictions.

31. In general, the schemes appear to be aimed exclusively to obtain multiple repayments of a single WHT paid upon distribution of dividends (i.e. potentially involving a tax fraud) often using a short selling transaction. Even though in certain cases market abuse violations may be found, the schemes do not seem to be necessarily related to violations of the market abuse regime.

32. In that respect, it should be considered that market integrity should encompass the fair and safe operation of markets, without misleading information or inside trades, so that investors can have confidence and be sufficiently protected.

33. Therefore, although multiple WHT reclaim schemes seem to be aimed at perpetrating a potential tax fraud, with no direct connections with violations of the market abuse regime, ESMA acknowledges that these schemes take place in the financial markets. As financial market regulators, the ESMA Board sees the need to understand those schemes to assess the extent to which these practices may fall under National Competent Authorities' remit and help identify potential solutions and best practices that might prevent or better detect such fraudulent activities.

4.2 ESMA's preliminary analysis regarding the MiFID II framework

34. The case at hand concerns the possible involvement of some financial institutions in disputable practices. The technical way to put in place these practices and the degree of involvement of supervised entities may differ (both supervised and non-supervised entities are involved with varying roles). Depending on national tax law some of these practices, or the technical way in which they are executed, may or may not constitute an illegal practice.

35. Even if national tax law allows these practices, or many other tax optimisation schemes, they may be considered ethically or morally disputable.

36. It should therefore be considered whether MiFID II requirements applicable to investment firms and credit institutions allow and require National Competent Authorities to pursue intermediaries involved in these (or in any other) dividend arbitrage practices, under which conditions and within which boundaries.

37. This analysis does not cover the AML regulatory framework nor other pieces of legislation which could be relevant (such as the CRD IV/CRR) and for which ESMA has no or a limited

competence. Furthermore, this analysis is obviously without prejudice to any other national legislation and the competence of other administrative authorities (such as Tax authorities) and Courts to pursue behaviours which are illegal under respective national legislation.

38. The main MiFID II requirements which can be relevant in the case at hand are the following:

- The obligation for national competent authorities to monitor the activities of investment firms to ensure that they act honestly, fairly and professionally and in a manner which promotes the *integrity of the market* (Article 24 of MiFIR[5] - *Obligation to uphold integrity of markets*, included in Annex 2 to this report).

- The obligation for National Competent Authorities to ensure that investment firms and their management bodies comply, inter alia, with requirements on the suitability of management bodies, which require members of these bodies to *act with integrity* (Article 9 of MiFID II - included in Annex 2 to this report - which, inter alia, cross refer to Article 91(8) of CRD IV, applicable to credit institutions and investment firms).

39. The perimeter of these requirements identifies the scope of supervisory powers and duties by National Competent Authorities under MiFID as well as the possibility and the right to take enforcement actions under MiFID vis-a-vis the investment firm and/or its directors for the violation of these obligations.

40. In relation to Article 24 of MiFIR (please see paragraph 38 above), the terms “integrity of the market” is commonly understood as a reference to the sound and orderly functioning of the financial market (threatened by breaches of financial legislation such as market manipulation and insider dealing). In this respect, *in abstracto*, the practices described above, even if they were considered illegal under tax law, per se do not necessarily threaten the integrity of the market.

41. On the other hand, and depending on the concrete circumstances of each case, one may find that large-scale, long running tax schemes which are fraudulent, and which are perpetuated through the financial markets, can create disorderly markets or can result in abusive market practices and can therefore have harmful consequences to the integrity of the market. At this stage, based on information available to ESMA, no direct connections between these tax practices and disorderly markets or abusive market practices has however emerged.

42. In relation to the second set of requirements (please see paragraph 38 above), Article 9(3) of MiFID II has emphasised the role of management bodies which are directly responsible for a firm’s governance arrangements to ensure the effective and prudent management of the firm, in a manner that promotes the integrity of the market and the interest of clients. In addition, MiFID II (by cross-reference to the CRD IV) provides that each member of a firm’s management body shall act with “*honesty, integrity and independence of mind*” to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor decision-making. Therefore, members of a firm’s

[5] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

management body may also be in breach of MiFID II/CRD IV on the basis that they do not act with integrity when (consciously or negligently) allowing the firm to facilitate an illegal practice, even beyond the violation of MiFID or other financial legislation.

43. The assessment of whether these requirements[6] have been violated however would require additional information on the illegality of a given practice[7] and on the degree of involvement of supervised entities and their directors (or on how widespread a practice in a given financial institution was). Under MiFID II, the possible sanctions would be administrative ones such as fines and disciplinary sanctions (up to the dismissal of members of management bodies). Any criminal sanctions incurred for a violation of MiFID II is dependent on national legislation.

4.3 Dividend-related trades: evidence from market data

44. To try to identify multiple WHT reclaim schemes from basic forms of dividend arbitrage[8], ESMA looked into the following market data:

— Cash trading volumes

— Securities lending volumes

45. In theory, both multiple WHT reclaim schemes and basic forms of dividend arbitrage may be structured using either regular cash transactions or securities lending transactions, reflecting national specificities, making it difficult to associate precisely EU-wide increases in traded volumes during the dividend season to one or another scheme. Moreover, increased trading activity around ex-dividend dates may simply reflect normal market reaction as investors digest company news.

46. The analysis is based on commercial data providers. This reflects the current unavailability of EU-wide data. Cash transaction details are available to national authorities, but not at EU-wide level. Granular transaction-level data on securities lending will become available once reporting begins under the EU Regulation on Securities Financing Transactions (SFTR), in April 2020.

47. Data on net short positions in EU shares reported under the EU Short Selling Regulation were also investigated, using the aggregate value of net short positions on individual issuers and the number of position notifications received by National Competent Authorities. There were no noteworthy developments to highlight. However, it is unclear whether this is an accurate reflection of market positioning around dividend payments, or whether this is related to SSR-specific features, namely the reporting thresholds (net short

[6] The EBA's view in relation to management body requirements for credit institutions should also be taken into account.

[7] The identification of these schemes as illegal practices may have an impact on whether members of a firm's management body may be regarded as having acted without integrity.

8 Dividend arbitrage has existed for many years in EU financial markets. For example, dividend arbitrage was first highlighted in ESMA's Report on Trends, Risks and Vulnerabilities (TRV), No.2, 2014, "The systemic relevance of securities financing markets in the EU", p.59, and then constantly monitored and underlined again in several subsequent ESMA TRV reports.

positions are to be reported only above certain thresholds, so net short positions below the thresholds were not considered) and the market-making exemption (market making activities are exempt from the reporting requirements).

4.3.1 Cash trading

48. A recent paper including empirical evidence on Cum/Ex trading in German stocks shows increasing transaction numbers shortly before ex-dividend dates, in particular before 2011 (Buettner et al., 2018)[9]. Our analysis relies on a similar methodology, focusing on stock-trading volumes around ex-dividend dates[10]. The first sample includes all ordinary shares that compose the Euro Stoxx 50 index in 2018, the second sample focuses on four EU Member States that are reportedly looking into multiple WHT reclaim schemes trading: Austria, Denmark, France, and Germany.

49. For the data[11] analysis, two alternative measures of cash trading volumes are considered: turnover and trade count. Turnover is the amount of shares expressed in the currency in which the instrument is traded. Trade count refers to the number of shares sold in a day.

50. Volumes up to eight trading days before and after ex-dividend dates are considered (i.e. 17 observations per share). For the majority of securities, this date falls in April or May, although there are national specificities and some companies pay dividends more than once a year (e.g. on a quarterly basis). In line with Buettner et al. (2018), cash trading from Cum/Ex trades should be reflected in large increases one or two days before the ex-dividend date.

51. As of November 2018, the Euro Stoxx 50 index includes ordinary shares from eight Euro Area countries[12]. For the 70 ex-dividend dates across the 50 shares comprised in the index, turnover peaks on the day before ex-dividend dates. However, this is mainly driven by a few stocks, with median turnover and trade count (not displayed) showing no particular pattern.

