

## **Correcting the liquidity assessment of single name credit default swaps referencing global systemically important banks for the purposes of public transparency under MiFIR**

### **Introduction**

The MiFIR Review sought to reform the framework for public transparency, with a key aim of simplifying the determination of which trades should benefit from deferred publication of post-trade transparency reports (“deferrals”) under MiFIR Articles 11 and 11a. Deferred publication is permitted for trades in instruments deemed to be illiquid, and for trades of medium size or above.

To this end, the liquidity assessment for both derivatives and bonds has been changed from a periodic assessment to a static determination.

Notwithstanding this, Commission Delegated Regulation (EU) 2024/791 amending MiFIR preserves the notion that liquidity providers should not be exposed to undue risk. To do otherwise, for example by treating illiquid instruments as if they are liquid and unable to benefit from deferrals, would risk exacerbating the illiquidity of those instruments, as liquidity providers price defensively or withdraw from those markets altogether.

In respect of derivatives, the liquidity assessment should consider the average frequency and size of transactions (MiFIR Article 2(17)(a)(ii)).

Revised MiFIR mandated ESMA to develop draft technical standards for derivatives, or classes thereof, for which a liquid market exists (MiFIR Article 11a(3)(c); and by extension, derivatives, or classes thereof, which are illiquid. Accordingly, ESMA has consulted on these points in its MiFIR Review Consultation Package 4 on transparency for derivatives, package orders and input/output data for the derivatives consolidated tape.

As explained in this paper, the approach to assessing liquidity for exchange traded derivatives and all OTC derivatives **other than** single name credit default swap (CDS) referencing global systemically important banks (G-SIBs) in the MiFIR Review Consultation Package 4 has typically been to do so at the most granular level feasible.

The assessment of bond liquidity is also at the most granular level feasible, as the liquidity status of each bond is determined individually based on its issuance size (MiFIR Article 2(17)(a)(i)).

### **About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: [www.isda.org](http://www.isda.org). Follow us on X, LinkedIn and YouTube.

Therefore, the liquidity assessment for single name CDS has been entirely inconsistent with that for other in-scope instruments. As set out in ISDA's response to Question 14 of the MiFIR Review Consultation Package 4, a consistent liquidity assessment for single name CDS referencing G-SIBs would conclude that these instruments are self-evidently illiquid.

### **The liquidity assessment for bonds**

In the case of bonds, issuance size has been used as a proxy for the liquidity of the respective bond issuance: a liquid market for bonds has been defined as one "in which there are ready and willing buyers and sellers on a continuous basis, where the market is assessed according to the issuance size of **the bond**".

That is, each bond issuance, and therefore each individual bond, is to be assessed individually to determine whether it is liquid or illiquid.

Therefore, the liquidity assessment for bonds is at the level of a unique combination of issuing entity, issue date, coupon, maturity and seniority of debt.

### **The liquidity assessment of OTC derivatives other than single name CDS referencing G-SIBs**

In the case of OTC derivatives that are in scope of transparency **other than** single name CDS referencing G-SIBs (i.e. those specified in MiFIR Article 8a(2)(a) and (c)), the assessment of liquidity took into account the combination of a number of factors relevant to each asset class and instrument, such as product differentiation (e.g. FRAs and basis swaps vs fixed-to-float swaps), reference index (e.g. OIS referencing FedFunds vs OIS referencing €STR), series (e.g. on-the-run and first-off-the-run series of iTraxx contracts vs other series, and tenor (e.g. index CDS with a 5Y tenor vs index CDS with other tenors).

In the case of index CDS, while ultimately contracts of 5Y tenor of the on-the-run and first off-the-run series of all in-scope iTraxx indices were assessed as liquid, it is clear from ESMA's Consultation Package 4 that analysis was performed for each individual index (*see section 3.4.3.4.2.2 of the consultation paper, paras 198-209, pp74-78; in particular Tables 52, 53 and 54*).

### **The liquidity assessment for exchange traded derivatives (ETDs)**

#### **Interest Rate ETDs**

- The analysis of the liquidity of interest rate bond futures was performed by ESMA at the level of the underlying bond (e.g. the Bund, the OAT and the BONO)

- The analysis of the liquidity of interest rate bond options was performed by ESMA at the level of the underlying bond future (e.g. the Bund future and the OAT future)
- The analysis of the liquidity of interest rate futures was performed by ESMA at the level of the underlying interest rate (e.g. 3-month EURIBOR)
- ESMA's Consultation Package 4 presented two options and expressed a preference for Option B "because it is more granular and allows a better distinction between liquid and illiquid instruments."

