24 September 2021

Wholesale Markets Review
Securities and Markets, Financial Services Group
HM Treasury
Horse Guards Road
SW1A 2HQ

Sent via email : WholesaleMarkets.Review@hmtreasury.gov.uk

Dear Tom,

Wholesale Markets Review

The International Swaps and Derivatives Association, Inc. (**ISDA**)[1] welcomes the opportunity to respond to HM Treasury's Wholesale Markets Review.

Summary

The Wholesale Markets Review (WMR) is a welcome opportunity to tailor the UK MiFID II/MiFIR framework to the UK markets and ISDA members support a large majority of the proposals made by HM Treasury. The WMR is an important step to improve the conditions under which market participants (trading venue operators, credit institutions and investment firms, institutional investors such as asset managers or insurers, data providers and corporates) operate in financial markets.

The implementation of the MiFID II/MiFIR framework has been a long and demanding process and the benefits are still difficult to assess. The fact that many concepts which were originally created to address the functioning of equity markets, are also used for the regulation of derivatives markets, generated uncertainties, and confusion. We welcome the recognition in the WMR of the important differences between asset classes and the acknowledgment that these differences should be reflected in the regulatory framework.

We agree that some rules have not delivered their intended benefits and that adjustments are required to improve the effectiveness of rules applicable to derivatives markets, particular on data, reporting, transparency and the systematic internaliser (SI) regime.

ISDA members are keen to engage with the UK authorities to make this review as comprehensive and effective as possible. ISDA generally support proposals that will make UK

[1] **About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 member institutions from 78 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. Follow us on Twitter, LinkedIn, Facebook and YouTube.

markets effective and that will contribute to mid- and long-term benefits for all market participants operating in the United Kingdom. They are also keen to ensure that there is an appropriate timeframe and phase-in approach to regulatory changes (notably on the transparency and systematic internaliser regimes) to limit the short-term operational costs and challenges. In setting implementation dates, it would be useful if there could be a phase-in period or some provision for firms that are currently relying on the Temporary Transitional Relief extended by the FCA and PRA, to avoid those affected firms having to execute two major implementation projects within the space of a few months.

We also noted the concerns expressed by members that the UK framework may evolve substantially from the EU framework. However, ISDA gives the priority to the long-term benefits for the industry and underlines that the review of the EU MiFID II/MiFIR framework is uncertain in terms of content and timeline.

We would welcome the opportunity to discuss these and any related issues further with you and are also very happy to answer any questions you may have in the meantime.

Yours sincerely,

Fiona Taylor

Director, UK Public Policy

Trading venues (chapter 2)

Question 2 Do you think it would be more appropriate for changes to be made to the definition of a multilateral system in legislation, or for the application of the existing definition to be clarified through FCA guidance?

We do not think that changes should be made to the definition of a multilateral system.

ISDA members consider that the rapid development of technology providers (aggregators, distributors of data, connectivity utilities) in the past few years has brought new solutions for end-users and are valued as such.

We equally recognise that the question of whether some of these technology providers should be treated as multilateral systems is legitimate as we support the principle that comparable trading systems should be regulated and supervised in a consistent manner.

In this respect, we consider that the key factor that should be taken into account in the definition of multilateral systems is whether the system enables (or not) multiple third parties to interact in the system. If the system only allows for multiple bilateral interactions -which would have to concluded on a bilateral basis- it should not be deemed a multilateral system. In other words, only the operators who aggregate buying and selling orders and enable the execution of the transaction through their system should be deemed multilateral systems.

Systematic Internalisers (chapter 3)

Question 20 Do you agree that the definition for SIs should be based on qualitative criteria?

Yes, we strongly believe that the definition for SIs should be based on qualitative criteria.

ISDA members have invariably noted that one of the main issues associated with the definition of SIs in derivatives markets is that rather than focusing on the nature of the instruments traded by SIs, the definition requires calculations which, once certain thresholds are reached, trigger the application of the regime to sub-asset classes of instruments that are bespoke and illiquid by nature.

ISDA has previously advocated for a qualitative clarification that the SI regime applies to TOTV instruments only. However, in light of HMT's proposal to remove the TOTV concept completely, we agree that, in general, the use of other qualitative criteria would be appropriate.

We support a qualitative approach and would like to re-iterate certain outstanding issues associated with the quantitative criteria, which currently combine a) the size of OTC trading carried out by the investment firm in relation to the total trading of the investment firm in a specific financial instrument; and b) the size of OTC trading carried out by the investment firm in relation to the total trading in the EU in a specific financial instrument.

In a recent ISDA paper on Pre-trade transparency and Systematic Internalisers regimes for OTC derivatives, we observe that it is currently impractical for some firms to accurately calculate whether they have exceeded limits (pre-set limits for determining whether an investment firm should be considered an SI) that includes derivatives which are not ToTV, because there is no information available for them to do so. The result is likely to have been that a number of firms that deal on own account elect to be treated as SIs for at least some classes of financial instrument simply to avoid uncertainty because they cannot carry out the requisite calculations.

Therefore, we strongly believe that firms should not be required to carry out calculations to determine their SI status where those calculations require data that is not available to the firm.

To date, ISDA has not formally asked for the removal of the calculations. Nevertheless, ISDA members would welcome an alternative approach, whereby the SI determination is based on a simple qualitative criterion (rather than one requiring complex and costly operational changes to systems).

ISDA members would also support retaining the ability for firms to opt into the SI regime on the same basis as now.

Question 21 If you answered no to question 20: Do you think the definition should be amended in another way?

N/A

Question 22 If you answered yes to question 20: Do you think that regulatory guidance should be used to support the definition in legislation?

Yes, we think that regulatory guidance should be used to support the definition included in the legislation. We recommend further discussion and consultation on this, and our members believe that we could learn from the CFTC swap dealer definition [2] – note that each of these limbs are seen as exclusive – 'or' rather than 'and':

- Holds itself out as a liquidity provider in OTC derivative markets.
- Makes markets in OTC derivatives based on client demand.
- Regularly enters into OTC derivatives transactions with counterparties in an ordinary course of business for its own account.
- Engages in activity in OTC derivatives instruments causing itself to be commonly known as a liquidity provider or market maker.

We believe that the FCA should consult with the industry on the regulatory guidance before it is published. Whilst we suggest that the regulatory guidance could be based on the CFTC swap dealer definition, we do not feel that that reference to CFTC guidance should be directly referenced in UK legislation or guidance and the FCA should not feel bound to follow any more detailed or future CFTC practice and interpretative guidance in this respect.

Question 23 Do you currently opt-in to the SI regime?

Some ISDA members have opted-in, and some others have not. For those members that have opted-in, the main reason has been to take on the post-trade reporting obligation.

For all firms, the transparency and reporting regime associated with the SI regime has proved burdensome and ineffective because of the way the regime was constructed and in particular because of the challenges with the use of ISINs.

For firms which have not opted-in, the SI determination process has been an additional burden made unworkable because of the absence of reliable data on non-ToTV instruments.

In any event, having the ability to opt in is important and ISDA members would recommend that the ability for firms to opt into the SI regime should remain on the same basis as now.

Question 24 Should SIs be determined at entity level instead of on an instrument-by-instrument basis, for reporting purposes?

SIs should be determined at asset class level, with the ability for any firm to continue to opt in to be an SI for other or all asset classes.

Some firms have opted in for some products and not for others because they are large market participants in certain asset classes but not in all asset classes. SI registration at entity level might be challenging for such firms.

[2] https://www.govinfo.gov/content/pkg/FR-2012-05-23/pdf/2012-10562.pdf

For firms that would prefer to opt-in at ‘entity level’, opting in at asset class level for all asset classes would deliver the same outcome.

More generally, one of the challenges in having the linkage between SI status and trade reporting responsibility has been the difficulty in determining with certainty SI status of counterparties.

Firms that deal on own account should be able to opt into the obligation to act as the reporting firm for post-trade transparency purposes for a particular financial instrument or class of financial instruments without being subject to being labelled an SI.

UK authorities could create and maintain a database of ‘super reporters’ by expanding the SI database, adding another section for super reporters where:

- It is made clear that the super reporter has the responsibility to report.
- Trades between super reporters are to be reported by the seller super reporter.

It is important that both the SI and the super-reporter status should operate on an asset class basis, as on the one hand that would give certainty to counterparties, and on the other hand it would allow firms to make sure their regulatory status and super-reporter obligations are aligned to their activities.

Question 25 What would be the risks and benefits of adopting such an approach?

The benefits of adopting an approach as outlined in our answer to Q24 are the certainty that it would bring to clients and the simplification of the reporting landscape.

Question 26 Do you agree with the government’s proposal to allow SIs to execute at the midpoint for all trades, provided the executed price is within the SI’s quoted price?

ISDA has no comment on this question.

Question 27 Do you think any other changes are needed to increase the effectiveness of the SI regime?

ISDA members generally consider that the application of the SI regime to derivatives instruments did not bring added value for end-users of derivatives but created much confusion as to which instruments are covered by transparency and reporting rules, how instruments are identified, and most importantly as to the role of SIs in derivatives compared to SIs in equity markets.