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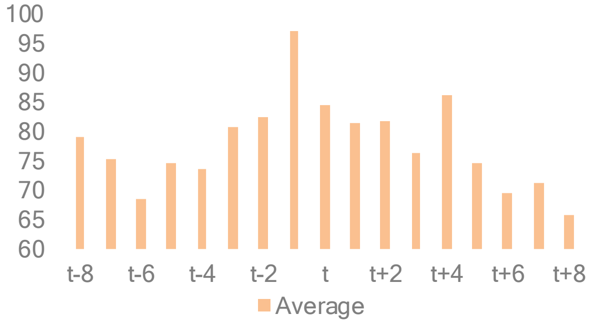
[9] T. Buettner, C. Holzmann, F. Kreidl and H. Scholz, 2018, “Withholding-tax non-compliance: The case of Cum-Ex stock-market transactions”.

[10] The so-called “Ex-dividend” date is the day that determines to whom dividends are paid out. The implication is that trading volumes should be highest around Ex-dividend dates, rather than the actual dividend payment date.

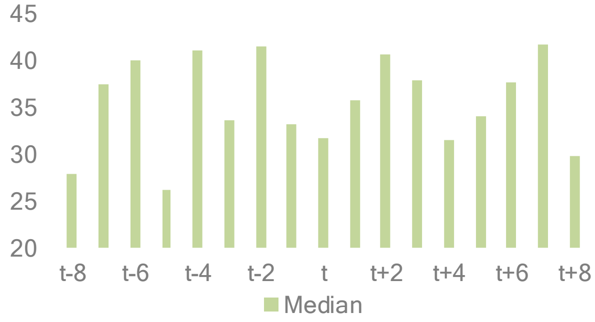
[11] Only volumes from the primary trading venues are included.

[12] These countries are Belgium (1), Finland (1), France (19), Germany (14), Ireland (1), Italy (3), Netherlands (5) and Spain (6).

Charts 1 and 2: Euro Stoxx 50 turnover per share in 2018 (t = ex-dividend dates)



Note: Average turnover in Euro Stoxx 50 shares, in million EUR. t=ex-dividend dates.
Sources: Thomson Reuters Eikon, ESMA calculations.

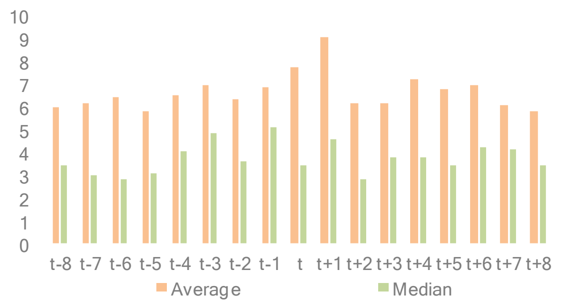


Note: Median turnover in Euro Stoxx 50 shares, in million EUR. t=ex-dividend dates.
Sources: Thomson Reuters Eikon, ESMA calculations.

52. The heterogeneity of the Euro Stoxx 50 index composition may to some extent influence those patterns. Indeed, national specificities in Cum/Ex or other multiple WHT reclaim schemes (or the absence thereof) may possibly lead to volume changes for some shares offsetting volumes for other shares. To circumvent this, trading volumes are subsequently analysed for the main blue-chip indices in Austria (ATX), Denmark (OMX 20), France (CAC 40) and Germany (DAX 30):

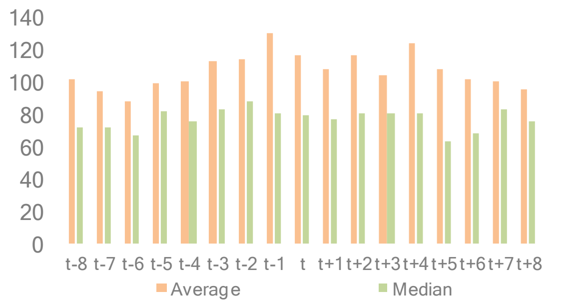
Charts 3, 4, 5 and 6: Index turnover per share in 2018 (t = ex-dividend dates)

Austria - ATX



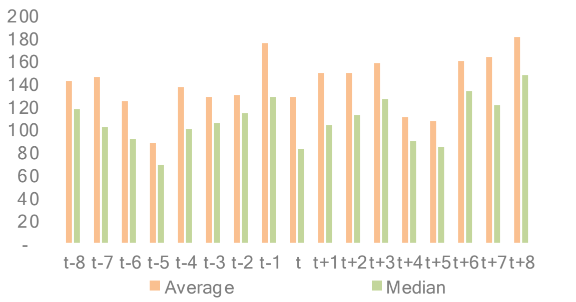
Note: Average and median turnover in ATX shares, daily data, in million EUR. t=ex-dividend date.
Sources:Tomson Reuters EIKON, ESMA calculations.

France - CAC 40



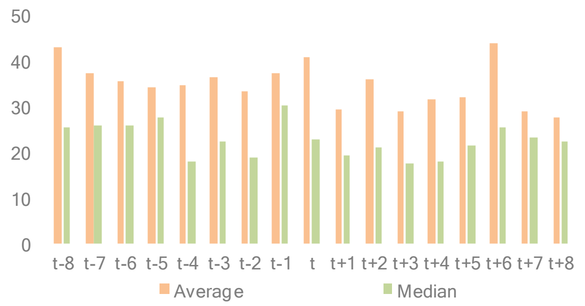
Note: Average and median turnover in CAC 40 shares, daily data, in million EUR. t=ex-dividend date
Sources: Tomson Reuters EIKON, ESMA calculations.

Germany - DAX 30



Note: Average and median turnover in DAX 30 shares, daily data, in million EUR. t=ex-dividend date.
Sources: Thomson Reuters EIKON, ESMA calculations.

Denmark - OMX 20



Note: Average and median turnover in OMX 20 shares, daily data, in thousand EUR. t=ex-dividend date.
Sources: Tomson Reuters EIKON, ESMA calculations.

53. The evidence from national indices is mixed. Average turnover in the four indices appear to show that cash trading does indeed increase in the days around ex-dividend dates. However, median values and trade counts again do not show any clear pattern or obviously abnormal trading activity.

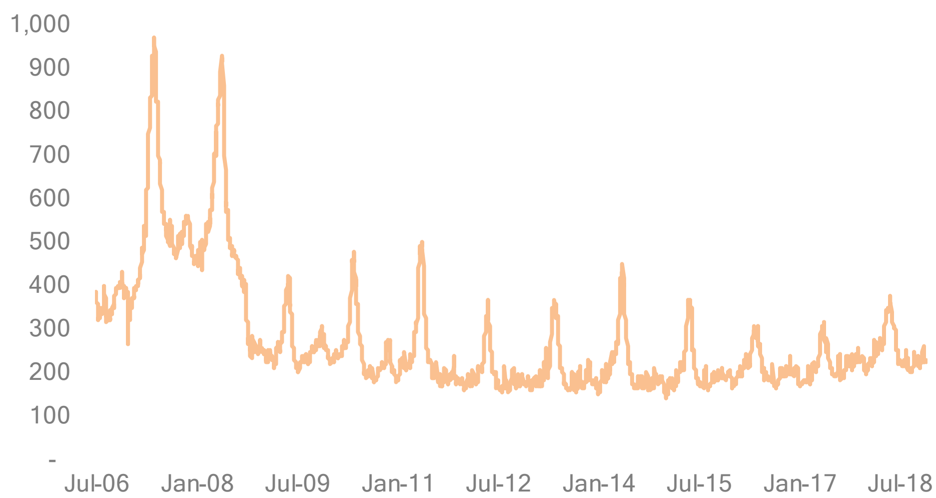
54. Higher-than-usual trading volumes around ex-dividend dates may simply reflect normal market reaction as investors digest company news. Drawing a conclusive link between the increased turnover and multiple WHT reclaim schemes is thus not possible on the basis of the analysed data.

4.3.2 Securities lending

55. The master agreement that governs the vast majority of securities lending transactions in Europe is known as the Global Master Securities Lending Agreement (GMSLA). Under the 2010 GMSLA, the borrower must manufacture back to the lender a sum of money equivalent to any income that the lender would be entitled to receive had it not loaned the relevant securities to the borrower.