## **Equity Derivatives**

- The analysis of the liquidity of equity ETDs could understandably not be performed at the level of the underlying stock or index, due to the sheer number of those stocks and indices
- However, of the three options presented in Consultation Package 4, ESMA expressed a preference for Option C "because it is more granular and allows a better distinction between liquid and illiquid instruments."

## **Commodity derivatives**

- As a starting point, ESMA determined in Consultation Package 4 that all commodity derivatives with an average daily number of trades (ADNT) below 100 trades should immediately be considered illiquid; and that classes of commodity and emission allowance ETDs with ADNT above 100 trades should be subject to further, more granular analysis
- The further analysis of the liquidity of electricity ETDs was performed at the level of contract type (e.g. futures, options), delivery zone (e.g. Germany, France, Nordic Market Area), load type (e.g. base load, peak load) and delivery period (e.g. monthly, quarterly, annually)
- The analysis of the liquidity of natural gas ETDs was performed at the level of contract type (e.g. futures, options), delivery zone (e.g. NL – TTF, DE – THE, FR – PEG) and delivery period (e.g. monthly, quarterly)
- The analysis of the liquidity of freight derivatives was performed at the level of contract type (e.g. futures, options), freight size (e.g. Capesize, Panamax) and freight route (e.g. Basket, 5TC)
- The analysis of the liquidity of agricultural ETDs was performed at the level of contract type (e.g. futures, options) and underlying base product (e.g. Milling Wheat, Rapeseed, Corn)

## **Emission allowance derivatives**

- ETDs on emission allowances have only one possible underlying: EUAE (which corresponds to European emission allowances, or EUAs, as recognised under the EU ETS Directive)

- Nonetheless, ESMA has proposed as granular a framework as possible for these ETDs, with futures and options treated differently

#### **FX derivatives**

- Similar to equity ETDs, it would not have been feasible to analyse the liquidity of FX ETDs at the level of the underlying currency pair, due to the sheer number of possible currency pairs
- Nonetheless, they were analysed at the level of contract type (i.e. future or option), which was the most granular level feasible
- FX futures were assessed as liquid, while FX options were assessed as illiquid

#### **Credit ETDs**

- ESMA's analysis only identified two credit ETDs, and has assessed both of these as illiquid
- ESMA does not name these contracts, and presents no analysis beyond stating that both have limited trading activity
- ISDA believes these to be the EURO Investment Grade future (which has the Bloomberg MSCI Euro Corporate Screened Index as its underlying), and the EURO High Yield future (which has the Bloomberg Liquidity Screened Euro High Yield Bond Index as its underlying)
- As ESMA has observed that both contracts have limited trading activity, it can be inferred that it assessed them separately – i.e., at the level of the underlying index

#### **The liquidity assessment for single name CDS referencing G-SIBs**

The underlying for a single name CDS is a debt security issued by a specific reference entity, known as the reference obligation. The reference obligation will be either a specific bond (known as a Standard Reference Obligation), or a bond that is not subordinated to that which is “cheapest to deliver”.

Therefore, when looked at considering the liquidity assessment for bonds, the reference entity is analogous to the issuer, and the reference obligation is analogous to the issuance.

The reference entities of those single name CDS that are in scope of public transparency under MiFIR comprise the 29 global banks that have been deemed systemically important by the Financial Stability Board (“global systemically important banks” or “G-SIBs”).

Each bond that is issued by each of those banks will be assessed individually to determine if it is liquid for the purposes of transparency. It might therefore appear

to be logical and consistent with the liquidity assessment for bonds for the liquidity of single name CDS to be assessed at the level of the reference obligation.

However, as many different reference obligations could be used for a given single name CDS, the correct approach would be to assess the liquidity of single name CDS at the level of the reference entity: i.e., to individually assess the liquidity of the single name CDS referencing each G-SIB.

This would be consistent with ESMA's general approach to the analysis and liquidity assessment for bonds, ETDs and all other OTC derivatives in scope of public transparency under MiFIR: namely, to do so at the most granular level feasible.