ISDA has consistently raised the concern that the inclination of certain policy makers to treat SIs (for regulatory purposes), as if they were competitors to multilateral trading venues (in particular exchanges) might threaten the ability of market makers to provide hedging solutions to their clients. as well as immediacy of execution to those clients by taking on the risk on balance sheet.

We appreciate that HM Treasury is seriously looking at making the SI regime more effective and we would welcome as a material improvement of the regime the following two outcomes of the review:

1. Clarification that transparency obligations do not apply to instruments that are not traded on trading venues. We note that HM Treasury suggest dropping the ToTV concept and to replace it with the clearing obligation scope. To us the key is to ensure that bespoke, illiquid instruments and packages are out of the transparency scope. The clearing obligation scope might be a pragmatic approach but would benefit from some refinement.

2. Removal of the requirement for SIs to report reference data on uToTV OTC derivatives.

Derivatives Markets (chapter 5)

Question 41 Do you agree that the scope of the derivative trading obligation (DTO) should be revised to bring it in line with the scope of the clearing obligation following the changes introduced by the European Market Infrastructure Regulation (EMIR) REFIT? What risks/ benefits do you see with this approach?

ISDA agrees that the scope of the DTO should be aligned with the scope of the clearing obligation, such that the DTO is always a subset of the clearing obligation, and no trade should be subject to the DTO if it is not subject to the clearing obligation. We would advocate strongly that alignment based on *transaction* terms rather than alignment based on counterparties is a better solution and would future proof UK legislation. We refer to our paper on this that we have shared with you: isda-recommends-aligning-clearing-and-trading-obligations.

Question 42 Do you think that all post-trade risk reduction services should be exempt from the DTO?

Yes, we believe that all post-trade risk reduction (PTRR) services should be exempt from the DTO, as long as these services can demonstrate that the resulting transactions are market risk neutral (other than narrow tolerances) and are not price forming.

Limiting exempted PTRR services to a prescribed set of exempted services could increase compliance costs and stifle innovation, with new services that may not fall within such a list struggling to establish themselves.

Question 43 If you answered yes to question 42:

a) Do you think that there should also be an aligned exemption from the EMIR clearing obligation for trades resulting from post-trade risk reduction services?

Yes, we believe that there should also be an aligned exemption from the EMIR clearing obligation for trades resulting from post-trade risk reduction services.

ISDA members strongly support clearing. From an industry perspective, the growth of the OTC derivative market and its ability to serve the needs of clients has been greatly enabled by clearing. Without clearing, limitations on scarce resources (e.g., capital, funding, leverage, balance sheet) across the industry would severely limit market efficiency. Furthermore, and crucially, the vast enhancements in the efficiency of trade compression since the initial implementation of the clearing obligation have resulted in a situation whereby around 75% of trade volume within the year is compressed and, when trade maturities are included, year-end notional amounts outstanding at CCPs are broadly similar[3] to those at the beginning of the year.

Clearing has increased steadily, as shown by graph A8 in the May 2020 BIS "Statistical release: OTC derivatives statistics at end-December 2019"[4]. Compression has increased at a similar rate, enabling the increase in cleared transactions.

[3] within approximately 10% rounding tolerance

[4] See https://www.bis.org/publ/otc_hy2005.pdf. For more granular detail, in January 2020 LCH published a press release announcing, once again, record volumes cleared in 2019. Specifically, to quote: "In 2019, SwapClear,

In short, for those products where it is available, clearing – together with compression and other post trade risk reduction (PTRR) services - has become a very efficient solution while, as set out by the G20, greatly reducing the overall risk in the system.

However, despite the efforts of the financial industry to clear portfolios of suitable transactions, firms still have sizeable bilateral portfolios. The trades that remain in bilateral portfolios between firms are often complex and customised. These portfolios mostly consist of transactions for which clearing is unavailable or where there is no widespread use of clearing in those markets. Unfortunately, simply expanding the scope of CCP service offerings to encompass such trades would represent a systemic risk that was recognised, and ruled out, by policymakers and regulators when designing regulations like EMIR.

However, while the first order counterparty risks are mitigated by margining of these portfolios, these portfolios can pose a growing, emerging risk to firms and the wider market:

- Default competition risk: if a market participant defaults, both CCPs and non-defaulting market participants, may compete for hedges to close out the defaulter's risk. The larger the bilateral portfolios, the greater this competition can become.
- Liquidity risk: bilateral positions can have different directionalities and tend to be offsetting to a large degree. Large market moves trigger large margin payments, and a firm cannot rely on receiving all incoming margin receipts on time so has to fund the gross outflowing margin.

In addition, there are general liquidity issues caused by inefficient margining in the bilateral portfolios. Margin (both IM and VM) has to be paid/posted to/by each counterparty. As a result, the requirement for high quality liquid assets (HQLA) is large and, in times of stress, might cause problems for some market participants with lesser access to liquidity.

We also believe that an exemption from the clearing obligation for transactions resulting from PTRR services would increase the use of such services:

- Smaller, less sophisticated firms might not be able to trade, price and risk manage swaptions etc., but would be comfortable with vanilla products.
- The use of swaptions for PTRR purposes could be seen as avoiding the clearing obligation.
- The use of more vanilla products will make the compression more straightforward and therefore easier to manage for firms.
- The use of swaptions might mean additional operational requirements to service these products.

b) What conditions do you think should be met for the exemption to be applicable?

LCH's interest rate derivatives clearing service, registered over $1,229 trillion in notional, an increase of 14% from 2018's volumes. Compression volumes also continued to grow, with more than $920 trillion compressed over the course of the year, up 19% from 2018."

"

To achieve this risk reduction in a strictly controlled manner, we propose an exemption from the clearing obligation for such technical risk reducing transactions under the following strict conditions:

- Independence of in-house traders to avoid gaming: PTRR exercises should be performed by providers independent of the market participants.
- Risk reduction exercises need to demonstrate that the risk in each affected bilateral portfolio has been reduced. Additionally, further efficiency can be achieved if de minimis risk increases are allowed in individual bilateral relations, within a strict predefined tolerance, and only if this enables significantly greater reductions in risk in other bilateral relations for both affected firms.
- If required, as an additional safeguard the following condition could be introduced: For each bilateral technical risk reducing transaction resulting from risk reduction exercises that is exempt from the clearing obligation, equal and opposite technical risk reducing transactions must be booked facing a CCP (on a net basis).

Note that these controls are only relevant for PTRR exercises that avail themselves of an exemption from the clearing obligation. We do not propose to apply these controls to services that are possible now and do not require an exemption from the clearing obligation.

- Control 1 of 3: **Independent of Trading Firms**

  The end-to-end process must be non-discretionary. In other words, at no point should a trader or other employee at any firm subject to the clearing obligation be making decisions about whether a trade should be cleared or not.

  Rather, the industry believes this should be a technical risk management process being run independently of the market participants by a regulated firm. There are firms that run trade compression services that operate on an all-or-nothing basis whereby trading firms submit their positions on a post trade basis, and these third-party companies calculate the appropriate adjustments needed to best manage the risk in the portfolios submitted. Firms participating in compression runs must either accept or reject in full the result of the exercise, with the PTRR run only completed if all participating firms accept it fully.

  By making these processes run by such firms supervised in an appropriate manner, the algorithms that are used, and their outputs, would be under the purview of regulators and, thus, both independent of market participants and subject to an appropriate level of oversight.

- Control 2 of 3: **Risk Reducing on a Portfolio-by-Portfolio basis**

  Where any two parties to such a process agree to book a transaction into a bilateral portfolio, they must be able to demonstrate by some measure that the risk in that portfolio is reduced.

  The appropriate measure would be developed as part of UK secondary legislation but, as an initial suggestion, it would be appropriate for participating firms to agree a suitable measure, in alignment with their own risk appetites with their prudential regulator.

  This would ensure that the definition of "reduction" for a given firm aligns with its business-as-usual risk management framework.

In this way, participating firms would be restricted in such a way as to allow risk reduction only ever on a bilateral basis. Since both illustrated emerging risks benefit when bilateral risks are reduced, we believe this is a necessary and useful control.

It is worthy of note that existing PTRR offerings, using products currently not subject to the clearing obligation (such as longer dated OIS trades), have shown that allowing counterparty risk to increase a de-minimis amount in some portfolios can significantly raise the potential for overall risk reduction. In such cases, small increases in counterparty risk in one bilateral counterparty relationship might be realised in order to facilitate greater counterparty risk reduction across netting sets.

Therefore, we believe consideration should be given to permitting this additional efficiency, noting that these tolerances would be small compared to the counterparty risk of each added transaction, meaning that no participating firm would know ex-ante in which direction the tolerance will be applied and therefore cannot use these tolerances (even if they were larger) to add price forming risk to the portfolio.

