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ISDA RESPONSE TO

FCA'S Markets in Financial Instruments Directive II Implementation – Consultation Paper I

Introduction

ISDA welcomes the opportunity to provide comments to the FCA on its Consultation Paper CP15/43 on implementation of the Markets in Financial Instruments Directive II. In general, ISDA supports the approach taken by the FCA in its CP, subject to the comments provided below in response to the FCA's questions. However, we would like to make the following general comments:

i. Copy-out approach to implementation

We welcome the FCA's copy-out approach to implementation, ensuring that the wording of the FCA Handbook is as close as possible to the wording of the Level 1 text. Since we expect that ESMA will provide guidance on interpretation of many provisions under MiFID2, this copy-out approach should ensure that any ESMA guidance clearly applies to interpretation of the relevant provisions of the FCA Handbook. However, in some places the proposed Handbook text diverges slightly from the MiFID2 wording. We have flagged some examples in our responses below, but we would welcome confirmation from the FCA that it intends to conform the Handbook text as closely as possible to the text of MiFID2.

ii. FCA's approach to signposting relevant technical standards

The FCA proposes to signpost relevant technical standards throughout the Handbook. Where the technical standards provide further detail on the obligations set out in the Level 1 text, this approach is appropriate to achieve the FCA's aims of implementing the Level 1 text while also signposting any relevant technical standards. However, in some cases the technical standards amend (rather than supplement) the obligation set out in the Level 1 text.

For example, Article 49 of MiFID2 requires Member States to require regulated markets and MTFs to adopt tick size regimes in shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and in any other financial instrument for which regulatory technical standards are developed under Article 49(4) of MiFID2. This obligation is reflected in new MAR 5.3A.14R. However, the technical standards developed under Article 49 of MiFID2 clarify that trading venues are only required to apply a tick size to orders in exchange-traded funds where those exchange-traded funds have as sole underlying equities or a basket of equities subject to the tick size regime under Article 2 of RTS 11.

This means that new MAR 5.3A.14R could be read as requiring firms to adopt a tick size regime in relation to all exchange-traded funds, where the technical standards only require firms to adopt a tick size regime in relation to equity ETFs.

MAR 5.3A.16G states that "nothing in MAR 5.3A.14R or MAR 5.3A.15R requires a firm to act inconsistently with any regulatory technical standards made under article 49.3 or 49.4 of MiFID". However, an obligation to adopt a tick size regime in relation to all exchange-traded funds is not necessarily inconsistent with the regulatory technical standards made under Article 49 of MiFID2. Rather it appears to impose a separate obligation that goes beyond that prescribed by the technical standards.

In other places in its proposed draft text the FCA has stated that a particular obligation applies "in accordance with" the relevant technical standards (e.g., in SUP 13.7.3C G, which provides that a UK MiFID investment firm must notify the FCA of certain matters in accordance with the relevant RTS and ITS). ISDA considers that this

approach gives greater clarity about the scope of the relevant obligations and does not create the risk of inadvertently imposing super-equivalent obligations to those set out in the technical standards.

ISDA would welcome amendments to the proposed draft text to ensure that this approach is followed consistently wherever Level 1 obligations are further specified by technical standards (particularly where the specification affects the scope of the Level 1 obligation).

iii. Coordination with other national competent authorities

As a general point, ISDA would encourage the FCA to work with other national competent authorities to ensure consistency between each Member State's implementation of MiFID2/MiFIR, particularly in those areas (such as the transparency waiver and deferral regimes) where Member States have greater discretion.

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1. Overview

Q1. Do you find our proposed MiFID II Guide helpful? If not, how can we amend and improve the prototype?

ISDA members agree that the MiFID II Guide serves as a useful overview of the FCA's approach to transposition and members consider that this should be expanded to cover other firms and areas of MiFID2/MiFIR. In particular, ISDA members would welcome the use of visual aids where appropriate (such as the one proposed by the FCA on page 70 of the consultation paper).

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2. Regulated Markets (RMs)

Q2. Do you agree with our approach outlined above to amend REC to take account of the MiFID II changes? If not, please give reasons why

ISDA members are generally supportive of the approach proposed by the FCA to implementing the MiFID2/R requirements for regulated markets. However, ISDA members would like to highlight the following points in relation to the proposed Handbook text:

- ISDA members would like to stress the importance of ensuring the Handbook adequately signposts firms to the applicable EU level 2 measures. In some places, the current draft rules do not this. For example:
    - REC 2.5.1UK(2)(i), (k) and (m) should also direct readers to RTS 7.
    - It would be helpful to readers if REC 2.5.4AG referred explicitly to all relevant RTS, rather than just RTS 7. RTS 8 to 12 are also relevant and should be explicitly referred to.
    - REC 2.9.1UK should direct readers to RTS 24.
    - REC 2.12.2AUK(3) and (4) should direct readers to RTS 17.
- As a significant amount of text is proposed to be deleted from REC, ISDA members have concerns that the FCA's proposed signposts will not be sufficiently detailed. For example, the FCA proposes that the existing Handbook text in REC 2.6.7EU is completely deleted and replaced with a note directing Handbook readers to Article 3 of MiFIR. However, without the deleted text it will not be clear to readers what types of requirements are being referred to. For transparency related signposts it would be useful to group all references to the MiFIR transparency requirements in one location in REC. For example, this could be included after the guidance in REC 2.6.29G(2).
- In REC 2.6.29G(2)(b)(ii), ISDA recommends deleting the wording "directly applicable" as this wording is not included in REC 2.6.29G(2)(a)(i) or (ii) or REC 2.6.29G(2)(b)(i).
- In REC 2.6.29G(2)(c), ISDA recommends amending the reference in square brackets to "all financial instruments" as Articles 12 and 13 of MiFIR do not apply to all financial instruments. The obligations to make pre- and post-trade data available separately and on a reasonable commercial basis only apply in respect of the types of financial instruments to which the MiFIR transparency obligations apply and to which REC 2.6.29G(2)(a) and (b) refer. REC 2.6.29G(2)(c) could be amended as follows:

  "(for all financial instruments referred to in REC 2.6.29G(2)(a) or REC 2.6.29G(b) traded on its trading venue)..."

- REC 2.8.3G(1A) – this should only refer to transactions in derivatives as Article 29(1) of MiFIR only refers to transactions in derivatives. REC 2.8.3G(1A) could be amended as follows:

  "(in relation to transactions in derivatives) the UK recognised body's ability to demonstrate that such transactions are cleared by a CCP in accordance with Article 29(1) of MiFIR)"

- The signpost in REC 3.25R(1) contains an incorrect reference. Article 31(2) of MiFID2 should be referred to instead of Article 30(2) of MiFID2.

Q3. Do you foresee any implementation issues with the approach above?

ISDA does not anticipate any implementation issues with the FCA's proposed approach to implementation of MiFID2/R requirements for regulated markets.

However, please see our response to Question 2 for general comments on the proposed Handbook text.