Instead, the entire set of single name CDS that are in scope of transparency has been assessed as one homogenous class, in stark contrast to other in scope instruments.

This is not only inconsistent, but entirely illogical: a default on a bond issued by one G-SIB cannot trigger a single name CDS referencing any other G-SIB.

### **Comparison against other asset classes using average daily number of trades and average daily volume**

As demonstrated above, there is no logical basis for determining the liquidity of single name CDS referencing G-SIBs at the level of the entire class of instruments. It is manifestly clear that a more consistent and reasonable treatment would be to assess liquidity at the level of the individual G-SIB.

The tables below compare the average daily number of trades (ADNT) and average daily volume (ADV) of single name CDS at the level of individual G-SIBs to the ADNT and ADV of the classes of OTC derivatives assessed as illiquid by ESMA, and to the ADNT and ADV of the interest rate ETDs assessed by ESMA as illiquid.

The data on OTC derivatives other than single name CDS and on interest rate ETDs was drawn directly from Consultation Package 4 (as mentioned above, no data was provided by ESMA for credit ETDs). The reference entity level data on single name CDS referencing G-SIBs was extracted from the DTCC Trade Information Warehouse.

The highest ADV of a single name CDS referencing a G-SIB is lower than the lowest two ADVs of any other instrument that has been assessed as illiquid:

Instrument	Index/Indices	Reference entity	Tenor	ADV (EUR, millions)	Liquidity assessment
OIS	FedFunds	N/A	3Y	100	Illiquid

Basis swaps	EURIBOR vs EURIBOR	N/A	10Y	100	Illiquid
Single name CDS	N/A	BANK OF AMERICA	5Y	71	Liquid

Table 1

The highest ADV of a single name CDS referencing a G-SIB is lower than the two highest ADVs of any other instrument that has been assessed as illiquid, by a factor of more than 10:

Instrument	Index/Indices	Reference entity	Tenor	ADV (EUR, millions)	Liquidity assessment
Basis swaps	EURIBOR vs EuroSTR	N/A	1Y	900	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	1Y	900	Illiquid
Single name CDS	N/A	BANK OF AMERICA	5Y	71	Liquid

Table 2

The highest ADNT of any single name CDS referencing a G-SIB is less than or equal to the ADNT of three other instruments that have been assessed as illiquid:

Instrument	Reference entity	Underlying	Tenor	ADNT	Liquidity assessment
Future	N/A	BONO	3M	31	Illiquid
Option	N/A	Long-Term Euro-BTP	3M	11	Illiquid
Future	N/A	CONF	3M	6	Illiquid
Single name CDS	BARCLAYS	N/A	5Y	6	Liquid
Single name CDS	SOCIETE GENERALE	N/A	5Y	6	Liquid
Single name CDS	DEUTSCHE BANK	N/A	5Y	6	Liquid

Table 3

Absurdly, multiple single name CDS referencing G-SIBs had no trading recorded at all in the past year, yet are deemed liquid by virtue of being assessed as a class of instruments:

Instrument	Reference entity	Tenor	ADNT	ADV (EUR, millions)	Liquidity assessment
Single name CDS	AGRICULTURAL BANK OF CHINA LIMITED	5Y	0	0	Liquid
Single name CDS	BANK OF COMMUNICATIONS CO., LTD	5Y	0	0	Liquid
Single name CDS	THE BANK OF NEW YORK MELLON	5Y	0	0	Liquid
Single name CDS	BPCE	5Y	0	0	Liquid
Single name CDS	ROYAL BANK OF CANADA	5Y	0	0	Liquid
Single name CDS	STATE STREET CORPORATION	5Y	0	0	Liquid
Single name CDS	THE TORONTO-DOMINION BANK	5Y	0	0	Liquid

Table 4

In contrast, no other instrument with zero trading activity over the period analysed by ESMA was assessed as liquid:

Instrument	Index/Indices	Underlying	Tenor	ADNT	ADV (EUR, millions)	Liquidity assessment
Option	N/A	Euro-OAT	3M	0	0	Illiquid
FRA	EURIBOR	N/A	2Y	0	0	Illiquid
FRA	EURIBOR	N/A	3Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	5Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	7Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	10Y	0	0	Illiquid