- Control 3 of 3: **For Each and Every Technical Risk Reducing Transaction Booked in a Bilateral Portfolio that benefits from this exemption, an Equal and Opposite Risk Must be Booked Facing a CCP**

If HMT feels necessary, as a third condition a requirement could be introduced that for each and every technical risk reducing transaction booked in a bilateral portfolio that benefits from this exemption, an equal and opposite risk must be booked facing a CCP. Mechanically this control would operate in the following way. Where firms A and B are proposing to enter in a technical risk reducing transaction (an output trade from the PTRR exercise) - for instance an interest rate swap (IRS) that is exempt from clearing (by virtue of a clearing obligation exemption facilitated by the outcome of this consultation), they would accept this swap and book it in their bilateral portfolio. In addition, they would book a second, equal and opposite technical risk reducing IRS, which they would give-up to a CCP.

As a technical matter, to avoid unnecessary booking (and subsequent compression) of large numbers of offsetting technical risk reducing transactions, PTRR service providers should be permitted to pre-compress CCP-facing technical risk reducing transactions such that the CCP facing risk is booked efficiently, while keeping records of the corresponding bilateral and cleared IRS to demonstrate compliance with control 3 to supervisors.

This third control has four desirable effects:

1. By definition, the total sum of the exposures of all the technical risk-reducing transactions booked must be zero and, thus, the overall exercise should be demonstrably non-price-forming. We believe this is a key aspect of post-trade portfolio management services, both from a regulatory perspective and, importantly, from a market perspective. In developing these services, it is key for trading desks and their customers to be assured that they will not move the market.
2. From an auditability perspective, it would be easy for supervisors to check that, indeed, for each and every bilateral IRS there was an equivalent cleared IRS, and that the risk booked versus the CCP equals (and offsets) the risk booked into bilateral portfolios under this limited exemption.

3. In line with the G20 commitment and general regulatory goals, this approach demonstrably rebalances risk between bilateral and cleared portfolios. Control 2 ensures that the bilateral risk must be reduced (in each and every portfolio) and, while it is possible that the overall risk in the CCP might be reduced or increased – it depends on the overall positions of the parties in question – what is certain is that the overall proportion of risk warehoused at the CCP (rather than bilaterally) will be increased, in line with policy goals.
4. By focussing only on transactions that would be exempt from the clearing obligation, existing PTRR services can continue unchanged.

This third control would ensure that affected PTRR transactions would not be price-forming and that risk would be migrated into the CCP. There could however be a concern that – depending how risk in in the cleared and uncleared portfolios are distributed, these PTRR exercises could result in moving risk from the cleared portfolio to the uncleared portfolio. We therefore see this control as elective.

By applying at least the first two controls cumulatively, we can be assured those risks can be managed, but controls are suitable and sufficient to prevent a weakening of the clearing obligation in existing regulation. Furthermore, as, and when the scope of the clearing obligation expands, this future-proofed approach automatically expands with it. It would also automatically cover other asset classes, such as FX and Equities as and when the clearing obligation is extended in scope to cover those products.

Note, this proposal is not intended to limit the scope of products available to PTRR service providers as there are good reasons why more complex products might be used by such service providers – particularly where a firm has offsetting complex bilateral risks. The proposal applies where a PTRR service provider, as part of its offering, proposes the booking of a technical risk reducing transaction - that would normally be subject to the clearing obligation - into a bilateral portfolio.

Question 44 Do you think the FCA should be given the power to modify or suspend the DTO quickly under certain circumstances, on a permanent rather than temporary basis?

Yes, ISDA members agree that the FCA should have the power to modify or suspend the DTO. In this context, it is important that the FCA sets out principles that would trigger a DTO suspension.

And importantly, the FCA, when using this power, should give firms sufficient notice that it intends to suspend the DTO, wherever possible.

Question 45 Do you think that the current transparency requirements support price formation and open, competitive, and fair markets? Please separate your answers by fixed income (please treat sovereign bonds, high-yield bonds, and investment-grade bonds separately) and derivatives (please distinguish between OTC and exchange-traded derivatives (ETDs) where relevant).

ISDA's response focuses only on derivatives markets.

ISDA members strongly believe that the current MiFIR pre-trade transparency regime for OTC derivatives traded outside trading venues does not meaningfully assist price formation or best execution but exposes market makers, notably those acting as SIs, to 'undue risks' (in the MiFIR Level 1 sense). They also consider that the post-trade transparency regime is flawed notably because of the use of an inappropriate identifier for derivatives (ISINs)

ISDA members have always held the view that the transparency requirements should be limited to instruments that are traded on trading venues.

ISDA members would urge HM Treasury to consider the following distinction between pre- and post-trade transparency.

- Pre-trade transparency is generally meaningless in derivatives markets and, should it be required, it should only apply to electronic order books.
- Post-trade transparency should reflect the underlying liquidity of instruments and take into consideration the risk pricing functionality provided by market makers.

Question 46 Do you think that using traded on a trading venue (ToTV) is a useful criterion for determining the scope of transparency requirements for non-equity instruments, and in particular OTC derivatives? Please separate your answers by fixed income (please treat sovereign bonds, high-yield bonds and investment grade bonds separately) and derivatives (please distinguish between exchange treaded and OTC derivatives).

ISDA's response focuses only on derivatives markets.

We note that, in the UK as well as in the EU, regulators and policymakers are reluctant to continue to use the concept of ToTV and indeed that HMT is proposing to remove it completely.

ISDA members note that this concept was established to limit the application of transparency rules in the first place but that the application of transaction reporting to all instruments traded on SIs (including non-ToTV instruments) made the distinction between ToTV and non-ToTV less relevant as non-ToTV instruments would also require generation of ISINs. ISDA members therefore recognise that the merits of keeping the ToTV concept are not anymore apparent.

Should the UK authorities confirm their willingness to drop the ToTV concept, ISDA members would urge UK policy makers to examine which of the following two options is the most appropriate for the scope of the transparency regime:

- Derivatives which are subject to the DTO under UK MiFID II
  Or
- Derivatives subject to the clearing obligation limited to G4 currencies

A phased approach could be based on the clearing obligation initially and ensures that it brings meaningful transparency, with the FCA undertaking periodic assessments of scope.

ISDA members note that HM Treasury is considering the scope of centrally cleared products irrespective of whether they are subject to a clearing mandate or are cleared voluntarily. ISDA members are sceptical as to how such scope could be workable in practice because there is no legal definition of contracts that are centrally cleared without clearing mandate. Most importantly, this might have unintended consequences for contracts that would prove clearable as it might disincentivise market participants to centrally clear them because they would not have the transparency system in place and because end-users may have reservations on the application of transparency requirements. It is very important here to keep in mind that corporates use bespoke interest rate derivatives to hedge the risks faced in the course of their industrial business and that the publication of the details of the trade (pre-trade and even post-trade if there was no deferral) would be inappropriate for their future ability to hedge risks.

ISDA members therefore do not believe the transparency regime should apply to all cleared instruments and would rather support the scope of clearing obligation as the maximum scope of products subject to transparency, initially limited to the G4 currencies.

We note that the UK Government seeks to achieve greater transparency with these reforms. We would propose a three-step process to achieve greater, more meaningful, transparency in the UK:

(1) Transparency must become more meaningful. ISDA members strongly believe that the current 'quantitative' approach to transparency is inappropriate as long as data quality issues are not fixed. ISDA members highlight that the reason why end-users of derivatives do not use transparency is that data quality is poor and not that the quantity of data is insufficient.
(2) The scope of the transparency regime in the UK should start with the set of either G4 products subject to mandatory clearing or those derivatives subject to the DTO and be subject to an appropriate phase-in. This will ensure that we get the transparency regime right for the UK, and that it is carefully crafted.
(3) Once the above steps are embedded successfully, the scope could be expanded, perhaps to specify certain products which are voluntarily cleared that could be subject to transparency rules without detrimental effects to the market.

Question 47 If you answered no to question 46: Do you think the concept of ToTV should be removed for OTC derivatives, and the scope of the transparency regime determined on the basis of whether the instrument is cleared? If so, what definition of 'cleared' should be used?

As stated in response to question 46, members would urge the FCA and HM Treasury to examine which of the following two options is the most appropriate:

- Products which are subject to the DTO under MiFID II
  Or
- Products subject to the EMIR clearing obligation, in which case we suggested it should be limited to G4 currencies

A phased approach could be based on the clearing obligation initially with the FCA undertaking periodic assessments of scope.

Question 48 Do you think there is another option to determine the scope of the fixed income and derivatives transparency regime? Please separate your answers by fixed income (please treat sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (please distinguish between exchange traded and OTC derivatives).

As an alternative to our suggestion made in response to questions 46 and 47, ISDA members would propose to look at the set of instruments for which broker-dealers are streaming prices and to treat these instruments as liquid. Members would also support amendments of the scope to benchmark tenors in EUR/USD/GBP single currency IRS, and constituents of the iTraxx Main and Crossover CDS indices. These changes would significantly simplify the liquidity calibrations and only include liquid instruments.

Question 49 What instruments do you think should be in scope of the fixed income and derivatives transparency regime? Please consider fixed income (please treat sovereign bonds, high-yield bonds and investment-grade bonds separately) ETCs, ETNs, structured finance products, emission allowances and derivatives (please distinguish between exchange traded and OTC derivatives).