3. Multilateral Trading Facilities (MTFs)

Q4 Do you agree with our approach to implementing the MTF requirements in MAR 5? If not, please give reasons why

ISDA is generally supportive of the approach proposed by the FCA to implementing the MTF requirements in MAR 5. However, ISDA would like to highlight the following points in relation to the proposed Handbook text:

- ISDA favours a copy-out approach of the MiFID2 requirements. In some places, the proposed Handbook text diverges slightly from the MiFID2 wording. Given the strong likelihood that future guidance on many MiFID2 provisions will be provided by ESMA (e.g. through Q&A) ISDA members would like to stress the importance of minimising differences in language which may result in different interpretations being given to national implementing measures. For example:
    - MAR 5.3.1(4)(b) – the relevant MiFID2 provision refers to "sufficient level of trading ability, competence and experience".
    - MAR 5.6.1(1) – the relevant MiFID2 provision also refers to the requirement to report systems disruptions to its relevant competent authority.
- ISDA would like to stress the importance of ensuring the Handbook adequately signposts firms to the applicable EU level 2 measures. In some places, the current draft rules do not this. For example, MAR 5.3.1A(5) should direct readers to RTS 27.
- The note under MAR 5.6.1 should also refer to Article 31(3) of MiFID2.

4. Organised Trading Facilities (OTFs)

Q5 Do you agree with our proposals on how to implement OTF rules in MAR 5A? If not, please give reasons why

ISDA is generally supportive of the approach proposed by the FCA to implementing the OTF requirements in MAR 5A. However, ISDA would like to highlight the following points in relation to the proposed Handbook text:

- ISDA favours a copy-out approach of the MiFID2 requirements. In some places, the proposed Handbook text diverges slightly from the MiFID2 wording. Given the strong likelihood that future guidance on many MiFID2 provisions will be provided by ESMA (e.g. through Q&A) ISDA member would like to stress the importance of minimising differences in language which may result in different interpretations being given to national implementing measures. For example:
    - MAR 5A.8.1(1) – the relevant MiFID2 provision also refers to the requirement to report systems disruptions to its relevant competent authority.
- ISDA members would like to stress the importance of ensuring the Handbook adequately signposts firms to the applicable EU level 2 measures. In some places, the current draft rules do not this. For example, MAR 5A.4.2(3) should direct readers to RTS 27.
- The note under MAR 5A.8.1 should also refer to Article 31(3) of MiFID2.

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5. Systematic Internalisers (SIs)

Q6 Do you agree with our approach to implementing the SI regime in MAR 6? If not, please give reasons why

ISDA is generally supportive of the approach proposed by the FCA in respect of the SI regime in MAR 6. As the majority of provisions relevant to SIs are contained in directly applicable legislation the Handbook should not seek to replicate these provisions. However, ISDA would like to highlight the following points:

- The FCA proposes to maintain its current approach to SI notifications, which requires firms to make a notification when they obtain that status and again when they cease to have that status. Although Articles 15(1) and 18(4) of MiFIR do not impose an obligation on Member States to require firms to notify them when they cease to be an SI, we agree that it would be appropriate for firms to notify the FCA if they cease to be an SI and are no longer required to comply with the obligations on SIs.
- We would welcome clarification that MAR 6 applies only to UK firms and UK branches of EEA or third country investment firms. MAR 6.1.1 states that MAR 6 applies to firms "when dealing in the United Kingdom". This could cover EEA firms dealing with counterparties in the UK on a cross-border basis (e.g. under the MiFID passport). While Article 35(8) of MIFID2 gives the FCA responsibility for supervising UK branches of EEA firms in respect of certain MiFID2 obligations, there is no equivalent provision giving the FCA responsibility for supervising EEA firms dealing in the UK on a cross-border basis with no presence in the UK.

6. Transparency

Q7 Do you agree that we should be prepared to use our power to grant waivers from pre-trade transparency in shares, ETFs, and depositary receipts in relation to:

• systems matching orders on the basis of a reference price
• systems that formalise negotiated transactions
• orders that are large in scale, and
• orders held in an order management facility pending disclosure?

If not, please give your reasons why

ISDA members do not offer a response to this question.

Q8 Do you agree that we should use our power to grant waivers from pre-trade transparency in bonds, structured finance products, derivatives and emission allowances in relation to:

• orders that are large in scale
• orders held in an order management facility pending disclosure
• actionable indications of interest in request-for-quote and voice trading systems, and
• derivatives that are not subject to the trading obligation under article 28 of MiFIR, and other financial instruments for which there is not a liquid market?

If not, please give your reasons why

Yes, ISDA members strongly agree that the FCA should use its powers to grant waivers from the pre-trade transparency requirements in Article 8 of MiFIR for:

- orders that are large in scale compared with normal market size;
- orders held in an order management facility of a trading venue pending disclosure;
- actionable indications of interest in request-for-quote and voice trading systems that are above a size specific to the financial instrument, which would expose liquidity providers to undue risk and take into account whether the relevant market participants are retail or wholesale investors; and
- derivatives which are not subject to the trading obligation, specified in Article 28 of MiFIR and other financial instruments for which there is not a liquid market.

Failure to grant trading venues waivers from the pre-trade transparency requirements in the circumstances above will expose market-makers and other liquidity providers to undue risk and could impede effective hedging strategies which may deter the provision of liquidity in non-equity markets. The risks to market-makers in the pre-trade context are significant – a firm is putting its capital at risk and pre-trade disclosure of its quoted prices increases the possibility that the market will move against the firm before it is able to execute those transactions. This would lead to firms pricing these risks into the price offered to clients, leaving end investors worse off.

Q9 Do you agree that our sourcebooks should provide more clarity in relation to: the process of applying for a pre-trade transparency waiver, and the information that we deem necessary in order to evaluate an application? If not, please give reasons why

We agree that the FCA's sourcebooks should provide more clarity in relation to the process for applying for a pre-trade transparency waiver and the information that the FCA deems necessary in order to evaluate an application.

MiFID2 does not require ESMA to publish information on the types of systems that have been granted (or refused) pre-trade transparency waivers, so it is not clear whether ESMA will continue to publish information on its opinions on the waivers that have been granted by national competent authorities. If ESMA does not intend to continue publishing this information, it would be extremely useful to firms seeking to apply for these waivers if the FCA could publish similar information on the types of systems that, in its opinion, qualify for the various pre-trade transparency waivers.

In light of the requirement in Article 9(2) of MiFIR for a national competent authority to notify ESMA and other national competent authorities of its intended use of a waiver at least four months before the waiver is intended to take effect, ISDA members would welcome further guidance from the FCA on the timeline for the waiver application process and, in particular, confirmation that the FCA will be ready to accept waiver applications sufficiently in advance of the start date for the MiFIR transparency requirements so that the waivers will be in place as of this start date.

ISDA members would also welcome confirmation from the FCA that the periodic assessment of transparency calculations (as required under Article 13 of RTS 2) will not necessitate reapplication for waivers which have previously been granted by the FCA.