56. Chart 7 shows the daily aggregate value of EU shares that are on loan, which has averaged at EUR 175bn over the past decade. The seasonal patterns reflect dividend arbitrage taking place each year in April and May. The difference between the lending peak during the main dividend season and the average for the rest of the year has fluctuated between EUR 150bn and 200bn since 2010.

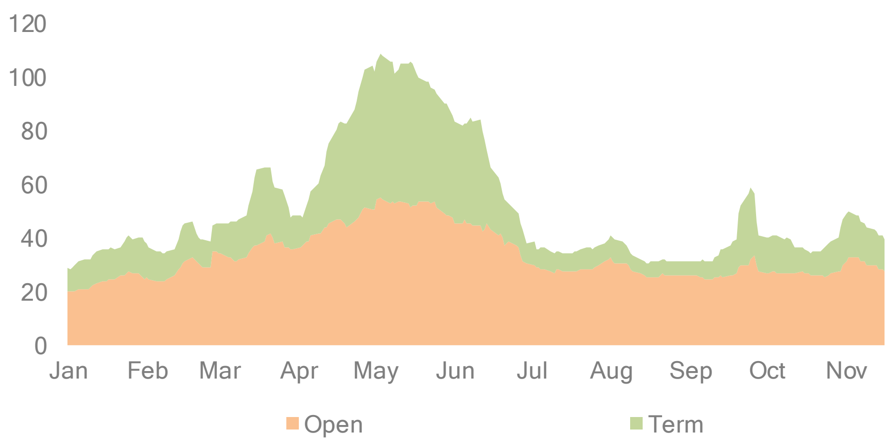
Chart 7: EU shares on loan (EUR billion)



Note: Total Value of EU shares on loan, daily data, in billion EUR.

57. Most equity loans are done on an open basis (i.e. no fixed maturity), which gives lenders the right to recall the security at any point in time. However, cyclical peaks suggest that investors tend to favour term lending for dividend arbitrage, possibly to reduce uncertainty[13]. The large increase in term loans of Euro Stoxx 50 shares (and the corresponding decline in average loan tenure) reflects this particular feature of the market (Chart 8).

Chart 8: Euro Stoxx 50 shares on loan by maturity type



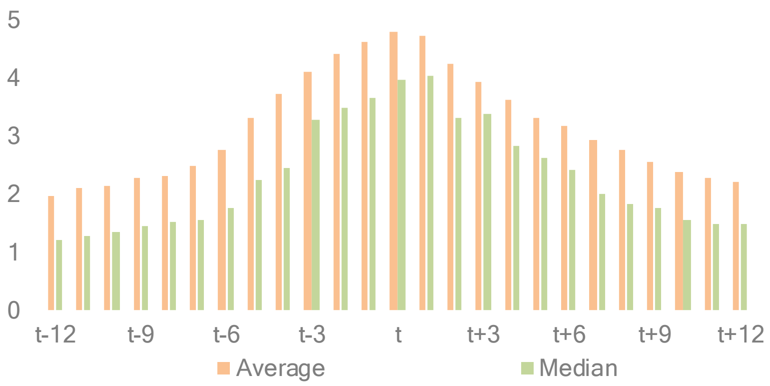
Note: Total value of Euro Stoxx 50 shares on loan, daily data, in billion EUR.

58. Following the same methodology as for cash trading, the value of EU securities on loan around the ex-dividend dates is calculated for Euro Stoxx 50 shares. Both the mean and

[13] In compensation for giving up this right, term transactions usually conjure higher borrowing fees. However, this does not apply in the case of Cum-Cum trades as it is the share of dividend manufactured back to the lender rather than the borrowing fee that is the object of the negotiation between the two counterparties.

the median display a pattern that clearly suggests the potential relevance of multiple WHT reclaim schemes and dividend arbitrage trades around dividend payment dates (Chart 9).

Chart 9: Average of Euro Stoxx 50 shares on loan around ex-dividend dates (EUR billion)



Note: Total value of Euro Stoxx 50 shares on loan, daily data, in billion EUR. t=ex-dividend date.

59. The size and frequency of the cyclical peaks appear to vary across countries, although the scale of dividend trading appears to have generally decreased since 2006-2008. In several countries (Germany, Italy and Austria), the peaks seem to have disappeared in recent years. However, it remains very significant in all other countries (e.g. in Belgium, Denmark, and Sweden relative to the average value on loan, and in France and UK in absolute terms).

60. The frequency of lending peaks also varies. For most jurisdictions, the largest increase in volume of loans occurs on an annual basis, typically around May. On the contrary, volumes appear to spike on a quarterly basis in a few countries (e.g. UK and Netherlands), presumably reflecting quarterly rather than annual dividend payments[14].

[14] Peaks in securities lending are also linked to operations aiming to increase voting rights at the General Assembly, since dividends are often paid soon after the General Assembly.

Charts 10-19: Shares on loan in selected EU Member States

Chart 10: Germany

Chart 11: France

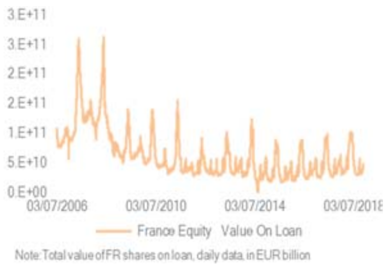


Chart 12: Italy

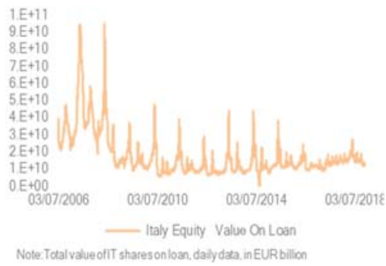


Chart 13: Spain

Chart 14: Netherlands

Chart 15: Belgium

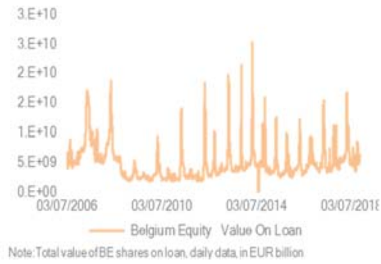


Chart 16: Austria

Chart 17: Denmark

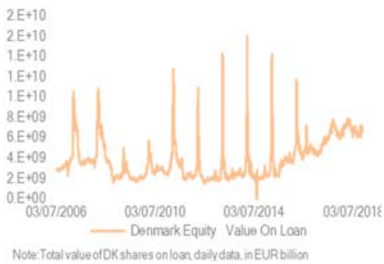


Chart 18: Sweden

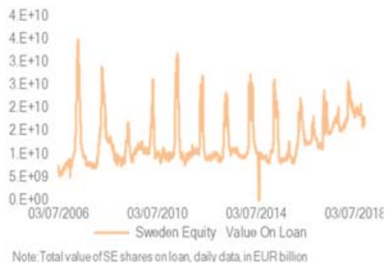
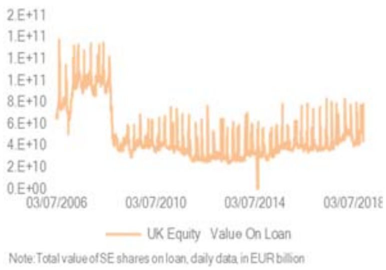


Chart 19: United Kingdom



5 Potential solutions to prevent and best practices to detect multiple WHT reclaim schemes

61. Given that the analysis carried out by ESMA has highlighted that a multiple WHT reclaim scheme has its roots in the fact that some national tax laws allow for the issuance of tax

certificates that do not contain any reference to the underlying distribution of dividends, ESMA would like to point out that a possible legislative change by those Member States could be beneficial, in order to make it possible to directly and automatically link a given tax certificate to the underlying distribution of dividends and/or to establish a single entity that is responsible for both collecting the WHT and issuing the tax certificate[15].

62. Once tax certificates can be directly linked to the underlying distribution of dividends, multiple issuance of certificates for a given distribution of dividends would no longer be possible, as the tax authorities would be in the position to make sure that only one repayment of WHT per distribution is done and that any additional claim is blocked and investigated. The same result may be achieved by entrusting a single entity to collecting the WHT and issue the tax certificate. In Germany, for example, since 2012 custodian banks are responsible both for collecting the WHT and issuing the tax certificate.