The scope should be limited to cover the benchmark tenors only (EUR/USD/GBP), single currency IRS, and iTRAXX main and crossover indices in the CDS market.

Question 50 What changes do you think are needed to enable liquidity calculations to work effectively? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds) and derivatives (ETDs and OTC derivatives).

The scope should be amended as per the answer to question 49.

Question 51 Do you think it would be preferable to move away from regular liquidity calculations towards a mix of qualitative and quantitative criteria? For example, on a sectoral basis? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

Yes, rather than calculations, ISDA members would support a qualitative approach as per the answer to question 49.

Question 52 How do you currently use pre-trade transparency? Is pre-trade information on bonds and derivatives valuable? Please differentiate between fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives), and each trading method (for example RFQ, and order book

ISDA members strongly believe that the current MiFIR pre-trade transparency regime for OTC derivatives traded outside trading venues does not meaningfully assist price formation or best execution but exposes market makers, notably those acting as SIs, to undue risks.

They note that pre-trade data is not used and that market makers would not normally receive any client RFQs based on published pre-trade data.

Question 53 Is there a case for removing MiFID II pre-trade transparency requirements for any asset class? Please separate your answers by fixed income (sovereign bonds, high-

yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

Yes, ISDA members strongly believe that there is a case for removing the pre-trade transparency regime for derivatives.

The current MiFIR pre-trade transparency regime for OTC derivatives traded outside trading venues does not meaningfully assist price formation or best execution but exposes market makers, notably those acting as SIs, to undue risks.

Question 54 If you answered yes to question 53: Do you think that RFQ, bilateral negotiations and indications of interest provide sufficient information for markets to function effectively? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

Yes, they do provide sufficient information to the market.

Question 55 How do you use pre-trade quotes streamed by SIs? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

ISDA has no comment on this question.

Question 56 For SIs, what impact do you think removing pre-trade transparency requirements would have on your business? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

ISDA has no comment on this question.

Question 57 Do you have any other comments on the pre-trade transparency regime?

ISDA has no comment on this question.

Question 58 How do you currently use deferrals? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

First of all, ISDA members would like to reiterate that the ability of market makers to provide liquidity and enable hedging activity by market participants depends in turn on their ability to offset those risks and avoid exposure to 'undue risk', i.e. the risk that their exposure is known by other market participants who would take advantage of it with predatorial behaviour ('Undue risk' is recognised as a basis for waivers and deferrals from post-trade transparency in MIFIR Level 1). Currently, post-trade transparency deferrals go up to 4 weeks.

If as suggested in our response to question 49, the scope of the post-trade transparency regime in the UK is narrowed down to the most liquid instruments, ISDA members believe that the UK could adopt a different and less complex deferral regime compared to the one we have today. In such a situation, the principle could be, for trades above a certain size, to be published individually 2 days after the trade occurred, with the volume protected/masked permanently (or at least for a 6-month period). For smaller or liquid trades, publication would be as close to real time as possible.

However, if the government decides to retain a relatively large scope in the UK, then it should permit a deferral regime that takes into account both the liquidity profile of the instrument and the size of the transaction.

Question 59 Which asset classes should deferrals apply to? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

Deferrals should apply to all transactions above a certain size and should also apply to less liquid instruments.

Question 60 Do you agree that the deferral regime would benefit from being simplified?

ISDA members support a simplification of the deferral regime in the UK. However, this is a complex challenge, and the deferrals regime will need to be carefully considered and calibrated and that will require technical input from market practitioners that deal in these instruments on a day-to-day basis.

Question 61 What do you think the optimum deferral length is? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

For large transactions and less liquid instruments the optimal deferral for volume information would be four weeks. Please refer to our answer to Q58 for further detail.

Question 62 What are your views on the government's proposal to delete the size specific to the instrument (SSTI), package order, and EFP deferrals? Do you think it would lead to more meaningful transparency? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

ISDA members believe that the entire MiFID II ruleset around packages would benefit from further consideration and possibly a targeted review.

While ISDA members understand there is a preference to simplify with one size threshold, any removal of SSTI must ensure that LIS is set at an appropriately reduced level.

MiFIR deems the SSTI thresholds to represent the point at which a liquidity provider is exposed to undue risk (Article 9.5(d)). It is critical that the new 'lower LIS threshold' provides market makers protection against exposure to undue risk.

Removing SSTI will not lead to more meaningful transparency. More meaningful transparency can only be gained through the use of effective identifiers.

Question 63 Do you think volume masking and/or aggregation helps to encourage real time publication? Please separate your answers by fixed income (sovereign bonds, high-yield bonds and investment-grade bonds separately) and derivatives (ETDs and OTC derivatives).

ISDA members are unclear on what this question is aiming to ask. Please refer to our answer to Q58 for further detail.

Question 64 What are the risks and benefits of allowing trading venues to calculate LIS thresholds for ETD post-trade reporting?

ISDA has no comment on this question.

Commodity Markets (chapter 6)

Question 65 Do you think that the scope of the 'commodity derivatives' regime should be narrowed to derivatives that are based on physical commodities?

For the purpose of the position limits regime, we agree that the scope of the commodity derivatives regime should be narrowed to refer to derivatives that are based on physical commodities.

Since the publication of the MIFID II legislative proposal in 2011, ISDA members have consistently said that one of the main implementation challenges of MiFID II's commodity derivatives provisions, in particular the position limits regime, is the complexity and the ambiguity of the definition of what a commodity derivative is.

The scope of commodity derivatives was extensively debated before the adoption of EU MiFID II, but unfortunately the final text did not give sufficient legal certainty as to the scope of commodity derivatives subject to position limits.

ISDA members observe that two categories of products would require further analysis and consultation between the UK authorities and market participants:

1) emissions allowances: emissions are not technically commodities, therefore the approach proposed by HMT would scope them out. We consider that spot emissions should indeed be scoped out and that emissions should be subject to a specific reporting regime. Further assessment as to whether there may be unintended consequences if emissions are scoped out entirely.
2) derivatives based on crypto/digital assets: we note that the legal classification of these contracts is being debated in many jurisdictions and currently there is no certainty in the UK and the EU on this matter. We also note that the US CFTC is proposing to classify them as commodity derivatives. Further analysis and consultation with the industry is required here.

Lastly, we urge HM Treasury to assess how the proposed significant change of commodity derivatives as financial instruments might affect other regulatory frameworks before making any decision. For instance, it might affect:

- the scope of the market abuse framework.
- the scope of the clearing obligation and margin requirements under UK EMIR – for example the question of how to classify derivatives which no longer fall under the commodity derivative definition, because of change of scope.
- ancillary activity exemption calculation by corporates.
- benchmark regulation (which includes a specific regime for commodity benchmarks).

Question 66 Do you think that financial instruments which refer to commodities as a pricing element but are securities in their legal form, should be removed from the regime?

Yes, we agree that these should be removed from the regime.

Question 67 Do you think economically equivalent OTC commodity derivative contracts should be removed from the commodity derivatives regime?

Yes, we agree that economically equivalent OTC commodity derivatives contracts should be removed from the commodity derivatives regime. This will provide legal certainty.

ISDA members have not been able to identify EEOTC contracts since the full application of the text. However, there is the possibility that EEOTC contracts will start to appear in the emissions market over time, given the UK's status as a third country in relation to the EU. As emissions are not commodities, this would not be a desirable outcome and represents another argument for removing EEOTC contracts from the regime.

Question 68 Are there any other instruments that you think should be deleted from the commodity derivatives regime?

We refer to the joint ISDA/GFMA/FIA/EFET letter to ESMA (22 February 2017) entitled 'Scope of Section C(10) contracts which are 'commodity derivatives' for the purposes of MiFID II'. This paper sets out the classes of Annex I section C(10) contracts that are not commodity derivatives and therefore not within the scope of position limits and reporting regimes: those being options, futures, swaps, forward rate agreements and other derivative contracts related to inflation derivatives (C(10)); an index or measure based on actuarial statistics (DR Article 8(h)); and other derivative contracts that do not exhibit the profile of or a direct relationship to a commodity as described elsewhere in the letter.

Question 69 What would be the risks and benefits of transferring responsibility for position limits from the FCA to trading venues?

Members acknowledge that venues will want to retain flexibility over the monitoring of position limits and market risk.

Question 70 What specific factors do you think should be addressed in the framework of requirements that UK authorities would provide for trading venues?

ISDA members do not support the automatic application of position limits on any contracts. Trading venues should have responsibility for position management, in accordance with principles set by the UK authorities, where the trading venues are already subject to oversight from the UK authorities.

ISDA members believe that position management/accountability limits would benefit greatly from increased flexibility for trading venues.

We note that positions are already monitored and investigated as part of sophisticated market surveillance arrangements, for example under UK MAR. Therefore, HM Treasury should not mandate a highly prescriptive process with little room for trading venues' discretion. We believe that the only way for accountability levels to properly function would be on the condition that discretion is given to the trading venue to determine on which contracts to set those accountability levels, when to actively monitor them (spot month and/or other month or even closer to delivery) and whether indeed to request additional information if an accountability level is exceeded.