Q10 Should the sourcebooks include templates setting the minimum information content that trading venues should provide to us when applying for a waiver? If not, please give reasons why

ISDA agrees that it would be useful for the sourcebooks to include templates setting out the minimum information content that trading venues should provide to the FCA when applying for a waiver.

Q11 Do you agree that we should be prepared to authorise operators of trading venues and investment firms to defer the publication of post-trade information in relation to large in scale transactions in shares, ETFs, and depositary receipts executed by investment firms acting in a principal capacity?

If yes, should we provide guidance in the Handbook on the process for applying for deferrals? If not, please give reasons why

ISDA members do not offer a response to this question.

Q12 Do you agree that we should authorise operators of trading venues and investment firms to provide for deferred publication in relation to transactions that are:

- **large in scale**
- **in financial instruments for which there is not a liquid market**
- **above the size specific to the instrument, and**
- **packages**

If yes, do you agree that we should set up the process for the use of guidance in the Handbook for the application of deferrals? If not, please give reasons why

Yes, ISDA strongly agrees that the FCA should authorise market operators, investment firms operating a trading venue and investment firms trading OTC to provide for deferred publication in accordance with Articles 11 and 21(4) of MiFIR, in respect of:

- transactions that are large in scale compared with the normal market size for the relevant instrument or class of instrument;
- transactions relating to instruments for which there is not a liquid market;

- transactions above a size specific to the relevant instrument or class of instrument, which would expose liquidity providers to undue risk and takes into account whether the relevant market participants are retail or wholesale investors; and
- package transactions (where the conditions in Article 8 of RTS 2 are met).

Failure to authorise deferrals from the post-trade transparency requirements in the circumstances above will expose firms to undue risk by making it more difficult for these firms to manage their exposures through a successful hedging strategy. The difficulties firms face managing their hedging strategies in relation to certain products will be reflected in wider prices being quoted to clients, leaving end investors worse off.

ISDA members would welcome confirmation from the FCA that the periodic assessment of transparency calculations (as required under Article 13 of RTS 2) will not necessitate reapplication for deferrals which have previously been granted by the FCA.

Q13 Should we:

• use our powers under article 11(3) of MiFIR further to calibrate post-trade deferrals in accordance with the above options
• require additional information to be made public during the deferral period?
and/or, should we:
• permit the omission of the volume, or the aggregation of information, for an extended time period of four weeks?

If not, please give reasons why

Yes, ISDA strongly supports the exercise of the FCA's powers under Article 11(3) of MiFIR to further calibrate post-trade deferrals by permitting enhanced deferral as follows:

i. ***For non-equity financial instruments that are not sovereign debt***: the FCA should exercise its powers under Article 11(3)(b) of MiFIR to allow the omission of the publication of the volume of an individual transaction during an extended time period of four weeks; and

ii. ***For non-equity financial instruments that are sovereign debt***: the FCA should use consecutively its powers under Articles 11(3)(b) and 11(3)(d) of MiFIR to allow for the omission of the publication of the volume of an individual transaction during an extended time period of four weeks followed, after this four week period, by the publication of several transactions executed over one calendar week on an aggregated basis for an indefinite period of time.

The extended deferral period of four weeks for the omission of volume is critical. It is essential that the size of transactions in illiquid instruments and liquid instruments when traded in large sizes are masked for an extended period of time in order to allow liquidity providers to de-risk effectively.

However, ISDA does not support the exercise of the FCA's powers under Article 11(3)(a) of MiFIR to require some transparency during the standard deferral period (through the publication of additional or aggregated information during the standard deferral period) or under Article 11(3)(c) of MiFIR to allow the publication of several transactions in an aggregated form for an extended time period of four weeks.

The exercise of these powers would risk undermining the purpose of the standard deferral, which is to protect firms from taking on undue risk by ensuring that these firms have time to sufficiently hedge their exposures. The exercise of these options would also complicate the post-trade transparency regime, making it more expensive for trading venues and investment firms to comply with, and offer little meaningful transparency to the market because of the incomplete nature of the information published.

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As an association representing the view of OTC derivatives market participants, references in this response to sovereign debt instruments have been included for completeness and in support of AFME's response (which ISDA members endorse) and are not the main focus of this response.

In aid of our proposals, we have attached two diagrams to this response. The first summarises our understanding of the options available to the FCA (see Diagram 1) and the second highlights the options ISDA supports in respect of non-equity financial instruments (see Diagram 2).

Diagram 1: Overview of the MiFIR post-trade transparency deferral regime as set out in RTS 2 (Sept 2015)