63. At the same time, ESMA has considered whether any best practice can be identified and shared among National Competent Authorities, in order for them to monitor the markets to detect and investigate those schemes.

64. Additionally, further to a request received by BaFin, ESMA has analysed the legal framework to see whether the information that the National Competent Authorities receive within the MiFID II and the Market Abuse Regulation regime could be shared with the national tax authorities, in order to foster inter agency cooperation against those potentially fraudulent schemes.

5.1 Potential best practices for National Competent Authorities to detect/investigate multiple WHT reclaim schemes

65. In this section ESMA has reported National Competent Authorities' best practices that could potentially be used to detect and investigate multiple WHT reclaim schemes. However, it should be highlighted that those practices have been identified thanks to the contributions of National Competent Authorities whose remit, due to national legislation, is not limited to the one assigned to them under the European legislative supervisory framework on financial markets.

66. Therefore, as further described below, the legal limitation to the remit of National Competent Authorities may prevent them from adopting some or all the below described best practices.

67. The information that ESMA has gathered from the National Competent Authorities has highlighted that multiple WHT reclaim schemes are not easily detected. This is mainly due to the fact that they do not typically involve violations of the Market Abuse Regulation and potential violations of the Short Selling regime are an ancillary part of the whole scheme. Therefore, they are often difficult to detect by traditional monitoring systems that National Competent Authorities have conceived and calibrated for those specific purposes.

[15] A number of Member States have already taken steps in the form of legislative measures to ensure that multiple WHT reclaim schemes can no longer take place.

68. In particular, the traditional market surveillance carried out on transaction reporting data received by National Competent Authority under the MiFID II regime, together with the suspicious transactions and orders report regime under the Market Abuse Regulation have to be cross referred to other sources of information in order to detect multiple WHT reclaim schemes.

69. Nonetheless, the assessment carried out by ESMA has shown that the National Competent Authorities' existing monitoring tools, i.e. systems to prevent and detect market abuse and short selling violations, could potentially be used to screen the information available and raise a flag regarding those situations that may hide multiple WHT reclaim schemes.

70. It should be noted however that such information might only become available post facto.

71. In that sense, National Competent Authorities are in principle in possession of tools to undertake enhanced market surveillance around key distribution of dividends dates, that is when multiple WHT reclaim schemes take place. To effectively detect potential multiple WHT reclaim schemes, the National Competent Authorities would need to gather more information on the elements of the schemes. For example, some elements include securities lending transactions and information about these transactions is currently not available to National Competent Authorities. The additional information provided by the upcoming reporting under SFTR may therefore become valuable for National Competent Authorities to be analysed in light of this aspect of market surveillance.

72. Markets surveillance around dividend dates by National Competent Authorities could represent a useful starting point to identify transactions requiring further and closer examination of unusual or suspicious trading patterns.

73. However, it should be noted that the monitoring powers, as well as the more intrusive investigative powers given to National Competent Authorities by the Market Abuse and the Short Selling Regulations, are to be linked to the legal basis for which the Co-Legislator attributed those powers, i.e. the combat of market abuse and short selling violations.

74. Whenever it becomes evident that no violations of the market abuse nor the short selling regime have taken place (as it seems to be in the case of multiple WHT reclaim schemes), the National Competent Authorities will not have the legal basis to resort to those powers. Even where violations of the short selling or the market abuse regime are identified, National Competent Authorities will not have the legal basis to resort to those powers to continue investigating the schemes further than in relation to the said market abuse and short selling violations.

75. Therefore, it seems that for most National Competent Authorities to be able to take action against multiple WHT reclaim schemes other than in the pursuit of violations of the Market Abuse or the Short Selling Regulation, their remit would have to be expanded through a legislative change. ESMA will assess whether it is possible and appropriate to deal with this issue within the process of adopting technical advice to be delivered to the European Commission in the context of the review of the Market Abuse Regulation[16].

[16] An extension of NCAs' remit in the manner envisaged would require an evaluation of the consequences on their existing remit.

76. Below ESMA reports some **best practices** that could represent a way forward for the National Competent Authorities to detect and investigate multiple WHT reclaim schemes, **subject to an extended remit that would allow for such wider NCA investigation powers**.

77. The best practices shared by some National Competent Authorities have highlighted that:

A. given the complexity of the schemes, it is difficult to have visibility over the full trading strategy. As to be profitable a multiple WHT reclaim scheme has to be perpetrated in large volumes, in order to detect such schemes specific and calibrated alerts could be set up in the surveillance systems based on the transaction reporting data, e.g. triggered when the percentage of traded shares reaches a significant level.

   As an alternative, where a National Competent Authority cannot carry out an ongoing exercise through calibrated alerts, it could perform a selective analysis around the key distribution of dividends dates for those shares that are deemed more likely to be the target of a multiple WHT reclaim scheme;

B. further to an alert or an anomaly being found, a preliminary enquiry could be opened, proactively following up on who and what trading strategies are driving the volumes traded;

C. National Competent Authorities could also take into account the information from central securities registers to check whether actual settlement and changes in the register ownership have taken place and whether transaction reporting data matches observed trading;

D. National Competent Authorities could also check the short selling register to determine what was declared under the obligation to report net short positions, as multiple WHT reclaim transactions that led to significant net short positions are less likely to be reported;

E. even where the off-exchange market seems to be small, the nature of the scheme is that the entities involved may not report all or any trades (in that case a breach of reporting obligations would also materialise).

   National Competent Authorities should liaise with central securities registers and also with tax authorities to understand the totality of available data. However, in some Member States (e.g. in Germany) the majority of shares are issued as bearer shares and not as registered shares. Consequently, there is no securities register kept by the company so far;

F. on identification of any instances of significant trading, the National Competent Authorities could then follow up directly with some firms via correspondence and visits, to understand the nature of the trading and who the underlying clients might have been. Where examined, the majority were institutional clients, with legitimate custodians who could provide verification of share ownership and consequential entitlement to the net dividend;

G. overall, the process of investigating complex phenomena such as multiple WHT reclaim schemes is resource intensive, and National Competent Authorities would need to have in place dedicated organisational structures composed of experienced staff and appropriate IT software;

H. given the complexity of the scheme, even those firms that were indeed involved in it often did not have visibility over the full trading strategy;

I. multiple WHT reclaim schemes cross the supervisory remit of the single authorities (National Competent Authorities and tax authorities), with none of them having the full picture;

J. the identified best practices of surveillance and market monitoring should be carried out primarily by the National Competent Authorities of those Member States that can be the target of the schemes, as they are in the best position by virtue of receiving all transaction reports about the relevant security. It should be noted though that there are still restrictions associated with the transaction reporting regime, e.g. in case of transaction chains involving links outside the scope of the transaction reporting regime.

78. Overall, it appears that further cooperation and mutual assistance between National Competent Authorities, tax authorities and other law enforcement bodies could potentially help to prevent the perpetuation of these types of schemes.

79. The analysis of the current legal framework on the possibility to share the information that the National Competent Authorities receive on the basis of MiFID II and the Market Abuse Regulation with the national tax authorities is presented in Section 5.2.

80. As any exchange of information between authorities must be done under a clear legal basis, in the absence of which such information exchange cannot take place, any attempt to foster cross sectoral supervisory cooperation may require a legislative change. In that respect, it should be pointed out that the impact on internationally accepted standards in the field of cooperation and information exchange amongst Competent Authorities would then need to be examined, as they currently do not allow for onward sharing of information to fiscal authorities.

5.2 Summary of the legal observations on the possibility for National Competent Authorities to transmit to tax Authorities information regarding STORs received from other National Competent Authorities and TREM data

81. ESMA has analysed the question whether STORs received from a National Competent Authority of another Member State and data received via TREM could be used for purposes different to those for which the information has been transmitted.

82. More specifically, in the case at hand the different purpose consists of screening the information for tax purposes and/or providing the – non-anonymized – information to the Tax Authorities for possible detection of tax infringements.