Basis swaps	EURIBOR vs EuroSTR	N/A	12Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	15Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	20Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	25Y	0	0	Illiquid
Basis swaps	EURIBOR vs EuroSTR	N/A	30Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	2Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	3Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	5Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	7Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	12Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	15Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	20Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	25Y	0	0	Illiquid
Basis swaps	EURIBOR vs EURIBOR	N/A	30Y	0	0	Illiquid

Table 5

## Conclusion

Two facts are indisputable from the above analysis:

1. The assessment of the liquidity of single name CDS referencing G-SIBs has been entirely inconsistent with the liquidity assessment of bonds, exchange traded derivatives and other OTC derivatives. It has been carried out at a far less granular level than those instruments, which were assessed at the most granular level possible.
2. If the assessment of the liquidity of single name CDS referencing G-SIBs had been carried out at the most granular level feasible (that is, at the level of the reference entity), no single name CDS referencing a G-SIB would have been deemed liquid.

ISDA urges ESMA to reassess the liquidity of single name CDS referencing G-SIBs, and to do so at the level of the reference entity. This would be consistent with the liquidity assessment for other OTC derivatives, exchange traded derivatives and bonds; and would correct the current manifestly inaccurate outcome.



This flawed outcome could have significant consequences for the real economy, as a properly functioning single name CDS market enhances the liquidity and stability of the underlying bond market.

An incorrect liquidity determination for a single name CDS instrument that places undue risk on liquidity providers is likely to lead to reduced liquidity in that single-name CDS, as those liquidity providers price defensively or withdraw from the market altogether.

This in turn will lead to increased price volatility of that single name CDS and increased costs for end users to hedge related bond positions. This reduced ability to hedge will impair liquidity in bonds issued by the G-SIB that is the reference entity for the affected single name CDS. Ultimately, this would result in higher borrowing costs in the real economy and impact the competitiveness of European markets.

It should also be noted that that UK regulators recognised the illiquidity of these instruments and have excluded them entirely from the UK transparency regime. International investors are likely to consider that this approach better balances transparency and liquidity, and favour trading of European CDS on the UK market accordingly. Such a shift of liquidity would further erode EU competitiveness.

**Appendix 1****ADV and ADNT of single name CDS referencing G-SIBS**

Instrument	Reference entity	Tenor	ADNT	ADV (EUR, millions)
Single name CDS	BARCLAYS	5Y	6	62
Single name CDS	SOCIETE GENERALE	5Y	6	49
Single name CDS	DEUTSCHE BANK	5Y	6	45
Single name CDS	MORGAN STANLEY	5Y	5	36
Single name CDS	GOLDMAN SACHS	5Y	5	34
Single name CDS	BANK OF AMERICA	5Y	5	71
Single name CDS	BNP PARIBAS	5Y	4	47
Single name CDS	HSBC	5Y	4	33
Single name CDS	UBS	5Y	3	39
Single name CDS	SANTANDER	5Y	3	30
Single name CDS	CREDIT AGRICOLE	5Y	3	24
Single name CDS	STANDARD CHARTERED	5Y	3	22
Single name CDS	CITIGROUP	5Y	3	40
Single name CDS	ING	5Y	2	16
Single name CDS	JPMORGAN CHASE	5Y	2	24
Single name CDS	BANK OF CHINA	5Y	2	24
Single name CDS	WELLS FARGO	5Y	1	10
Single name CDS	INDUSTRIAL AND COMMERCIAL BANK OF CHINA	5Y	1	17
Single name CDS	CHINA CONSTRUCTION BANK	5Y	1	10
Single name CDS	MITSUBISHI UFJ FG	5Y	0	2
Single name CDS	MIZUHO BANK	5Y	0	2
Single name CDS	SUMITOMO MITSUI BANKING CORPORATION	5Y	0	1
Single name CDS	AGRICULTURAL BANK OF CHINA LIMITED	5Y	0	0
Single name CDS	BANK OF COMMUNICATIONS CO., LTD	5Y	0	0
Single name CDS	THE BANK OF NEW YORK MELLON	5Y	0	0
Single name CDS	BPCE	5Y	0	0
Single name CDS	ROYAL BANK OF CANADA	5Y	0	0
Single name CDS	STATE STREET CORPORATION	5Y	0	0
Single name CDS	THE TORONTO-DOMINION BANK	5Y	0	0