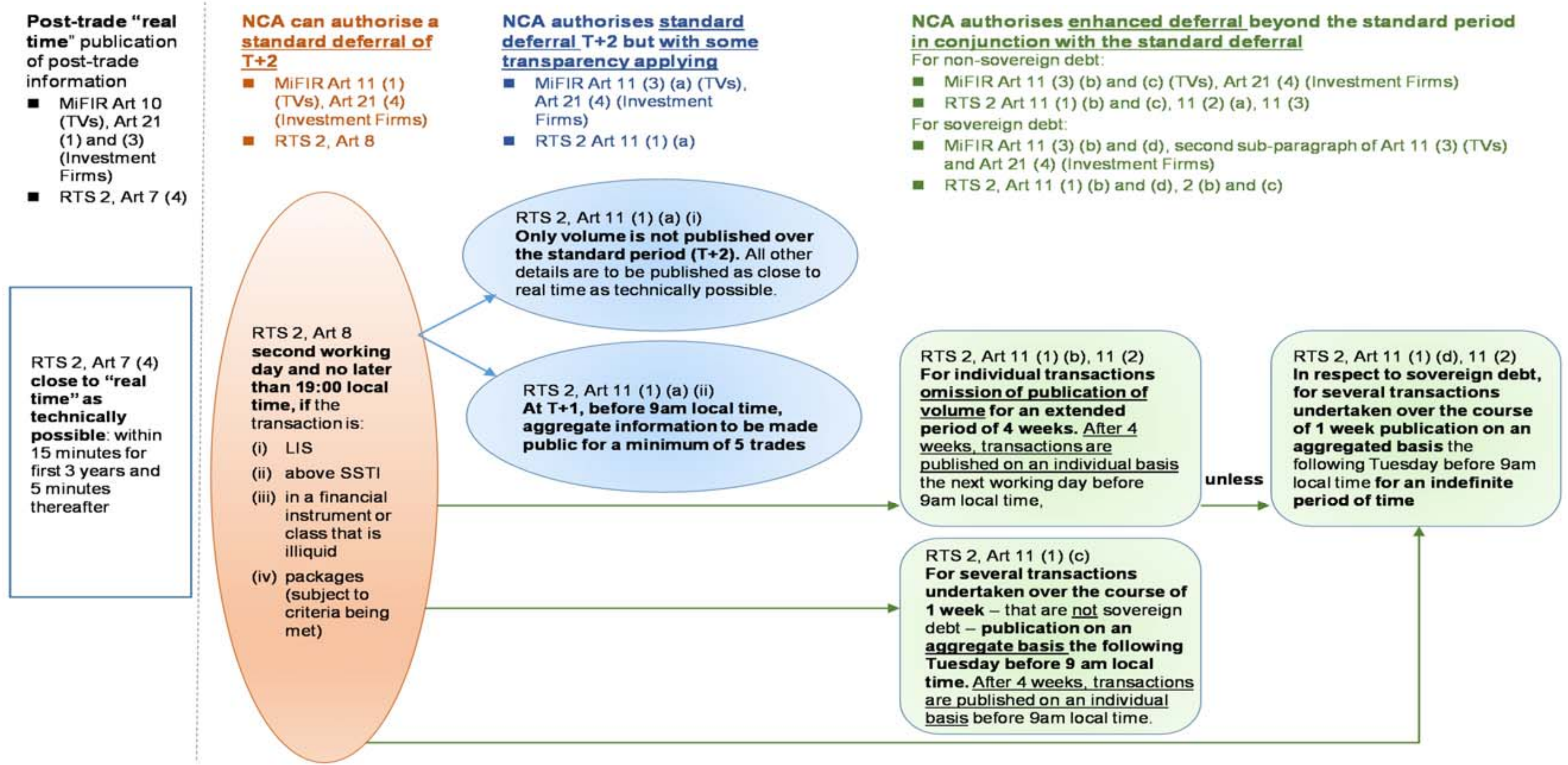

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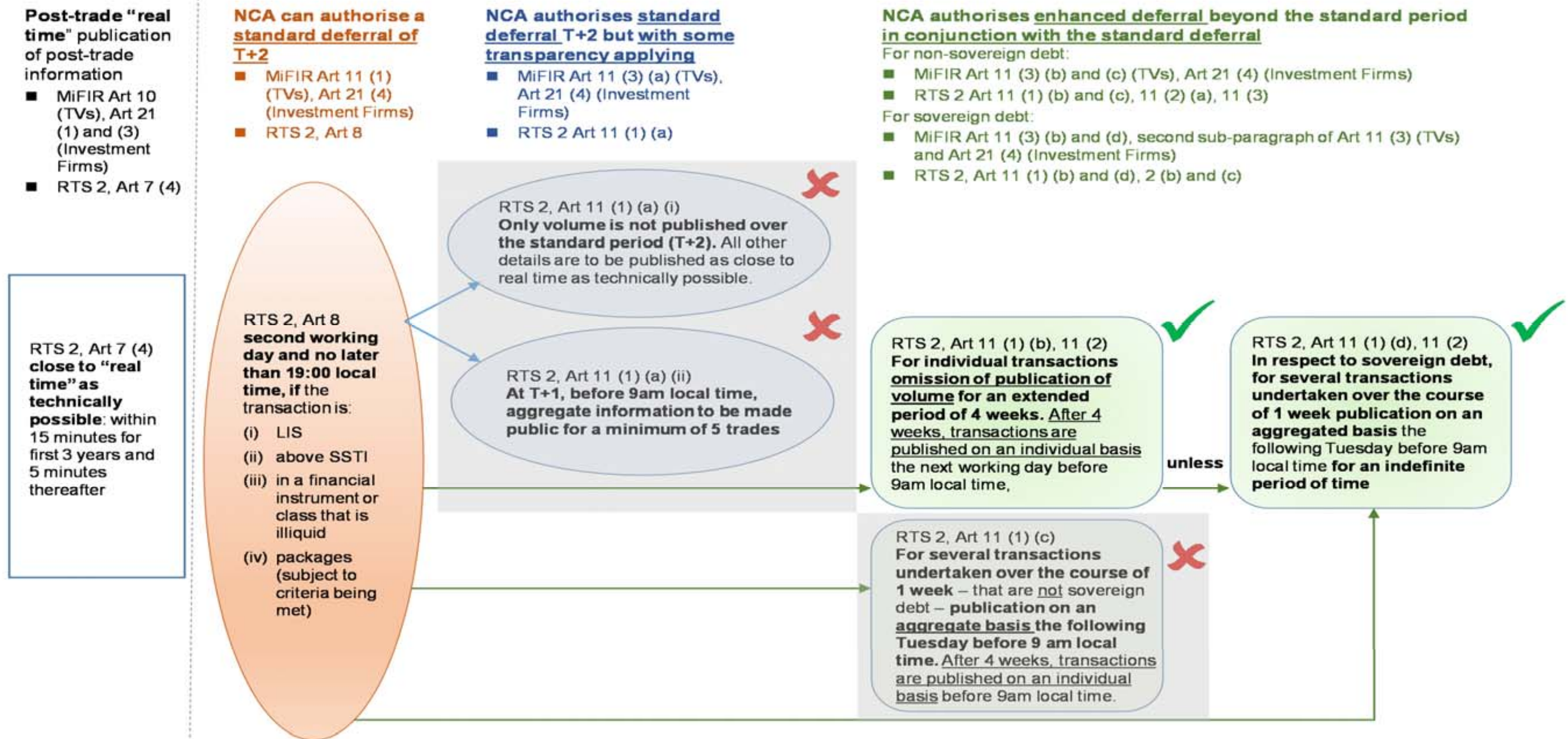
Diagram 2: ISDA proposal for the post-trade transparency deferral regime for non-equity instruments



In support of our proposal, ISDA would like to make the following points:

A. The FCA should have regard to the full range of options available to it under Article 11(3) of MiFIR (and Article 11 of RTS 2)

The summary provided on page 25 of the consultation paper of the options available to the FCA under Article 11(3) of MiFIR does not fully reflect the range of options available to the FCA, as provided for under Article 11(3) of MiFIR and Article 11 of RTS 2.

In particular, the summary does not reflect the ability for national competent authorities to use the options in Articles 11(3)(b) and 11(3)(d) of MiFIR consecutively for sovereign debt instruments. This possibility is explicitly provided for in the second sub-paragraph of Article 11(3) of MiFIR and further detail as to how these options can work together is set out in Article 11(2) of RTS 2.

Whilst we appreciate that the consultation paper only seeks to describe the options available to the FCA at a high level, ISDA would like to stress the importance of ensuring that adequate consideration is given to all the options available to the FCA. In addition, if the FCA is intending to provide guidance to trading venues and investment firms on the application of the MiFIR transparency regime, we would recommend utilising the summary of the supplementary deferral regime prepared by ESMA in its September 2015 Final Report (page 153) and our own summary which has been attached to this response.

B. The FCA should ensure that its post-trade deferral regime is applied consistently across all trading venues and classes of financial instruments to ensure its workability

ISDA strongly believes that the FCA's chosen approach to post-trade deferrals should be applied uniformly across all trading venues and classes of instruments. Granting different deferrals to trading venues or varying the deferrals granted by class of financial instrument would create unnecessary complexity and would make the regime difficult and costly to comply with in practice.