In particular, ISDA members believe that the UK authorities should provide the following principles for trading venues:

- trading venues have discretion to set accountability levels as and where they deem it necessary and appropriate to do so (under the oversight of their regulators), which is in line with UK MiFID II Art. 57(8) laying down the powers for trading venues to establish position management controls;
- the FCA should set out in guidance as to the outcomes trading venues should achieve through their internal position management and controls, in line with outcomes already set out in the FCA's principles and objectives (e.g., market conduct and market integrity) and regulations such as UK MAR which address market integrity and market manipulation issues;
- trading venues should have flexibility as a guiding principle and focus on outcomes rather than detailing inputs and processes, while being aligned with global best practice reflecting the global nature of these markets. This would prevent unnecessary burdens on trading venues and market participants while ensuring a more dynamic regime, benefiting those who rely on commodity markets to manage the price risk inherent in their business in the underlying physical markets; and
- trading venues have the ability to take account of OTC contracts but restrict this to what is absolutely necessary to maintain orderly markets on that venue, discouraging gold-plating of the basic requirements and making it clear that trading venues are not required to monitor OTC contracts.

Question 71 Do you think that the scope of contracts that are automatically subject to position limits should be limited? If yes, do you think that it should be limited to contracts that are critical or significant, which includes those that are physically settled, and agricultural?

We have framed this response on the understanding that contracts that are critical or significant are those that are agricultural and physically settled and that, at the moment, the UK does not envisage any other contracts falling within that category.

We agree that the scope of contracts subject to limits should be limited to critical or significant contracts. However, we consider that there should not be an automatic application of limits to critical or significant contracts and that the definition of critical or significant contracts would require further nuance.

ISDA members note that there are two dimensions in the scope of contracts covered by limits as envisaged by HM Treasury:

a. Non-critical and non-significant contracts are not automatically subject to limits;

And

b. Critical and significant contracts cover physically settled contracts and agricultural contracts.

On point a) ISDA members believe that contracts that are not significant or critical should not be subject to position limits. ISDA members also believe that the application of limits to significant or critical contracts should not be automatic but that trading venues should have flexibility to set limits to critical and significant contracts depending notably on the characteristics of the underlying physical market and the liquidity of the contract. On point b), we call for a more nuanced approach by HM Treasury on the definition of critical and significant contracts.

ISDA members' understanding of the wording used by HM Treasury is that all agricultural contracts and all physically settled contracts would be deemed critical or significant and therefore subject to limits. ISDA members strongly believe that these contracts include some that are not very liquid, and some that are new and in a development phase that would make the application of limits overly prescriptive. This would re-create the problem that market participants were facing under MiFID II, with the application of limits to new and illiquid contracts.

We would then advise HM Treasury to consider a quantitative approach to the definition of critical and significant contracts.

We note that in a slightly different context, the recent review of RTS 21 by ESMA under the EU MiFID Quick-fix led to a revision of the definition of a commodity derivative "traded in significant volumes on a trading venue". In this context, the definition has been adjusted to refer to an agricultural commodity derivative where the average daily open interest exceeds 20,000 lots in the spot month and other months combined (the previous threshold was 10,000 lots). It is too early to establish the appropriate quantitative criterion for 'critical or significant' contracts subject to limits but ISDA members consider that contracts below 20,000 lots of average daily open interest should be scoped out.

In general, ISDA members strongly believe that an effective position limits regime should be based on three pillars:

1. FCA produces high-level guidance on limitation in scope: non-critical or significant contracts should be out of scope and high-level criterion should be listed for critical and significant contracts. However, the FCA should not list the contracts subject to limits.
2. Trading venues establish the list of critical and significant contracts subject to limits; This approach would contribute to preventing market abuse while also allowing new and nascent products to develop.
3. Trading venues set limits.

Question 72 Do you think that the UK commodity derivatives regime should allow position limits exemptions for liquidity providers?

ISDA members believe that all liquidity providers, both on a mandatory and voluntary basis, should benefit from the exemptions.

Question 73 Do you think that the UK commodity derivatives regime should introduce a 'pass through' hedging exemption to enable investment firms to support a wider range of hedging practices?

Yes. We believe that, as a minimum, the UK should employ the same exemptions as in the EU Quick-fix and therefore include a hedging exemption for financial institutions in the UK.

Question 74 Do you think any other activities should be exempt from the regime?

ISDA members consider that the hedging exemption should be based on the characteristics of the transaction itself rather than on the legal status of the counterparties. ISDA members have always been of the view that financial firms could benefit from this exemption and that the limitation to non-financial firms under MiFID II was causing liquidity issues, notably in the less developed markets where only a few market makers are offering hedging tools to end-users.

ISDA members suggest that the UK authorities consider the US CFTC regime in this respect which is based on a 'bona fide' exemption, i.e., any participant can benefit from the exemption as long as the transactions meet certain economic conditions[5].

Question 75 Are there areas of the UK's position reporting regime which could be improved?

ISDA members have not identified any areas at present where the UK's position reporting regime could be improved.

Question 76 Do you think that the ancillary activities test (AAT) should revert to a qualitative assessment of the activities performed by a market participant?

ISDA supports FIA's response.

Question 77 Do you think that the basis of the AAT should be expected activity, rather than historic activity?

ISDA supports FIA's response.

Question 78 Do you agree that the annual notification requirement should be abolished?

Yes. ISDA supports FIA's response.

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[5] https://www.law.cornell.edu/cfr/text/17/151.5: § 151.5 Bona fide hedging and other exemptions for Referenced Contracts.

(a) *Bona fide hedging transactions or positions.*
(1) Any person that complies with the requirements of this section may exceed the position limits set forth in § 151.4 to the extent that a transaction or position in a Referenced Contract:
(i) Represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;
(ii) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and
(iii) Arises from the potential change in the value of one or several -
(A) Assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;
(B) Liabilities that a person owns or anticipates incurring; or
(C) Services that a person provides, purchases, or anticipates providing or purchasing; or
(iv) Reduces risks attendant to a position resulting from a swap that -
(A) Was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction pursuant to paragraph (a)(1)(i) through (iii) of this section; or
(B) Meets the requirements of paragraphs (a)(1)(i) through (iii) of this section.
(v) Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging for purposes of § 151.4 unless such transactions or positions are established and liquidated in an orderly manner in accordance with sound commercial practices and the provisions of paragraph (a)(2) of this section regarding enumerated hedging transactions and positions or paragraphs (a)(3) or (4) of this section regarding pass-through swaps of this section have been satisfied.

Question 79 Does the continued existence of the separate Oil Market Participant (OMP) and Energy Market Participant (EMP) regimes for commodity derivative market participants serve any meaningful purpose?

ISDA supports FIA's response.

Question 80 Do you think that the OMP and EMP regimes should be removed as particular regulatory statuses from the UK's regulatory perimeter?

ISDA supports FIA's response.

Question 81 Do you think any changes would need to be made to the MiFID II regime, if the OMP and EMP regimes are removed as particular regulatory statuses?

ISDA supports FIA's response.

Market Data (chapter 7)

Question 82 Do you agree that the government should take action to encourage the development of a CT?

We note that specific questions on the construction of a consolidated tape are primarily devoted to equity and fixed income instruments rather than derivatives. ISDA members nevertheless wish to express the following views on the feasibility of a consolidated tape for derivatives instruments.

ISDA members strongly believe that the MiFID II/ MIFIR transparency regime as it is constructed – i.e., in the UK as well as the EU – cannot provide investors/end-users with meaningful information because of material data quality issues.

Most importantly, an appropriate product identifier for derivatives transactions should replace the current ISIN-based identification system. ISINs as currently constructed are not fit for transparency purposes as they lead to different products having the same ISIN and identical products having different ISINs.[6] This makes price comparisons on an "apples-to-apples" basis impossible. Beyond the tape itself, we note that ISINs are not only used currently for transparency purposes but also for the transaction reporting system (RTS 23). The co-existence of two different identifiers – one for the purpose of the consolidated tape and (on the other hand) ISINs for transaction reporting – must be avoided.

Other reporting and data quality elements should also be considered in the development of a consolidated tape. Two such examples: the identification of CCPs through which the contracts are cleared, as this materially affects pricing of contracts, and the transparency for package transactions components, which, even if flagged (individually), bring very limited value, as the price of each component is intrinsically linked to the package as a whole.[7]

Once the new identification system is in place, it is important to recognise how liquidity is provided in the derivatives markets and to safeguard that liquidity. The derivatives markets differ significantly from the equity markets in terms of their market structures, and in the nature and composition of liquidity available for market participants.