83. On the basis of the legal observations set out, EU financial law (namely the Market Abuse Regulation, MiFID II and MiFIR) does not provide any legal basis to a National Competent Authority receiving relevant information under those pieces of legislation to transmit it to the tax Authorities.

84. More specifically, regarding STORs received from another National Competent Authority in the context of the Market Abuse Regulation, Articles 16, 25 and 27 of that Regulation (included in Annex 2 to this report) were considered with respect to the potential use of such information for tax purposes. However, based on further legal analysis it needs to be concluded that none of these legal provisions could be used as a legal basis by the National Competent Authority receiving the information for screening it for tax purposes and/or forwarding it to a national tax authority.

85. Articles 16, 25 and 27 of the Market Abuse Regulation have to be interpreted in the context of that Regulation, thereby taking into consideration the purpose of prevention and detection of market abuse. In addition, one needs to take into account the specific legal provision(s) on which the foreign National Competent Authority relies in order to transmit the relevant information to a National Competent Authority of another Member State. Consequently, the National Competent Authority receiving the relevant information is restricted with respect to the potential use of it and therefore might only use it in the context of activities of the Market Abuse Regulation, i.e. unless otherwise foreseen the National Competent Authority receiving the relevant information needs to take into consideration the purposes for which the foreign National Competent Authority provided this information to it.

86. The same is relevant in the context of the framework of MiFID II and MiFIR regarding data exchanged between National Competent Authorities via TREM. ESMA analysed several legal provisions, namely Article 26 MiFIR as well as Articles 81(2) and (3) MiFID II and 76(3) and (4) MiFID II (included in Annex 2 to this report).

87. As regards the data provided to it by a foreign National Competent Authority, the National Competent Authority receiving relevant data needs to take into account the purpose for the transmission of the data to it as set out in the relevant articles of the MiFID II framework. Therefore, data collected in the context of the MiFID II framework can in general only be used in accordance with the situations described in the relevant legal provisions.

88. In particular, as regards the use of data transmitted to a National Competent Authority, Article 81 MiFID II contains specific provisions regarding the use of information exchanged between competent authorities. As regards the case at hand, the restrictions set out therein would not allow the National Competent Authority to – by default – make use of the data for tax purposes without the consent of the National Competent Authority that provided the relevant data to it.

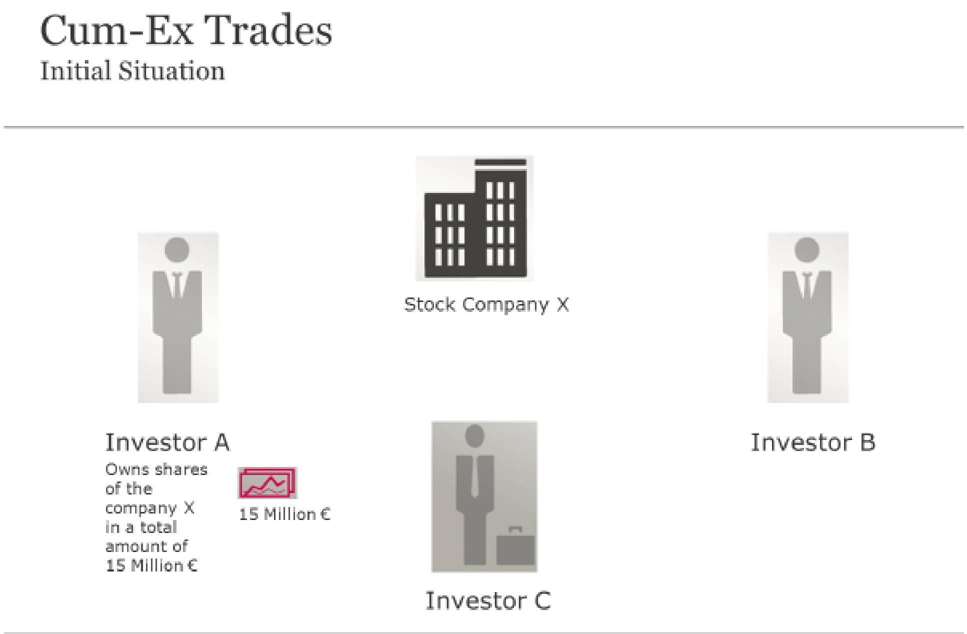
89. Taking into account the aforementioned as well as the specific context in which the National Competent Authority receiving the data would like to make use of it one has to assume that also Article 76 of MiFID II does not provide a legal basis for making use of the data for tax purposes.

6 Annexes

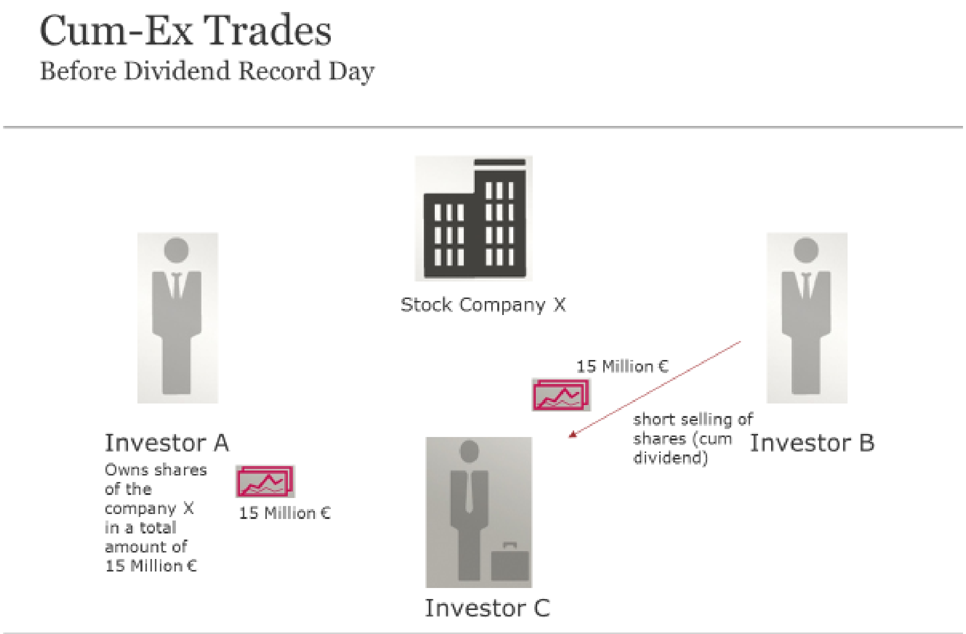
6.1 Annex 1 - Functioning of a multiple WHT reclaim scheme based on a basic Cum/Ex trading in Germany

1. The information gathered allowed to reconstruct the functioning of the scheme in Germany, which is explained with the aid of the slides below, involving for the sake of simplicity three investors (A, B and C) trading on share X.

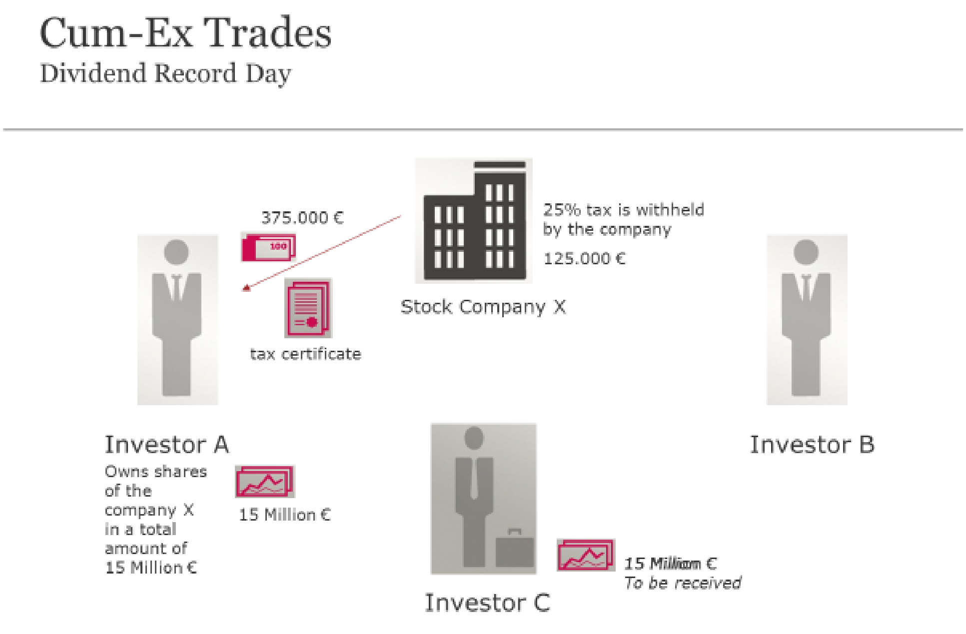
2. While this scheme has been identified in Germany, it seems to be potentially applicable to all those Member States where the tax law provides for the issuance of tax certificates that can then be claimed back in the form of a reimbursement from the tax authorities.