C. The FCA should recognise the importance of extended volume omission for the liquidity of certain non-equity financial instruments

As indicated above, the extended deferral period of four weeks for the omission of volume from publication is critical. It is essential that the size of transactions in illiquid instruments and liquid instruments when traded in large sizes are masked for an extended period of time in order to allow liquidity providers to de-risk effectively.

In many illiquid markets it can take several months for liquidity providers to hedge their exposures and, in liquid markets, large trades are often only proxy-hedged initially, then warehoused by liquidity providers for significant periods of time. For example, large trades in a single instrument are often managed on a market-maker's book by hedging them with a broad range of other instruments with varying degrees of correlation. Until this position has been reduced, information as to the exact position of a market-maker will be extremely detrimental to its ability to work its way out of the position. The inability to de-risk before the size of a large and/or illiquid instrument is made public will act as a significant deterrent to the provision of liquidity.

For price formation purposes, there is little value to general market participants in knowing the exact size of a trade. It should be sufficient for the market to know that a large or illiquid trade has taken place and this can be achieved by including the appropriate flag when the other details of the trade are published after the initial, shorter, deferral period.

In addition to ensuring that market-makers and other liquidity providers have sufficient time to hedge their exposures, there are other reasons why an extended time period of deferral is needed in respect of volume. There are circumstances in which the publication of trade size may contribute to market instability. For example:

- A planned cross-border corporate take-over by one corporation of another corporation. Such transactions have significant exchange rate risk and it is common for the take-over to be preceded by

large foreign exchange forward transactions (sometimes conditional on completion of the transaction) some days or weeks in advance of expected finalisation of the take-over. In the absence of extended volume omission, a very large foreign exchange transaction would be published, which would give rise to rumour and speculation, could result in distortion of other market prices, and could even imply a leakage of material non-public information.

- Similarly, pre-hedging of new bond issues can give rise to activity in interest rate swaps, and large trades being published post-trade without volume omission would give rise to rumour, speculation and ultimately market instability.

We are aware that the CFTC does not provide for an equivalent deferral period. However, given the differences between the two regimes we consider that such a deferral period is not necessary under the CFTC regime as this regime provides other protections for market participants. This is recognised by ESMA at paragraph 41 on page 227 of ESMA's December 2014 Consultation Paper on MiFID2/MiFIR (ESMA/2014/1570) (see the "supplementary deferral regime at the discretion of the NCA" section of Chapter 3.7).

For these reasons, ISDA requests that the FCA exercise the following powers:

i. ***For non-equity financial instruments that are not sovereign debt***: the FCA should exercise its powers under Article 11(3)(b) of MiFIR to allow the omission of the publication of the volume of an individual transaction during an extended time period of four weeks; and

ii. ***For non-equity financial instruments that are sovereign debt***: the FCA should use consecutively its powers under Articles 11(3)(b) and 11(3)(d) of MiFIR to allow for the omission of the publication of the volume of an individual transaction during an extended time period of four weeks followed, after this four week period, by the publication of several transactions executed over one calendar week on an aggregated basis for an indefinite period of time.

This would achieve the following post-trade transparency regime:

- No details published until 7pm local time on T+2 if transaction qualifies for a deferral.
- At 7pm on T+2, utilise 11(3)b) such that all details of eligible transactions on individual transactions are published on T+2 except volume.
- Within the 4 week deferral period, no details published on volume, whether aggregated or not, for all eligible transactions.
- Volume of individual transactions published after 4 weeks except if transaction in a sovereign debt instrument.
- No publication of volume for an indefinite period for sovereigns even after 4 weeks; instead aggregated volume for sovereign instruments published on the Tuesday following the expiry of the 4 week deferral before 9:00 local time as per Article 11(2)(c) of RTS 2.

Our suggestion that the FCA exercise its powers consecutively under Articles 11(3)(b) and 11(3)(d) of MiFIR is made on the basis that it would prevent large, individual sovereign bond transactions being made public which could lead to sensitive inventory information being identified.

As an association representing the view of OTC derivatives market participants, references in this response to sovereign debt instruments have been included for completeness and in support of AFME's response (which ISDA members endorse) and are not the main focus of this response.

D. The FCA should not introduce additional complexity to the post-trade deferral regime by requiring some transparency during the standard deferral period

As indicated above, ISDA does not support the exercise of the FCA's powers under Article 11(3)(a) of MiFIR to require some transparency during the standard deferral period (through the publication of additional or aggregated information during the standard deferral period) or under Article 11(3)(c) of MiFIR to allow the publication of several transactions in an aggregated form for an extended time period of four weeks.

The exercise of these powers would risk undermining the purpose of the standard deferral, which is to protect firms from taking on undue risk by ensuring that these firms have time to sufficiently hedge their exposures.

The exercise of these options would also complicate the post-trade transparency regime, making it more expensive for trading venues and investment firms to comply with, and offer little meaningful transparency to the market because of the incomplete nature of the information published.

E. The FCA should work with other national competent authorities to encourage greater consistency between each Member States' post-trade deferral regimes

Whilst we recognise that it is for each Member State to decide how to exercise its powers under Article 11(3) of MiFIR, we would strongly encourage the FCA to work with other national competent authorities with the aim of harmonising, to the extent possible, the application of post-trade deferrals across the EU.

F. The FCA should ensure that its post-trade deferral regime takes into account any future developments regarding the EU rules specifying the details of the MiFIR transparency regime

ISDA's response to this question is dependent on the final EU regulatory technical standards specifying the details of the MiFIR transparency regime, particularly the rules determining how liquidity assessments will be calibrated.

To the extent that these rules are amended over the coming months to make the liquidity determinations more accurate and to set the large-in-scale and size specific to the instrument thresholds at levels suitable for each class of financial instruments, it is possible that the enhanced deferral regime proposed by ISDA in this response may not be necessary for all types of transactions which can benefit from the standard deferral. Whilst this may be the case for some transactions in liquid instruments, ISDA does not consider that this will ever be the case for transactions in illiquid instruments (irrespective of their size) or for very large transactions in liquid instruments.

If the necessary improvements to the EU regulatory technical standards are made over the next few months, the below table (Table 1) sets out an alternative approach which still recognises that enhanced deferral is vital for illiquid and very large transactions.

However, ISDA would stress that it would **only** support the deferral regime outlined below if significant improvements are made to the EU regulatory technical standards referred to above. If these improvements are not made, ISDA is of the view that the enhanced deferral regime should be applied in respect of all transactions which can benefit from the standard deferral under Article 11 of MiFIR.