Equities, for example, trade as a relatively limited number of wholly fungible securities, in small trade sizes and high volumes. Derivatives trade as a large number of non-fungible individual contracts with large trade sizes and low volumes. Whereas transactions in the equity markets are primarily executed on electronic order books by matching of price-driven orders by market participants, transactions in the derivatives markets are executed by market makers

[6] For example, the use of the trade date as a data field means that there is no distinction drawn between a 10-year swap that starts 2 years forward (running from 2023 to 2033) and a spot starting 10-year swap (running from 2021 to 2031). The two contracts are economically different but will have the same ISIN. The effective date should be the relevant field, rather than the trade date. In addition, ISINs include termination dates, and this means that two identical contracts with different termination dates will have different ISINs. It is essential to stop using the termination date and to replace it with the tenor / term i.e., the actual length of the swap contract.

[7] Package transactions typically involve multiple swaps, each of whose execution and price is contingent upon the execution and price of other components; conceptually they are similar to booking a multi-leg air travel itinerary in one transaction at the same time in order to save money and increase efficiency.

who provide balance sheet liquidity to counterparties and trade either through request-for-quote or bilateral negotiations.

The ability of market makers to provide that liquidity and enable hedging activity by market participants depends in turn on their ability to offset those risks and avoid exposure to 'undue risk'. Currently, post-trade transparency deferrals may go up to 4 weeks.

Consequently, it is vitally important that mechanisms to protect market makers from undue risks need to be factored into the consolidated tape, if they are to be able to optimise pricing available to end users. This includes, for example, volume caps, i.e., above a certain size, only that threshold size is reported and not the actual size of the trade. In addition, ISDA members agree that end-users of derivatives will use the tape if and only if the data is accurate, meaningful and published shortly after the transactions were made ('as close to real time as possible'); however, a limited time deferral will also be necessary for public reporting of some transactions.

Deferrals were established for reasons that are still valid. If as suggested in our response to question 49, the scope of the post-trade transparency regime in the UK is narrowed down to the most liquid instruments, then ISDA members believe that the UK could adopt a different and less complex deferral regime to the one we have today. This deferral regime would also serve as a basis for the consolidated tape.

The principle could be, for trades above a certain size, that these trades should be published individually 2 days after the trade occurred, with the volume protected/masked permanently (or at least for a 6-month period). For smaller or liquid trades, publication would be as close to real time as possible.

However, if the Government decides to retain a relatively large scope in the UK, then in that case, it would be imperative for the government to keep a deferral regime that takes into account both the liquidity profile of the instrument and the size of the transaction.

Reporting (chapter 8)

Question 93 Where do the current regulatory reporting regimes for wholesale markets contain duplicative reporting requirements?

Our response to the Bank of England's *Transforming Data Collection DP* (May 2020) touched on duplicative reporting requirements. Different regulations will have various aims and purposes, such as to detect market abuse or to identify systemic risk. Despite the differing aims, the same basic data may be required by multiple regulations, and only the format or representation of the data may vary. This is seen with the trade data reported under the EMIR and MiFIR regulations. When the same trade is in scope for both regimes, many of the same data points within a trade booking are to be reported. However, the way in which EMIR and MiFIR require that data to be represented within their reports can differ, resulting in firms implementing two ways of representing and reporting the same set of trade data. For example, under the MiFIR definitions, 'Price' can be reported as a monetary value, percentage, yield or as basis points. Under EMIR rules, basis points are not a permitted value for Price. As such, separate logic is required in order to report Price for the same trade, and potentially with a different value submitted for EMIR than is submitted for MiFIR.

Were a definition of Price to be standardised within a single data model, the same value could be reported to both UK EMIR and UK MIFIR without either regime losing any visibility to the overall trade data.

Price is one example where the same data point is reported under two regimes in different formats, but there are many data points reported under UK EMIR and UK MiFIR in the same format, meaning that much of the data required for UK MiFIR can be gleaned from UK EMIR reporting and vice versa.

Another example of duplicative reporting currently in effect has resulted from the onshoring of EU EMIR reporting regulations. Specifically, where an AIFM based in the EU executes a contract for an AIF that is based in the UK, the contract would be reportable under both UK EMIR and EU EMIR reporting rules. The same duplicative reporting requirement would apply if the AIFM is based in the UK and the AIF is based in the EU. Reporting eligibility requirements for comparable regulations would ideally be implemented to avoid the counterparties' country of incorporation putting the same contract in-scope for multiple jurisdictions. In this example, the EMIR reporting liability would ideally be with the AIF only.

Therefore, where there are overlapping requirements within regulations, there is an opportunity to reduce costs by aligning the definitions of those requirements by use of a standard data model. In the case of UK EMIR and UK MiFIR, if a data model were to represent the same trade in a consistent way, firms may only need to report the trade once in order to fulfil the requirements of both regimes. This should reduce data reporting operating costs further. A standard data model should not be applicable to UK reporting only but be applicable across global jurisdictions thereby improving efficiency and accuracy, whilst reducing costs and duplication of work. ISDA has developed the Common Domain Model (CDM) to establish a standard representation of trade components and their lifecycle events. An industry initiative – the Global Digital Regulatory Reporting (GRDD) initiative – is in progress that will utilise the CDM to digitise regulatory reporting rules and represent the requirements as machine executable code. Over time, this will lead to the establishment of a single and non-ambiguous digital representation of the reporting requirements for all G20 jurisdictions.

Question 94 Is intervention needed to mitigate against duplicative reporting for firms undertaking securities financing transactions (SFTs) with members of the European System of Central Banks?

The FCA's Temporary Transitional Powers (TTP) allow that parties subject to SFTR in the UK will not have to report SFTs transacted with ESCB central banks, as these will be exempt under the TTP until 31 March 2022. After this date however, and unless there is a change to the Binding Technical Standards, entities reporting under UK SFTR would have to report SFTs with members of the ESCB under both UK MiFIR and UK SFTR. Therefore, there is a need for intervention to mitigate against duplicative reporting.

Question 99 Have you experienced any issues with the utilisation of International Securities Identification Number (ISINs) as identifiers?

The origination of ISINs for derivatives has proved challenging in many instances and requires improvements. ISINs are used for the identification of derivatives in the UK and EU and are the basis for transparency, which itself is based on ToTV instruments.

However, there have been issues with the origination of ISINs for derivatives that require appropriate adjustments. These issues make transparency for OTC derivatives difficult to implement and potentially misleading for end users.

On the one hand, there are large numbers of ISINs and often multiple ISINs for economically comparable products (more than 60 million ISINs have now been issued for OTC derivatives since the start of MiFID II). Several trade-level attributes are included in ISINs for certain OTC derivatives instruments – for example, 'expiry date' (maturity date) is a required attribute for interest rate swaps. Each day, interest rate swaps are traded with different maturity dates and therefore mapped to different ISINs.

The consequence of including these trade level attributes is the creation of multiple ISINs for comparable OTC derivatives instruments/products, making it very difficult for end users to benefit from transparency. If interest rate swaps referenced only the tenor of a swap instead of also requiring the maturity date, the number of ISINs required for what would essentially be the same swap product would be greatly reduced. While tenor was introduced in ESMA's Q&A on September 26, 2018 (and subsequently onshored to UK reporting), it was added alongside maturity date, resulting in more ISINs, not less. This example supports the view that regulators should reassess the criteria for generating ISINs.

On the other hand, some price forming attributes are not included in ISINs for certain OTC derivatives instruments, leading to the same ISIN being used for different instruments.

For example, 'effective date' is not a required attribute for an interest rate swap. Therefore, a five-year swap traded today will have the same ISIN as a one-year forward-starting four-year swap with the same attributes. These are different instruments and are therefore priced differently despite having the same ISIN.

In addition, there is no way to distinguish between standard and non-standard versions of OTC derivatives instruments that may include additional price-forming terms and features (such as embedded options and bespoke fallbacks). Not including all these price-forming attributes means transparency on such ISINs is not meaningful for end users. Generally, ISINs do not effectively support more innovative products, such as digital assets, and the ISIN creation templates cannot cater as well for more complex instruments. This can lead to problems if a reporting regime has a high dependency on ISINs.

Policymakers also need to clarify how the ISIN will be used after the international standard for the identification of derivatives – the unique product identifier (UPI) – goes live. ISINs are now so ingrained in MiFID that it is important to make UPIs converge with ISINs to avoid creating duplication and forcing firms to obtain two different identifiers for the same contract, or a situation where some OTC derivatives are reported with ISIN and others with UPI. Consistency of approach with the global roll out of the UPI is also desirable. A wide consultation with all stakeholders is necessary to agree how to improve the ISIN system (notably, the calibration and usefulness of ISINs for some derivatives), and how it might evolve in the light of the UPI roll out.

Question 100 Do you have any suggestions on how the use of identifiers could be improved?

A range of identifiers have been developed to assist with the accuracy and effectiveness of regulatory reporting, and generally can be applied across jurisdictions. One such example is the Unique Product Identifier (UPI) which will reliably identify key attributes of OTC derivative products for multiple reporting regimes. We are very supportive of the adoption of UPIs across global jurisdictions, although we caution that UPIs are designed for transaction reporting. The UPI is designed to be a product identifier, but it is not intended for transparency.

Regarding identifiers for price transparency, please see our answer to Q82.