3. The starting point is the situation where Investor A owns shares X (in the example for an amount of 15 million Euro), where Company X is a highly liquid share listed on a German regulated market.



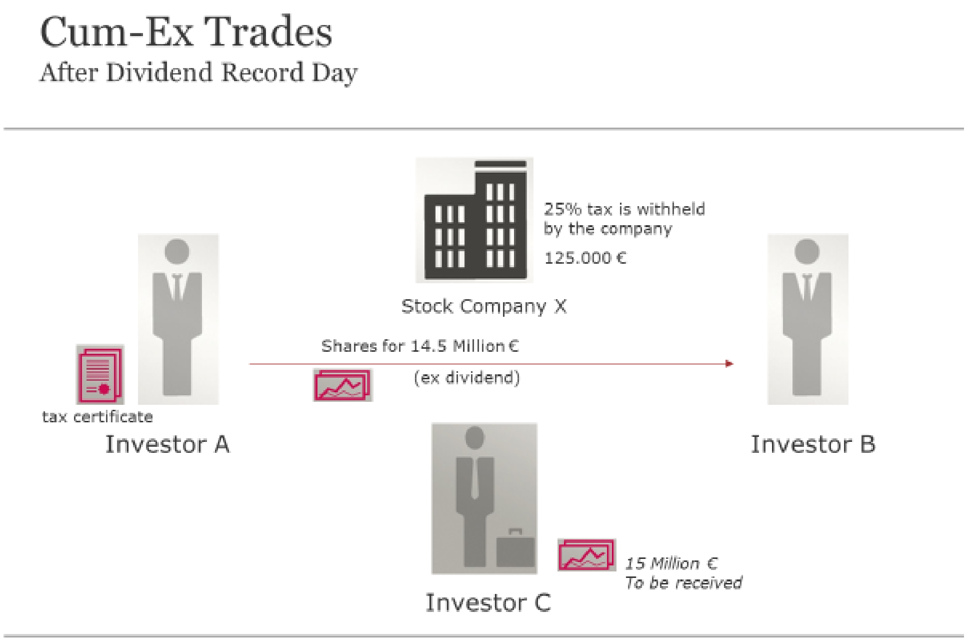
4. Shortly before the dividend is paid, Investor B short sells to Investor C shares X for the same amount held by Investor A. Investor B should enter into an arrangement to ensure that the shares X will be made available to Investor C in time for settlement (in T+2, given that the transaction has been executed on exchange). Investor C buys the shares CUM dividend.



Cum-Ex Trades

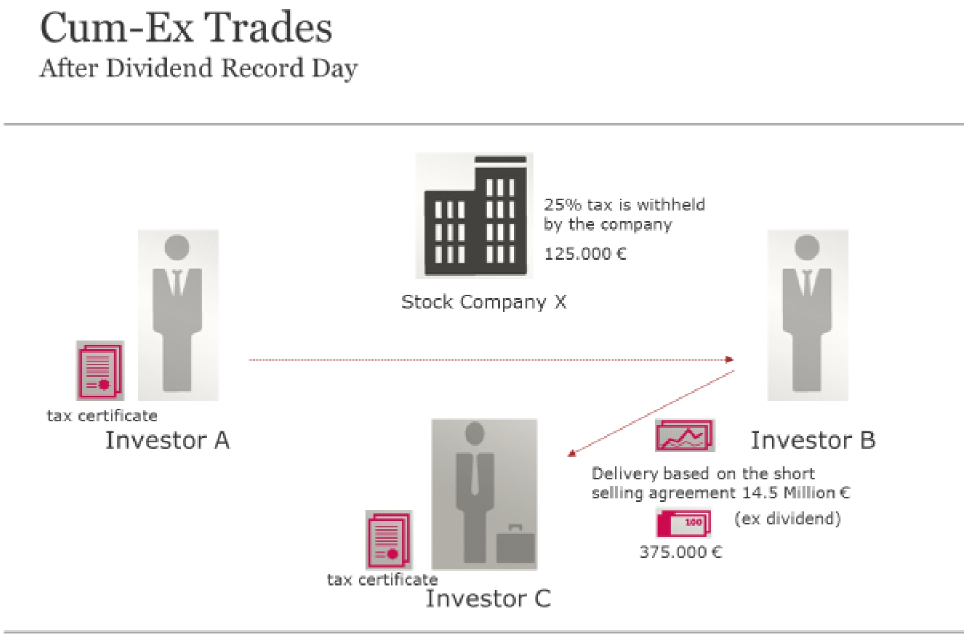
5. On the day Company X distributes dividends, Company X withholds a 25% tax that is directly paid to the German government. Investor A receives a tax certificate from its

custodian bank that will allow them to claim for a tax refund for the amount withheld. BaFin explained that, in Germany, the tax certificate does not contain the details of the transaction.



Cum-Ex Trades

6. After the distribution of dividends, Investor B buys over the counter (OTC) shares X from Investor A, in order to benefit from a reduced time for settlement (shorter than the T+2 settlement time in regulated markets) and be able to deliver the shares for settlement to Investor C (to whom they were previously sold short). The shares obtained by Investor B are now EX dividend.



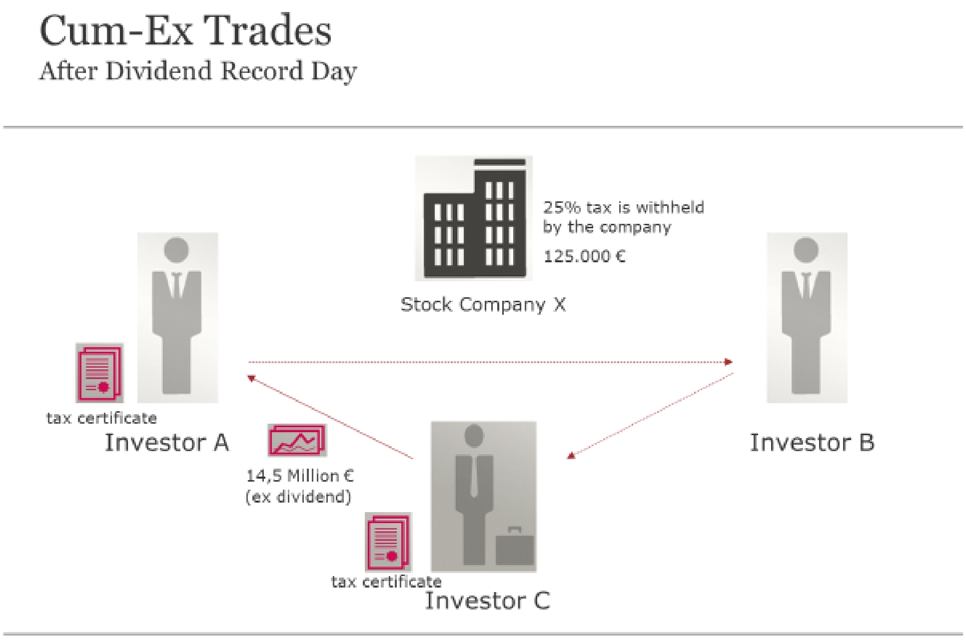
Cum-Ex Trades

7. Investor B delivers shares to Investor C in time for settlement. Given that Investor B should deliver to Investor C shares CUM dividend, but can only deliver shares EX dividend, Investor B pays an amount (375,000 Euro in the example in the slide below) as compensation to Investor C, which Investor B can pay since they received 15 Million Euro from Investor C.