Table 1: ISDA's recommended deferral regime if significant improvements are made to the liquidity calibrations in RTS 2

Regime	Liquid/Illiquid	LIS	SSTI
Enhanced deferral	Illiquid	above	above
Enhanced deferral	Illiquid	below	above
Enhanced deferral	Illiquid	below	below
Enhanced deferral	Liquid	above	above
Standard deferral	Liquid	below	above
Post-trade real time (no deferral)	Liquid	below	below

7. Market Data

Q14 Do you agree with our approach to DRSPs in MAR 9? If not, please give reasons why

ISDA members broadly agree with the approach set out in MAR 9, but would make the following points:

- We do not consider it accurate to state that ARMs "transaction report" on behalf of investment firms (MAR 9.1.2G (4)), as the obligation applies to a firm that executes a transaction in an in-scope instrument. Consequently, we would propose the following amendments to MAR 9.1.2G (4):

  approved reporting mechanisms **(*ARMs*) to provide the service of submitting transaction ~~reporting~~ reports on behalf of *investment firms*.**

- The new definition of 'approved publication arrangement' does not specify the kinds of services provided by an APA. For clarity, and to avoid the risk of unintentionally including certain entities with the definition, we would propose the following amendments:

  a *person* permitted under regulation 5 of the *DRS Regulations* to provide an *investment firm* with the ~~services~~ service of publishing trade reports on behalf of that ~~to an~~ *investment firm* in order for the *investment firm* to meet its ~~transaction reporting~~ post trade disclosure obligations under articles 20 and 21 of *MiFIR*.

- For the sake of clarity, we also consider that the amended definition of 'approved reporting mechanism' should be further amended as follows:

  a *person* permitted under regulation 5 of the *DRS Regulations* to provide an *investment firm* with the ~~services~~ service of reporting details of transactions to the FCA in order for the ~~to an~~ *investment firm* ~~for it~~ to meet its transaction reporting obligations under article 26 of *MiFIR*.

Q15 Do you agree with our proposal not to apply the transaction reporting obligation to managers of collective investment undertakings and pension funds? If not, please give reasons why

Yes, in light of the exemption in Article 2(1)(i) MiFID II for managers of collective investment undertakings and managers of pension funds, we consider it appropriate that the transaction reporting obligations do not apply to such persons.

Q16 Do you agree with our proposals to require connectivity with our systems for certain entities sending transaction reports and reference data to us? If not please give reasons why

Yes, ISDA members agree with the proposals and welcome the flexibility for firms to be able to report either directly to the FCA, through an ARM acting on behalf of the firm, or by the trading venue through whose systems the transaction was completed. ISDA members note that direct transaction reporting to the competent authority is already permitted in France.

In respect of SUP 17A.2.5G, ISDA members understand that all MiFID investment firms (including systematic internalisers) may use ARMs to satisfy their transaction reporting obligations. Nevertheless, where a systematic internaliser is required to provide the FCA with reference data relating to financial instruments traded on its systems, a technology connection with the FCA must be established in order to submit that reference data.

8. Algorithmic and High Frequency Trading (HFT) Requirements

Q17 Do you agree with our proposal to add in the rules outlined above to our Handbook? If not, please give reasons why

In relation to MAR 7A, please see our responses to Qs 18 - 22 (below).

We broadly agree with the proposed changes to MAR 5 and new provisions set out in MAR 5A. However, we would note the following in respect of MTFs:

- In order to clarify MAR 5.3.1 R(6) and align it more closely with Article 18(4) of MiFID2, we would propose the following amendments:

  (as between the interests of the *MTF*, its owners, or the *firm*, and those of the members and participants or users, and ~~in~~ the sound functioning of the trading venue) arrangements to identify clearly and to manage any conflict with adverse consequences for:

  (a) the operation of the *trading venue* ~~for the members and participants or users~~; or

  (b) the members and participants or users otherwise.

- MAR 5.3.1AR(2) should make clear that a firm's arrangements and systems should be able to identify "**all significant risks** to its operation". This is in keeping with the requirement set out in Article 19(3)(a) MiFID II.
- Article 48(5) MiFID II provides that a regulated market or MTF must "ensure that the parameters for trading are appropriately calibrated…". This indicates that a firm could comply with this provision by overseeing the calibration process (rather than actually performing the calibration itself). However, MAR 5.3A.6R states that "a *firm* must calibrate the parameters for halting trading". We consider that this wording is unduly restrictive and that MAR 5.3A.6 R should track the wording set out in Article 48(5) MiFID II:

  For the purposes of MAR ~~5.2A.3R~~ 5.3A.5R and to avoid significant disruptions to the orderliness of trading, a firm must ~~calibrate~~ arrange for the parameters for halting trading to be calibrated in a way which takes into account the following [...]

- We consider that where a firm has reported the parameters mentioned in MAR 5.3A.6R to the FCA in writing or by email to its usual supervisory contact, it should be regarded as having complied with the obligations set out in MAR 5.3A.7R. In our view, requiring firms to ensure that they have received an electronic confirmation of receipt would impose an unnecessary level of regulatory burden for minimal benefit (and is not required to implement Article 48(5) of MiFID II). We would propose the following amendments to MAR 5.3A.7R:

  The firm must report the parameters mentioned in MAR 5.3A.6R to the FCA in writing, by electronic mail to an address for the usual supervisory contact of the firm at the FCA~~, and obtain an electronic confirmation of receipt~~.

- In accordance with Article 48(9) MiFID II, MAR 5.3A.11R(3) should be limited to shares or suitable baskets of shares, rather than "financial instruments or suitable baskets of financial instruments".
- In accordance with Article 48(10) MiFID II, MAR 5.3A.13R should make clear that members and participants of an MTF must flag orders generated by algorithmic trading. Consequently, we would propose the following amendments to MAR 5.3A.13R:

A *firm* must require members and participants of an *MTF* operated by it to flag:

(1) orders generated by *algorithmic trading*;~~ in order for the *firm* to be able to identify the following~~:

~~(1)~~ (2) different algorithms used for the creation of orders; and

~~(2)~~ (3) the persons initiating those orders.,

in order for the firm to be able to identify them.

Where applicable, the above comments apply equally to the equivalent OTF provisions.

Q18 Do you agree with our proposal to add a new section to MAR for Algorithmic and HFT firms, DEA providers and general clearing members? If not, please give reasons why

Yes, we agree with the inclusion of the new chapter in MAR. This approach should make it easier for algorithmic and HFT firms, DEA providers and general clearing members to see which obligations under the FCA Handbook apply to them.

Q19 Do you foresee any implementation issues with the content of MAR 7A? If so, please provide examples

In order to ensure consistent implementation across the industry, ISDA members are of the view that it would be beneficial to receive further clarity on certain points arising from MAR 7A.3.7R. In particular:

Duration of the Report

In the event of regular reporting, ISDA members consider that it would be helpful to clarify the duration that firms need to consider when producing the report under MAR 7A.3.7R, as the details required to be included in the report will vary over a period of time. For example, sometimes the period could be as short as a trading day.

Scope of the Report

ISDA members understand that the report should contain only the algorithms that are deployed as at the date of producing the report, or that were in use prior to the date of producing the report.