Several global identifiers have been established to date which have led to improvements of consistency and accuracy for regulatory reporting. Where possible, we advocate the adoption of global standards for regulatory reporting requirements and leverage existing standards when it makes sense to do so, (that is to say, only apply existing standards to the function they have been designed for). The application of global standards enables trade data to be more easily shared across jurisdictions. There remain however, elements of these global identifiers where improvements can be made.

<u>UTI</u>

We are supportive of the CPMI IOSCO technical guidance on harmonisation of the Unique Transaction Identifier (UTI) and are of the view that a globally consistent transaction identifier can help to produce and share aggregated trade data across global jurisdictions. The full effectiveness of the CPMI IOSCO UTI guidelines will only be fully realised though if they are applied consistently across global regulations. Therefore, while we support the use of UTIs for derivative products, it is important global regulations are aligned as closely as possible in order to achieve a single global UTI.

While broadly in agreement with the CPMI IOSCO UTI technical guidelines, we make the following comments regarding how the counterparty responsible for generating the UTI is determined.

- Step four of Table 1 of the guidelines – 'Is the transaction cross-jurisdictional' – has known problems as a counterparty may not know what jurisdictions the other counterparty is in scope to report for. This means there may be times where this step does not work as intended. There is currently no obvious way to overcome this, but as jurisdictions implement the CPMI IOSCO UTI generation guidance, the preference is for global reporting alignment where possible.

- Step 13 of Table 1 of the guidelines proposes that a Trade Repository (TR) would be the UTI generator (under certain circumstances). However, the primary purpose of TRs is to consume, validate and reconcile trade data, and not to generate data themselves which is to be consumed by their users. This step would also require each counterparty of a trade to know which TR the other counterparty reports to (as a TR would only generate the UTI if both parties use the same TR). This would require additional reference data to be set up and maintained by report submitting parties. Therefore, we recommend that TRs should not be identified as UTI generators despite it being part of the CPMI IOSCO guidance.

UPI and ISINs

We are supportive of the CPMI IOSCO technical guidance on harmonisation of the Unique Product Identifier (UPI). Furthermore, while ISINs have been an element of regulatory reporting for several years now, they can be improved upon, (see the answer to question 99) and should only be employed towards their specific purposes otherwise their effectiveness is compromised.

UPI and ISIN have been designed to serve different functions; the UPI has been developed specifically to fulfil the need for a global standard product identifier, whereas the ISIN is applied at a more granular (instrument) level. As such, the type of identifier required for regulatory reporting should be carefully considered, as depending on several elements such as the type of data, the purpose of the data and the granularity of data required by regulators, a UPI and/or ISIN may or may not be suitable.

Cross Cutting Issues (chapter 9)

Question 101 What further steps can UK authorities take to enable firms to take advantage of technological innovation in capital markets?

There are currently a number of legal and regulatory barriers to the deployment of new technology (such as DLT and digital assets) in capital markets. We have highlighted some of these barriers below and propose steps that UK authorities can take to reduce or eliminate them. We note that many of these points have already been raised and discussed in more detail as part of ISDA's response to the HM Treasury Consultation and Call for Evidence on UK Regulatory Approach to Cryptoassets and Stablecoins.[8]

Regulatory Uncertainty

There is currently a lack of clarity as to the application of certain areas of existing financial regulation in the context of DLT-based systems, including the boundaries of applicable regulatory frameworks. Likewise, certain requirements under existing financial regulation can serve as obstacles to some DLT-based applications. This can, in some cases, act as a barrier to deployments that involve recording the securities on a distributed ledger.

[8] https://www.isda.org/a/UkATE/ISDA-response-to-HMT-cryptoasset-and-stablecoin-consultation.pdf

In providing amendments, clarifications, or guidance, we would urge regulators to have regard to the potentially different nature of different DLT-based arrangements, with a view to defining the perimeter precisely and developing regulation that is appropriate based on the relevant features of the DLT-based system, its use, and risks. In particular, records on a distributed ledger may simply be used to evidence rights and obligations, in the same way as other systems of books and records, rather than creating any new asset that is distinct from the underlying rights and obligations evidenced in the distributed ledger or giving rise to a change in activity from a regulatory perspective. In other words, the deployment of a DLT-based system should be capable in certain circumstances of being a neutral event from a regulatory perspective.

We would also urge regulators to act quickly in resolving areas of regulatory uncertainty, in order to support innovation. This may involve: (i) adapting regulatory requirements that are a clear obstacle to digitisation; (ii) reviewing areas of regulation where further changes may be required; (iii) creating a framework within which firms can test DLT products with the benefit of exemptions to existing rules; (iv) providing guidance on the interpretation of existing rules in a DLT context; and/or (v) taking an agile and flexible approach to the application of existing rules to accommodate new technologies.

Regulatory Compliance

There is currently considerable scope for inconsistency in the way in which financial markets participants interpret technical specifications, particularly in relation to data, for reporting and compliance purposes. There is an opportunity for regulators to work with the industry to adopt RegTech solutions to promote a more uniform approach to compliance.

The use of a Common Domain Model (CDM) would provide greater confidence to both market participants and regulators about the common interpretation of rules for compliance purposes, enabling more efficient and effective implementation than was possible a decade ago. it will also enable regulators to issue new rules directly in the CDM in addition to legal text, allowing updates to be implemented far more efficiently.

We note that ISDA has been supporting the work of the Bank of England towards developing common data standards and that a number of the Bank's initiatives in this regard (including non-derivatives applications) will leverage the ISDA CDM

Digital Assets

We note that there is a broad spectrum of DLT platforms and many different types of cryptoasset. Creating a precise definition or taxonomy of different types of DLT system and/or cryptoasset or digital asset is challenging, given the rapid development of the technology, the range of platforms used and the kind of assets that are digitally represented on these platforms. We note that there is currently no such taxonomy at a national or international level.

This lack of taxonomy presents challenges in determining the extent to which DLT-based collateral systems might fall within or outside of the current regulatory perimeter. We believe that developing such a taxonomy will require national governments, judiciaries, regulators, and international standards-setting bodies to work on developing or adapting global legal standards.

We would encourage UK authorities to consider the broad technological, economic, and legal features of these different types of digital asset before amending any specific legislation or developing new legislation as a means of regulating the use of these novel assets within the capital markets and financial markets infrastructure.

Conflicts of Law Rules

The use of DLT in particular can create novel conflicts of laws issues which need to be addressed. In particular, solutions that involve treating records of a distributed ledger as a medium of value raise questions as to the situs of those assets. The situs of assets held solely through a distributed ledger may not be clear under current conflicts of law rules. We believe that overcoming these issues will require national governments, judiciaries, regulators, and international standards-setting bodies to work on adapting global legal standards.

Regulating Novel Structures

In some cases, the use of DLT in financial markets may de facto alter the allocation of risks and responsibilities between parties. Regulators should consider whether it would be appropriate in any circumstances to reallocate regulatory responsibilities to reflect that. Again, consideration should be given to the structure of the DLT-based system and the role played by those interacting with the system.

Question 102 What further steps can UK authorities take to support the wholesale markets sector as we move towards a low carbon economy?

We believe that the UK government could take the following actions to support the transition:

- Support the development of innovative derivative products that can help market participants manage climate-related risks but also promote the flow of capital toward sustainable investments.
- Promote the potential for scaling voluntary carbon markets and establish clarity as to the treatment of the underlying voluntary carbon credits.
- Linking the new UK Emissions Trading System and the EU's Emissions Trading System to allow both the UK and EU to reach net zero faster and more cost effectively.
- Encourage globally consistent sustainability reporting standards.

Role of Derivatives in Sustainable Finance

The financial sector is a key enabler of economic activity and plays a critical role in facilitating and accelerating the transition to a low carbon economy, and the transition to a sustainable economy will take a significant amount of long-term funding. ESG investments and hedges will be absolutely critical in the transition to a green economy, enabling companies to meet their sustainability goals effectively and efficiently.

Derivatives perform a critical role in economic activity by facilitating the raising and allocation of capital for green finance, enabling, and helping businesses and investors better manage the risks to which they are exposed, and to more effectively align their exposures with risk tolerance and risk management requirements. The derivatives market also plays a major role in enhancing transparency through providing information on the underlying commodities, securities or assets, which can ultimately contribute to long-term sustainability objectives.

Sustainability-linked products - whose liquidity, price transparency and attractiveness to investors can be further enhanced through the use of derivative instruments – can attract much-needed investment for research and the low-carbon transition. Such investments have long-term objectives and require a long-term orientation. As markets for ESG investments develop and trillions need to be raised to finance the transition to a sustainable economy, the derivatives market will be critically important in facilitating the financing of green investments, as well as providing hedging tools to manage the associated risks. To this end, derivatives can play a very important role in achieving the goals outlined by the UK Government in its Green Finance Strategy and financial market participants should be able to use them unrestrictedly.

This is because derivatives:

i. can facilitate the raising and allocation of green capital towards sustainable investments at scale;

ii. help firms hedge risks related to ESG factors;

iii. facilitate transparency, price discovery and market efficiency; and

iv. contribute to long-termism since longer-term investments can be enabled via the efficient hedging of investment risks.