8. Investor C receives shares for 14.5 Million Euro worth (EX dividend), compensated by a cash compensation of 375,000 Euro and a tax certificate from its custodian bank for 125,000 Euro, that Investor C will claim back from the Government. However, Investor C did not receive the actual dividend but only a compensation for not receiving it. The actual dividend was received by Investor A, which should be the only one entitled to receive the tax certificate.

9. The reasons for the custodian bank to be able to issue a tax certificate lies in the concept of "economic *ownership*", used in the German tax system as opposed to the legal ownership. In the scheme above, Investor C is the economic owner of the shares at the moment of the distribution of dividends, as Investor C bought the shares before the distribution of dividends and therefore at that time Investor C would bear any economic consequence attached to the ownership of the shares, even if the legal ownership will only be transferred with the settlement.

10. BaFin reported that, until 2012, a controversial reading of the German tax provisions seemed to have created a possibility that the economic owner should be entitled to the dividend, and therefore to the tax certificate related thereto.



Cum-Ex Trades

11. At the end of the scheme Investor C sells back the shares to Investor A.

12. The result of the whole scheme is that Investor A comes again into possession of the shares X, but overall the series of transactions resulted in two tax certificates being issued against a single distribution of dividend, with an overall profit that amounts exactly to the value of the tax certificate.

13. As the double issuance of a tax certificate is the only profit realised with the series of transactions described above (125,000 Euro, in the example above to the benefit of Investor B), the participants will share it at the completion of the scheme.

14. According to the German tax authorities, despite all possible interpretations regarding the concept of "economic *ownership*", the fact that at the end of the scheme the shares go back to the initial owner (Investor A) clearly showed that the scheme represented a potential tax fraud, as it served no other purpose than obtaining a second tax certificate for a unique distribution of dividends.

6.2 Annex 2 – Relevant legal provisions

6.2.1 Market Abuse Regulation[17]

Article 16

Prevention and detection of market abuse

1. Market operators and investment firms that operate a trading venue shall establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing, market manipulation and attempted insider dealing and market manipulation, in accordance with Articles 31 and 54 of Directive 2014/65/EU.

A person referred to in the first subparagraph shall report orders and transactions, including any cancellation or modification thereof, that could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation to the competent authority of the trading venue without delay.

2. Any person professionally arranging or executing transactions shall establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions. Where such a person has a reasonable suspicion that an order or transaction in any financial instrument, whether placed or executed on or outside a trading venue, could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation, the person shall notify the competent authority as referred to in paragraph 3 without delay.

3. Without prejudice to Article 22, persons professionally arranging or executing transactions shall be subject to the rules of notification of the Member State in which they are registered or have their head office, or, in the case of a branch, the Member State where the branch is situated. The notification shall be addressed to the competent authority of that Member State.

4. The competent authorities as referred to in paragraph 3 receiving the notification of suspicious orders and transactions shall transmit such information immediately to the competent authorities of the trading venues concerned.

(…)

Article 25

Obligation to cooperate

1. Competent authorities shall cooperate with each other and with ESMA where necessary for the purposes of this Regulation, unless one of the exceptions in paragraph 2 applies. Competent authorities shall render assistance to competent authorities of other Member States

[17] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, (OJ L 173 12.6.2014, p. 1).

and ESMA. In particular, they shall exchange information without undue delay and cooperate in investigation, supervision and enforcement activities.

The obligation to cooperate and assist laid down in the first subparagraph shall also apply as regards the Commission in relation to the exchange of information relating to commodities which are agricultural products listed in Annex I to the TFEU.

The competent authorities and ESMA shall cooperate in accordance with Regulation (EU) No 1095/2010, in particular Article 35 thereof.

Where Member States have chosen, in accordance with Article 30(1), second subparagraph, to lay down criminal sanctions for infringements of the provisions of this Regulation referred to in that Article, they shall ensure that appropriate measures are in place so that competent authorities have all the necessary powers to liaise with judicial authorities within their jurisdiction to receive specific information related to criminal investigations or proceedings commenced for possible infringements of this Regulation and provide the same to other competent authorities and ESMA to fulfil their obligation to cooperate with each other and ESMA for the purposes of this Regulation.

(…)

Article 27

Professional secrecy

1. Any confidential information received, exchanged or transmitted pursuant to this Regulation shall be subject to the conditions of professional secrecy laid down in paragraphs 2 and 3.

2. All the information exchanged between the competent authorities under this Regulation that concerns business or operational conditions and other economic or personal affairs shall be considered to be confidential and shall be subject to the requirements of professional secrecy, except where the competent authority states at the time of communication that such information may be disclosed or such disclosure is necessary for legal proceedings.

3. The obligation of professional secrecy applies to all persons who work or who have worked for the competent authority or for any authority or market undertaking to whom the competent authority has delegated its powers, including auditors and experts contracted by the competent authority. Information covered by professional secrecy may not be disclosed to any other person or authority except by virtue of provisions laid down by Union or national law.

6.2.2 MiFID II[18]

Article 9

Management body

1. Competent authorities granting the authorisation in accordance with Article 5 shall ensure that investment firms and their management bodies comply with Article 88 and Article 91 of Directive 2013/36/EU.

ESMA and EBA shall adopt, jointly, guidelines on the elements listed in Article 91(12) of Directive 2013/36/EU.

2. When granting the authorisation in accordance with Article 5, competent authorities may authorise members of the management body to hold one additional non-executive directorship than allowed in accordance with Article 91(3) of Directive 2013/36/EU. Competent authorities shall regularly inform ESMA of such authorisations.

EBA and ESMA shall coordinate the collection of information provided for under the first subparagraph of this paragraph and under Article 91(6) of Directive 2013/36/EU in relation to investment firms.

3. Member States shall ensure that the management body of an investment firm defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of the investment firm including the segregation of duties in the investment firm and the prevention of conflicts of interest, and in a manner that promotes the integrity of the market and the interest of clients.

Without prejudice to the requirements established in Article 88(1) of Directive 2013/36/EU, those arrangements shall also ensure that the management body define, approve and oversee:

(a) the organisation of the firm for the provision of investment services and activities and ancillary services, including the skills, knowledge and expertise required by personnel, the resources, the procedures and the arrangements for the provision of services and activities, taking into account the nature, scale and complexity of its business and all the requirements the firm has to comply with;

(b) a policy as to services, activities, products and operations offered or provided, in accordance with the risk tolerance of the firm and the characteristics and needs of the clients of the firm to whom they will be offered or provided, including carrying out appropriate stress testing, where appropriate;

[18] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), (OJ L 173 12.6.2014, p. 349).

(c) a remuneration policy of persons involved in the provision of services to clients aiming to encourage responsible business conduct, fair treatment of clients as well as avoiding conflict of interest in the relationships with clients.

The management body shall monitor and periodically assess the adequacy and the implementation of the firm’s strategic objectives in the provision of investment services and activities and ancillary services, the effectiveness of the investment firm’s governance arrangements and the adequacy of the policies relating to the provision of services to clients and take appropriate steps to address any deficiencies.

Members of the management body shall have adequate access to information and documents which are needed to oversee and monitor management decision-making.

4. The competent authority shall refuse authorisation if it is not satisfied that the members of the management body of the investment firm are of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their functions in the investment firm, or if there are objective and demonstrable grounds for believing that the management body of the firm may pose a threat to its effective, sound and prudent management and to the adequate consideration of the interest of its clients and the integrity of the market.

5. Member States shall require the investment firm to notify the competent authority of all members of its management body and of any changes to its membership, along with all information needed to assess whether the firm complies with paragraphs 1, 2 and 3.

6. Member States shall require that at least two persons meeting the requirements laid down in paragraph 1 effectively direct the business of the applicant investment firm.