Trading Parameters and Limits

ISDA members understand that the algorithms used by most firms include trading parameters and limits that are configurable, as well as embedded in the algorithmic code. Configurable parameters and limits will be adjusted, dependent on market conditions. In addition, parameters and limits could be absolute or percentages and will vary across platforms and firms. Consequently, ISDA members would like clarity on whether the FCA is interested in the types of parameters and limits that the firm's system is subject to, or the actual values of the parameters and limits, or both. ISDA members would also like to understand whether firms are permitted to provide a general overview of the parameters and limits that each algorithmic platform is subjected to that demonstrate the types of controls under this section.

Details of testing of firms systems

ISDA members already undertake tests as required and applicable to the algorithm and will be additionally performing tests as mandated by the regulation. The types of tests include system tests, conformation tests, stress tests, performance tests and penetration tests, to name a few.

ISDA members would like to understand if the intention of the FCA is to capture the detailed test cases of each type of test under this section, which may also include proprietary information detailing the behaviour of the algorithm.

ISDA members would suggest that firms provide the types of testing that are applicable to the algorithm and the frequency in which they are conducted, together with the last tested date, to the regulators.

Accurate and Time Sequenced Records

As mentioned above, the duration or time period to be considered for the report has a significant impact on the amount of data required to be transmitted for accurate and time sequenced records. Firms also face the additional challenge of transmitting large volumes of data. Consequently, ISDA members would like to understand what mechanisms will be in place for firms to provide this information. Otherwise, firms might be required to develop additional technical and operational support to provide this information.

Further information

ISDA members request that the FCA provide additional guidelines or examples of further information that firms may be requested to provide.

General guidelines on report format and details to be included

Systems and controls, testing details and parameters and limits will constitute a very large set of data that firms will need to transmit. ISDA members are of the view that providing additional guidelines on the format of the submission and guidelines on details to be included in each section would be helpful in ensuring a consistent response from firms, as well as aiding interpretation by regulators.

Mode of Submission

As a large amount of data is being requested by the FCA under this section, ISDA members are of the view that clarifying the mode of submission will enable firms to put the required technical and operational support in place.

In addition, we foresee difficulties with implementing the requirements under MAR 7A.3.8 (2) as it is unclear whether the HFT requirements apply to the firm as a whole or is restricted to those businesses that engage in HFT. If all of the business lines at the firms are obligated to store accurate and time sequenced records of all of their placed orders including cancelled orders, executed orders, and quotations on trading venues, irrespective of whether or not they qualify as HFT, this would impose an enormous data storage burden that would be extremely expensive and difficult to implement. Given that the MAR 7A.3.8 (2)(c) does not distinguish between firm versus indicative quotes, this is going to have a material impact in terms of performance and cost if firms need to record and store this information (potentially billions of messages per day) as firms stream indicative quotes as part of their market making activity. Applying HFT record keeping requirements to indicative quotes would not give regulators significant data benefits since these quotes are not executable, and, in addition to being inconsistent with market transparency requirements under the SI regime (applying to firm quotes only), would impose a data retention burden to firms that is disproportionate to the risk.

Q20 Are you in favour of the reports under MAR 7A.3.7 and MAR 7A.4.5 being submitted to us regularly, as opposed to an ad hoc basis?

Before stating a preference, ISDA members request that further detail be provided on the requirements for 'regular' and 'ad hoc' reporting (for example, the frequency with which reports should be made under a 'regular' reporting regime and the circumstances in which the FCA would request reports under the 'ad hoc' reporting regime). This level of detail is not currently included in the FCA's Consultation Paper.

In addition, ISDA members are concerned that if ad hoc reporting were to be introduced, the requirements in MAR 7A.3.7 and MAR 7A.4.5 to provide the relevant information to the FCA "within 14 days from receipt of the request" would not give firms sufficient time in which to provide all the information specified. Consequently, ISDA members would propose that the timeframe for providing such information be extended to "within **30** days from receipt of the request".

ISDA members are supportive of a reporting regime that is proportionate (taking into account all relevant factors, including the burdens that it imposes on firms) to the perceived risks that it is seeking to guard against.

ISDA members also understand that the U.S. Commodity Futures Trading Commission's proposed rules on automated trading will require the annual reporting of information that is of a similar nature to that required under MAR 7A.3.7 and MAR 7A.4.5. In order to leverage off of the new systems that firms may build in order to comply with the automated trading regime, ISDA members propose aligning MAR 7A reporting with the automated trading regime to the extent possible.

Q21 If you are in favour, what will be the advantages of regular reporting as opposed to ad hoc reporting?

As stated above, in light of the absence of detail regarding the regimes and how frequently 'regular' reporting would be required, ISDA members are currently unable to state a preference between 'regular' and 'ad hoc' reporting. However, ISDA members do recognise that 'regular' reporting would provide increased certainty as to their obligations.

Q22 If we were to require regular reporting, what would be the cost to your firm?

ISDA members are unable to provide an accurate estimate of the cost to them of regular reporting until further detail on the regime is provided. The response to Q.19 above sets out certain information that ISDA members will require in order to determine the systems build and associated costs of compliance with the regular reporting regime.

9. Passporting and branches of non-European Economic Area (EEA) firms

Q23 Do you agree with our proposed Handbook changes on passporting? If not, please give reasons why

We broadly agree with the proposed changes to the Handbook. However, we would propose the following amendments

- Proposed amendment to SUP 13.3.1G (2)(a):

  Note that if a *UK MiFID investment firm* is seeking to use a *tied agent* established in another *EEA State* in order to provide *investment services or activities*, ~~the tied agent is assimilated into the branch. As such, the appointment of a tied agent established in another EEA State~~ this amounts to the exercise of establishment rights and leads to the application of conduct requirements to the *tied agent's* business as if it was the *branch* of a *UK MiFID investment firm*.

  The first amendment is intended to make clear that the obligation under MiFID II are without prejudice to the right of tied agents to undertake activities covered by other Directives and related activities in respect of financial services or products not covered by MiFID II.

  We have also proposed combining paragraphs (2)(a) and (b) as it is not clear what the FCA means by "the tied agent is assimilated into the branch", as a UK MiFID investment firm may have a tied agent in an EEA State where it does not have a branch, so there would be no branch for the tied agent to be assimilated into. If the FCA would prefer to follow the wording of MiFID2 more closely, it should track the wording of Article 35(2) MiFID2 (which makes it clear that a tied agent will only be assimilated into a branch if one exists) and provide guidance on what is meant by "assimilated into".

- Proposed amendment to SUP 13A Annex 2G:

  We would propose that section 11 of this Annex be deleted as it relates to the ability of competent authorities to impose super-equivalent requirements under MiFID1.

Q24 Do you agree with the drafting of our proposed rule to apply obligations in directly applicable regulations to UK branches of non-EEA firms? If not, please give reasons why

We agree that in order to prevent a third country investment firm from being treated in a more favourable way than an EEA firm when conducting MiFID business from an establishment in the UK, obligations in directly applicable regulations should apply to UK branches of non-EEA firms.

We have no comments on the proposed drafting of GEN 2.2.22A.