The role of derivatives in sustainable finance is explored in greater detail in a July 2020 paper published by the Centre for European Policy Studies ("CEPS") and the European Capital Markets Institute ("ECMI")[9].

The financial sector is responding to the challenges in sustainable finance with a diverse range of product structures and transaction types in the derivatives market. While conventional derivatives can certainly be used to hedge green instruments, a new wave of sustainability-linked derivatives and exchange-traded ESG derivatives has also developed in recent years, alongside emissions trading derivatives, renewable energy and renewable fuels derivatives, and catastrophe and weather derivatives. In January 2021, ISDA published a research report that gives a valuable overview of such ESG-related derivatives products and transactions[10].

As interest in such ESG-related derivatives products gains momentum, standardisation will be more important than ever because it is only through robust standards that products and markets can scale efficiently. In this context, please note ISDA's publication of a white-paper, outlining key performance indicators (KPIs) guidelines for Sustainability-Linked Derivatives (SLDs).[11] Work is well advanced on expanding ISDA's suite of documentation templates to include renewable energy certificates and other contracts. We will continue to work on standardisation of documentation, market practices and operational process in line with market developments, and welcome engagement with the UK authorities in this space.

<u>Scaling up Voluntary Carbon Markets</u>

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[9] The role of derivatives in sustainable finance is explored in greater detail in a July 2020 paper published by the Centre for European Policy Studies ("CEPS") and the European Capital Markets Institute ("ECMI"),

https://www.isda.org/a/KOmTE/Derivatives-in-Sustainable-Finance.pdf

[10] ISDA paper on Overview of ESG-related Derivatives Products and Transactions, https://www.isda.org/a/qRpTE/Overview-ofESG-related-Derivatives-Products-and-Transactions.pdf

[11] ISDA paper on sustainability-linked derivatives: KPI Guidelines https://www.isda.org/2021/09/07/sustainability-linked-derivatives-kpi-guidelines/

It is also important to highlight the role that carbon pricing plays in the transition to a low carbon economy. ISDA supports the use of market-based mechanisms, including a price on carbon that supports long-term decision-making. As highlighted in the Principles for a U.S. Transition to a Sustainable Low-Carbon Economy[12], published by the US Climate Finance Working Group in February 2021, carbon pricing can also spur development of climate-related financial products, promote transparent pricing of climate-related financial risks, and can inform and help scale key initiatives like voluntary carbon markets.

Derivatives transactions will play a crucial role in ensuring price transparency and liquidity in voluntary carbon credits, as discussed further in ISDA's response to the Taskforce's on Scaling Voluntary Carbon Markets Phase I consultation document[13]. ISDA supports the work of the Taskforce in developing general trading terms and promoting standardization of primary voluntary carbon market contracts, which is an essential foundation for the development of the related derivatives markets

In order to ensure continuous derivatives trading in voluntary carbon credits, we believe that it is essential to establish clarity around the legal nature of voluntary carbon credits for the purposes of drafting standardized documentation and providing supporting legal opinions. Market participants will require certainty as to the treatment of the underlying voluntary carbon credits in all relevant jurisdictions, including for purposes of netting, insolvency, and taking security. Global legal standard setters (for example, UNCITRAL and UNIDROIT) have a good track record in working with other intergovernmental bodies and regulators in producing legislative guidance on a range of substantive law issues regarding a wide range of commercial transactions for states across all regions. Given that the UK is a member state of both UNCITRAL and UNIDROIT it could positively influence decision making regarding current and future projects in either body that help in enhancing legal certainty in trading in digital and environmental products. Such global standards would increase legal certainty across all jurisdictions which, in turn, will facilitate the issuance of positive legal opinions by industry bodies to support the voluntary carbon market and associated contractual documentation.

The UK has a unique position on leading climate action and exporting financial services, which provides a natural backdrop for the UK to establish itself as the global hub for trade in voluntary carbon offsets. ISDA supports the work of the UK VCM Forum that will implement the framework recommended by the TSVCM and market architecture needed to ensure UK-based firms and branches of global firms based in the UK can best promote the potential for scaling carbon markets. Establishing the UK as a carbon trading hub also highlights the need to ensure that English law provides a sound underpinning for these transactions, including the legal nature of carbon credits.

In addition, ISDA supports the strengthening of existing carbon compliance markets. In this context, we issued a paper[14] on 23 July on the implications of the Fundamental Review of the Trading Book (FRTB) for Carbon Certificates, which explores the impact of the FRTB on the trading of carbon certificates. According to the paper's findings, the FRTB would result in

[12] Principles for a U.S. Transition to a Sustainable Low-Carbon Economy, https://www.isda.org/a/qXITE/Financing-a-USTransition-to-a-Sustainable-Low-carbon-Economy.pdf

[13] ISDA response on Consultation Document of the Taskforce on Scaling Voluntary Carbon Markets, http://assets.isda.org/media/9a674bfd/b0ffbc11-pdf/

[14] ISDA paper on Implications of the FRTB for Carbon Certificates, Microsoft Word - FRTB_and_carbon_certificates_final_version (isda.org)

higher capital charges for carbon trading under the standardized approach to market risk, which could impair the ability of banks to act as intermediaries in the emissions trading system market globally, hampering a key tool for policymakers to ensure a cost-effective transition to a carbon-neutral economy.

Linkage between UK and EU Emissions Trading Systems

In line with the objective to scale up carbon emissions trading, as a mechanism to achieve GHG emissions reduction in a most efficient manner going forward, the UK Government should give considerate thought to initiating the process of linking the new UK Emissions Trading System (UK ETS) with the EU's Emissions Trading System (EU ETS). This would result in a level playing field in terms of carbon pricing, avoid competitive distortions, and lead to aligned cost implications for industry across the UK and the European Economic Area (EEA). Such a linking agreement would further display and solidify the UK's leadership in tackling climate change.

The success of a link up will be further accelerated by the existence of widely similar definitions, practices and overlapping legal provisions in the respective UK and EEA markets. A successful link up and close collaboration between EU and UK authorities going forward, would be the ideal outcome for carbon compliance markets, in particular with respect to the need for cross-border transactions to create liquidity and supply of carbon allowances to either market.

Globally consistent sustainability reporting standards

Finally, we believe that a globally harmonized approach to sustainability reporting is key to prevent the proliferation of various public and private reporting initiatives. Absent a harmonized approach, reporting will be costly and time-consuming for reporting parties that operate on a global scale as they may have to comply with duplicative, and potentially conflicting reporting regulatory regimes. In addition, users of the reported information may find it difficult or confusing to receive data from various reporting standards and requirements, threating the overall reliability of sustainability reporting.

To enhance reliability, any disclosure regime should include third-party assurance requirements. Financial institutions should be able to rely on information verified by qualified third-party assurance providers that have the necessary expertise and accreditation/licenses to verify such non-financial, sustainability-related information. Requiring such assurances would enable investors have more confidence in the completeness and accuracy of information disclosed.

We encourage the UK Government to consider working with, or leveraging the anticipated work of, the International Financial Reporting Standards (IFRS) Foundation. In December 2020, ISDA and other industry representatives encouraged the IFRS Foundation to establish a "Sustainability Standards Board" that would be geared towards establishing a global set of internationally recognized sustainability reporting standards[15].

[15] ISDA response to the International Financial Reporting Standards (IFRS) Foundation on its consultation paper on sustainability reporting,

https://www.isda.org/a/DIfTE/ISDA-letter-to-IFRS-on-Sustainability-Reporting.pdf

ISDA has commented that it believes the IFRS Foundation is best positioned to establish such standards because the organization already has experience in:

- Establishing and running an appropriate governance structure to oversee the process of global standard setting. The IFRS Foundation provides overall oversight and is accountable, with responsibilities and decision delegated as appropriate, for example for accounting standards to the International Accounting Standards Board.
- Engaging effectively with stakeholders, to gather their feedback and respond to it in a transparent process. IFRS is globally supported and has therefore been adopted in large part because stakeholders are able to participate in the standard setting process and are therefore inclined to support the final standards having contributed to their development.

Any sustainability reporting approach adopted by the UK Government should make global harmonization a priority. In this regard, we encourage HM Treasury to work with international organizations, including the IFRS Foundation, and leverage global standards that are being developed for sustainability reporting. Absent a harmonized approach to sustainability reporting, investors will not be able to readily access reliable sustainability-related information from companies and financial institutions, especially from those that operate on a global scale and have the potential to be subject to duplicative and conflicting reporting requirements.

At present, existing accounting frameworks, as they relate to ESG-linked transaction activity, do not seem to provide decision-useful information to users of the financial statements on how ESG factors impact accounting and reporting on embedded ESG features. A recent ISDA paper proposes that ESG-related issues are better covered through qualitative sustainability disclosures that many entities are already reporting on.[16]

[16] Accounting Analysis for ESG-related Transactions and the Impact on Derivatives, https://www.isda.org/a/JvTgE/Accounting-Analysis-for-ESG-related-Transactions-Sept-2021.pdf