By way of derogation from the first subparagraph, Member States may grant authorisation to investment firms that are natural persons or to investment firms that are legal persons managed by a single natural person in accordance with their constitutive rules and national laws. Member States shall nevertheless require that:

(a) alternative arrangements be in place which ensure the sound and prudent management of such investment firms and the adequate consideration of the interest of clients and the integrity of the market;

(b) the natural persons concerned are of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties.

Article 76

Professional secrecy

1. Member States shall ensure that competent authorities, all persons who work or who have worked for the competent authorities or entities to whom tasks are delegated pursuant to Article

67(2), as well as auditors and experts instructed by the competent authorities, are bound by the obligation of professional secrecy. They shall not divulge any confidential information which they may receive in the course of their duties, save in summary or aggregate form such that individual investment firms, market operators, regulated markets or any other person cannot be identified, without prejudice to requirements of national criminal or taxation law or the other provisions of this Directive or of Regulation (EU) No 600/2014.

2. Where an investment firm, market operator or regulated market has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties may be divulged in civil or commercial proceedings if necessary for carrying out the proceeding.

3. Without prejudice to requirements of national criminal or taxation law, the competent authorities, bodies or natural or legal persons other than competent authorities which receive confidential information pursuant to this Directive or to Regulation (EU) No 600/2014 may use it only in the performance of their duties and for the exercise of their functions, in the case of the competent authorities, within the scope of this Directive or of Regulation (EU) No 600/2014 or, in the case of other authorities, bodies or natural or legal persons, for the purpose for which such information was provided to them and/or in the context of administrative or judicial proceedings specifically relating to the exercise of those functions. However, where the competent authority or other authority, body or person communicating information consents thereto, the authority receiving the information may use it for other purposes.

4. Any confidential information received, exchanged or transmitted pursuant to this Directive or to Regulation (EU) No 600/2014 shall be subject to the conditions of professional secrecy laid down in this Article. Nevertheless, this Article shall not prevent the competent authorities from exchanging or transmitting confidential information in accordance with this Directive or with Regulation (EU) No 600/2014 and with other Directives or Regulations applicable to investment firms, credit institutions, pension funds, UCITS, AIFs, insurance and reinsurance intermediaries, insurance undertakings, regulated markets or market operators, CCPs, CSDs, or otherwise with the consent of the competent authority or other authority or body or natural or legal person that communicated the information.

5. This Article shall not prevent the competent authorities from exchanging or transmitting in accordance with national law, confidential information that has not been received from a competent authority of another Member State.

Article 81

Exchange of information

1. Competent authorities of Member States having been designated as contact points for the purposes of this Directive and of Regulation (EU) No 600/2014 in accordance with Article 79(1) of this Directive shall immediately supply one another with the information required for the purposes of carrying out the duties of the competent authorities, designated in accordance to

Article 67(1) of this Directive, set out in the provisions adopted pursuant to this Directive or Regulation (EU) No 600/2014.

Competent authorities exchanging information with other competent authorities under this Directive or Regulation (EU) No 600/2014 may indicate at the time of communication that such information must not be disclosed without their express agreement, in which case such information may be exchanged solely for the purposes for which those authorities gave their agreement.

2. The competent authority having been designated as the contact point in accordance with Article 79(1) may transmit the information received under paragraph 1 of this Article and under Articles 77 and 88 to the authorities referred to in Article 67(1). They shall not transmit it to other bodies or natural or legal persons without the express agreement of the competent authorities which disclosed it and solely for the purposes for which those authorities gave their agreement, except in duly justified circumstances. In this last case, the contact point shall immediately inform the contact point that sent the information.

3. Authorities as referred to in Article 71 as well as other bodies or natural and legal persons receiving confidential information under paragraph 1 of this Article or under Articles 77 and 88 may use it only in the course of their duties, in particular:

(a) to check that the conditions governing the taking-up of the business of investment firms are met and to facilitate the monitoring, on a non-consolidated or consolidated basis, of the conduct of that business, especially with regard to the capital adequacy requirements imposed by Directive 2013/36/EU, administrative and accounting procedures and internal-control mechanisms;

(b) to monitor the proper functioning of trading venues;

(c) to impose sanctions;

(…)

5. Neither this Article nor Article 76 or 88 shall prevent a competent authority from transmitting to ESMA, the European Systemic Risk Board, central banks, the ESCB and the ECB, in their capacity as monetary authorities, and, where appropriate, to other public authorities responsible for overseeing payment and settlement systems, confidential information intended for the performance of their tasks. Likewise such authorities or bodies shall not be prevented from communicating to the competent authorities such information as they may need for the purpose of performing their functions provided for in this Directive or in Regulation (EU) No 600/2014.

6.2.3 MiFIR[19]

Article 24

Obligation to uphold integrity of markets

Without prejudice to the allocation of responsibilities for enforcing Regulation (EU) No 596/2014, competent authorities coordinated by ESMA in accordance with Article 31 of Regulation (EU) No 1095/2010 shall monitor the activities of investment firms to ensure that they act honestly, fairly and professionally and in a manner which promotes the integrity of the market.

Article 26

Obligation to report transactions

1. Investment firms which execute transactions in financial instruments shall report complete and accurate details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day.

The competent authorities shall, in accordance with Article 85 of Directive 2014/65/EU, establish the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for those financial instruments also receives that information.

The competent authorities shall make available to ESMA, upon request, any information reported in accordance with this Article.

(…)

4. Investment firms which transmit orders shall include in the transmission of that order all the details as specified in paragraphs 1 and 3. Instead of including the mentioned details when transmitting orders, an investment firm may choose to report the transmitted order, if it is executed, as a transaction in accordance with the requirements under paragraph 1. In that case, the transaction report by the investment firm shall state that it pertains to a transmitted order.

5. The operator of a trading venue shall report details of transactions in financial instruments traded on its platform which are executed through its systems by a firm which is not subject to this Regulation in accordance with paragraphs 1 and 3.

[19] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173 12.6.2014, p. 84).

(…)

7. The reports shall be made to the competent authority either by the investment firm itself, an ARM acting on its behalf or by the trading venue through whose system the transaction was completed, in accordance with paragraphs 1, 3 and 9.

Investment firms shall have responsibility for the completeness, accuracy and timely submission of the reports which are submitted to the competent authority.

By way of derogation from that responsibility, where an investment firm reports details of those transactions through an ARM which is acting on its behalf or a trading venue, the investment firm shall not be responsible for failures in the completeness, accuracy or timely submission of the reports which are attributable to the ARM or trading venue. In those cases and subject to Article 66(4) of Directive 2014/65/EU the ARM or trading venue shall be responsible for those failures.

Investment firms must nevertheless take reasonable steps to verify the completeness, accuracy and timeliness of the transaction reports which were submitted on their behalf.

The home Member State shall require the trading venue, when making reports on behalf of the investment firm, to have sound security mechanisms in place designed to guarantee the security and authentication of the means of transfer of information, to minimise the risk of data corruption and unauthorised access and to prevent information leakage maintaining the confidentiality of the data at all times. The home Member State shall require the trading venue to maintain adequate resources and have back-up facilities in place in order to offer and maintain its services at all times.

Trade-matching or reporting systems, including trade repositories registered or recognised in accordance with Title VI of Regulation (EU) No 648/2012, may be approved by the competent authority as an ARM in order to transmit transaction reports to the competent authority in accordance with paragraphs 1, 3 and 9.

Where transactions have been reported to a trade repository in accordance with Article 9 of Regulation (EU) No 648/2012 which is approved as an ARM and where those reports contain the details required under paragraphs 1, 3 and 9 and are transmitted to the competent authority by the trade repository within the time limit set in paragraph 1, the obligation on the investment firm laid down in paragraph 1 shall be considered to have been complied with.

Where there are errors or omissions in the transaction reports, the ARM, investment firm or trading venue reporting the transaction shall correct the information and submit a corrected report to the competent authority.

8. When, in accordance with Article 35(8) of Directive 2014/65/EU, reports provided for under this Article are transmitted to the competent authority of the host Member State, it shall transmit that information to the competent authorities of the home Member State of the investment firm, unless the competent authorities of the home Member State decide that they do not want to receive that information.

(…)