10. Principles for Business (PRIN)

Q25 Do you agree with our proposal to apply Principles 1, 2, 6, 7 and 8 in full to firms when conducting business with ECPs under MiFID II? If not, please give reasons why

ISDA members are supportive of a proportional approach being taken in the application of Principles 1, 2, 6, 7 and 8 to firms conducting business with ECPs under MiFID II.

For example, ISDA members would not consider it appropriate for guidance developed primarily with retail customers in mind to be applied to the provision of services and products to ECPs. ISDA members would therefore welcome confirmation from the FCA that such guidance does not apply when conducting business with ECPs.

Q26 Do you agree with our proposal to update PRIN 1 Annex 1 to delete the possibility of local authorities being treated as ECPs for the purposes of PRIN in respect of non-designated investment business? If not, please give reasons why

ISDA makes no comment on the proposal to delete the possibility of local authorities being treated as ECPs in respect of non-designated investment business.

However, ISDA disagrees with the proposal to delete PRIN 4.1.4G(1)(a) as certain requirements under MiFID II are disapplied in respect of eligible counterparty business. For example, Article 30(1) MiFID II states that investment firms "may bring about or enter into transactions with eligible counterparties without being obliged to comply with the obligations under Article 24, with the exception of paragraphs 4 and 5, Article 25, with the exception of paragraph 6, Article 27 and Article 28(1) in respect of those transactions or in respect of any ancillary service directly relating to those transactions". Consequently, ISDA members are of the view that PRIN 4.1.4 G(1)(a) should not be deleted.

ISDA Safe, Efficient Markets

11. Perimeter Guidance (PERG)

Q27 Do you agree with our proposal to continue to offer perimeter guidance in relation to the scope of EU legislation by updating PERG 13? If not, please give reasons why

Yes, ISDA members welcome the continuation of the perimeter guidance provided by PERG. However, in relation to the FCA's proposed amendments to PERG 13, ISDA members note the following:

- For clarity, Q15 in PERG 13.3 should be amended as follows:

  This activity could ~~includes~~ include the issue of their own *financial instruments* by an *investment firm* or a *credit institution*. However, as set out in further detail in our answer to Q15A, not every issue of *financial instruments* amounts to the MiFID investment service of execution of orders on behalf of clients.

- Proposed amendments to Q24 in PERG 13.3:

  We would propose the following amendments to the final sentence of the proposed response to Q24 in PERG 13.3:

  "A multilateral trading facility involves a multilateral trading system (for example, a trading platform) operated either by an investment firm or by a market operator which brings together multiple third-party buying and selling interests ~~buyers and sellers of~~ in financial instruments – in the system and in accordance with non-discretionary rules - in a way that results in a contract."

  We understand that the word "brings" has been deleted from the FCA's draft text in error. The other amendments are proposed to bring the text of Q24 in line with the definition of "multilateral trading facility" in MiFID2. These amendments would also ensure consistency with the approach taken in response to Q24A in PERG to the definition of "OTF".

- Proposed amendments to PERG 2.7.7DD G(3):

  The proposed wording in PERG 2.7.7DDG(3) which currently omits reference to securitised derivatives. The definition of "derivatives" in Article 2(1)(2) of MiFIR refers to financial instruments defined in Article 4(1)(44)(c) of MiFID2 (i.e. securitised derivatives) as well as financial instruments falling within section C4 to C10 of Annex I of MiFID2. We would propose amending PERG 2.7.7DDG(3) as follows:

  "However, a product in (2) is only a non-equity MiFID ~~investment~~ instrument if it also falls into one of the following categories:

  (a) a bond;

  (b) a structured finance product; ~~or~~

  (c) an instrument falling within point 44(c) of Article 4(1) of MiFID; or

  (d) an instrument falling within section C4 to C10 of Annex I of MiFID (these are described in PERG 13.4)."

  Alternatively, we would welcome amendment of PERG 2.7.7DD G to reflect the definition of "non-equity MiFID instrument" set out in the FCA's proposed amendments to the Glossary in Annex A to the CP, under the definition of "operating an organised trading facility".

Q28 Do you agree with our interpretation of the definition of a multilateral system? If not, please give reasons why

We welcome the FCA's proposed guidance on what constitutes a "multilateral system", as set out in the proposed PERG 13.3 Q24B guidance. As the FCA highlights, this term forms a fundamental part of the definitions of both an organised trading facility and a multilateral trading facility, and is the trigger for the requirement in Article 1(7) MiFID2 to operate as a regulated market, an MTF or an OTF. In order to limit any uncertainty in the scope of these provisions and on the applicability of MTF and OTF requirements to trading activity in general, it is therefore critical to clearly delineate the extension of this term. It is likely that without this clear delineation, the scope of instruments traded on a trading venue would increase significantly.

In particular, the proposed guidance does not clearly distinguish between (i) systems which are designed with the purpose of matching third-party trading interests, and (ii) trading activity which incidentally involves ad hoc matching of such interests. In our view the latter should not constitute the operation of a multilateral system, as it does not involve the operation of a system designed to allow for interaction between third-party interests. In contrast, it may simply involve alignment of particular third-party interests in the context of a particular transaction and incidental to the investment firm's business model.

For example, in a non-equities context a bond trader may receive an order relating to a large position from one client, which the trader may unwind by engaging in matched trades with one or more clients taking opposing positions. Such activity may involve matched principal trading, in part or in whole, if this would follow client instructions or would be advantageous to the quality of execution provided to the client, but is unlikely to be the way in which a dealer would structure its business as a whole. In our view, this activity should be permissible for a systematic internaliser, provided that it does not result from the design of the trading system of the systematic internaliser's business model. FCA perimeter guidance would therefore be welcome on this point, however the proposed drafting does not provide certainty on the extent to which such activity may occur. Similar concerns arise in relation to ad hoc futures crossing by brokers and ad hoc internalisation.

We would therefore propose the following amendment to paragraph six of the proposed PERG 13.3 Q24B guidance, in order to clarify that activity will only constitute the operation of a multilateral system where it involves a system whose purpose is to facilitate interaction of third-party trading interests:

In particular, a platform will be considered a multilateral system (and hence be required to operate as a regulated market, MTF or an OTF in accordance with article 1(7) of MiFID) if the system <u>is designed with the purpose of</u> ~~provides the ability for trading interests to interact by~~:

- **allowing multiple participants to see such information about trading interest in financial instruments, or to submit such information about trading interest in financial instruments for matching; and**
- **enabling them, through technical systems or other facilities, to take steps to initiate a transaction, or be informed of a match.**

We would also propose deleting the last sentence of the proposed PERG 13.3 Q24B guidance, as this appears to be inconsistent with the rest of Q24B and with Article 1(7) of MiFID2. If all systems which qualify as multilateral systems are required to be authorised as regulated markets, MTFs or OTFs, the definition of "multilateral system" should not go beyond the definition of an OTF, MTF or of the systems operated by regulated markets. We would propose the following amendment to address this point:

~~The definition of a multilateral system goes beyond the definitions of an OTF and MTF and of the systems operated by regulated markets.~~