ISDA Safe, Efficient Markets

ISDA Commentary on EP Transparency Amendments to the MISP Master Regulation

Introduction

ISDA welcomes the opportunity to comment on Parliamentary amendments (AMs) to the European Commission's proposal for a Market Integration and Supervision Package (MISP) Master Regulation. This paper addresses those AMs that may affect the transparency regime for derivatives, in particular post-trade transparency for OTC derivatives. For completeness, it considers both AMs contained in Rapporteur Markus Ferber's compromise text for MiFIR and the AMs excluded from that text.

Executive Summary

ISDA strongly supports amendments intended to reduce the burden of post-trade transparency under MiFIR Article 21 and make it more proportionate. We oppose amendments that seek to place trading of OTC derivatives on an unlevel playing field, that would require investment firms to report and justify use of third-country trading venues, that would capture pre-negotiated transactions in OTC derivatives in the scope of transparency, and that would negatively impact liquidity for large trades. For completeness, we support the European Commission's proposal in the MISP Master Regulation to remove forward rate agreements and single currency basis swaps from the scope of transparency due to their illiquidity and urge the EP not to oppose this proposal.

Summary of recommendations

Topic	MiFIR Articles	Support	Oppose
Exemption from post-trade transparency	Article 21(1)	AM 837-843	
Pre-trade transparency, hybrid trading systems and block ETD trading systems	Article 2(1)(10aa) *(new)*, Article 8a(1), Article 8a(2), Article 9(5)(b), Article 9(5)(f)		AM 106, 112, 113, 265, 269, 739, 740, 808-811, 813
Waivers for pre-arranged transactions	Article 9(5)(b)		AM 812
Report and justify activity on third-country trading venues	Article 23b *(new)*, Article 23c *(new)*		AM 852, 853

1. Exemption from post-trade transparency

About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 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 LinkedIn and YouTube.

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ISDA supports amendments to the MISP Master Regulation that would provide legal certainty for the existing exemption from post-trade transparency for certain transactions made public under third-country regimes analogous to MiFIR, and that would extend that exemption to all such transactions.

In 2020, ESMA published an opinion[1] that when concluding transactions on third-country trading venues which are subject to transparency provisions similar to those applicable to EU trading venues under the MiFID II/MiFIR framework, EU investment firms should not be required to make those transactions public under MiFIR Articles 20 and 21.

The MISP Master Regulation proposes to recreate this exemption in MiFIR Article 21 for OTC derivatives only. ISDA understands this to have been in response to concern that a scoping criterion in ESMA's opinion may no longer be valid for OTC derivatives. In their joint briefing on this proposal[2], ISDA, AFME, EBF and ICMA ("the Associations") supported it but argued the exemption should be recreated in Level 1 for all asset classes in scope of post-trade transparency, as it is preferable for such provisions to be in legislation rather than guidance. The Associations also argued that the exemption should be extended to transactions with non-EEA clients that are executed away from a trading venue with non-EEA clients and made public through third-country approved publication arrangements, and that the requirement for ESMA to assess whether a third-country trading venue meets the criteria in the opinion and maintain a list of such venues should not be transposed into MiFIR Articles 20 and 21.

In that briefing, the Associations highlighted that the reasons provided in ESMA's opinion for the exemption from post-trade transparency of transactions executed on third-country trading venues which are subject to similar post trade transparency requirements as EEA trading venues apply equally to transactions executed with non-EEA counterparties that are made public on a third country approved publication arrangement (APA), where the third-country regime imposes on investment firms transparency provisions that are similar to those applicable to EEA investment firms under the MiFID II/MiFIR framework. Exempting such transactions would remove duplicative reporting under separate regimes and improve the accuracy of post-trade transparency data by removing double counting of trades. This would in turn enhance the value of consolidated tapes across those regimes by delivering more accurate and coherent data sets that will collectively cover the separate regimes.

The Associations also highlighted that the requirement for ESMA to maintain a list of suitably qualified third-country trading venues imposes burden on ESMA itself and on investment firms needing to use that list as reference data, while providing little practical

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[1] ESMA70-154-165

[2] ISDA, AFME, ICMA and EBF Briefing on Post-Trade Transparency amendments in the European Commission (EC) Market Integration and Supervision (MISP) proposal

benefit. Removing the requirement to maintain and refer to that list is therefore consistent with the simplification and burden reduction agenda.

AMs 837-843 tabled by MEPs Crosetto, Ventola, Vivaldini, Squarta and Nesci would collectively achieve these aims. AM 837 moves the existing exemption out of Level 3 into Level 1 for all asset classes. AM 838 simplifies what qualifies a third-country trading venue for the exemption to apply by specifying that it must simply be subject to post-trade transparency requirements similar to those applicable to EEA trading venues. AM 839 extends the exemption to transactions between non-EEA branches of EEA firms and non-EEA counterparties that are made transparent on third country APAs, where the third country regime imposes transparency obligations on investment firms similar to those applicable under EU MiFIR. Collectively, AM 837-842 remove the criteria listed in the MISP Master Regulation that third-country trading venues must meet for trades executed thereon to qualify for the exemption. AM 843 removes the requirement for ESMA to maintain a list of suitably qualified third-country trading venues. Therefore, ISDA strongly supports these amendments.

- ***We strongly recommend supporting Crosetto/Ventola/Vivaldini/Squarta/Nesci AMs 837, 838,839, 840, 841, 842 and 843, and urge that the EP reintroduces them into its final position.***

2. Pre-trade transparency, hybrid trading systems and block ETD trading systems

ISDA opposes amendments that would define "hybrid trading systems" and the extension of pre trade transparency under MiFIR Article 8a(2) to prices advertised on such systems, as they do not achieve their intended objective. We also oppose amendments that would define "ETD block trading systems" and the extension of pre-trade transparency under MiFIR Article 8a(1) to prices advertised on such systems, as they could have significant negative consequences for liquidity provision more broadly.

In the EP draft report on the MISP Master Regulation, Rapporteur Ferber proposes AM 106, which introduces a definition of "hybrid trading system", and AMs 112 and 113, which aim to expand pre-trade transparency to these systems. The stated objective appears to be to apply pre-trade transparency to block trading activity of exchange-traded derivatives (ETD) and thereby remove any incentive to use this trading protocol purely to avoid pre-trade transparency.

However, this drafting is inherently flawed, as AM 112 seeks to amend Article 8a(2), which addresses only OTC derivatives offered for trading on MTFs and OTFs. ETDs are not mentioned in Article 8a(2), and nor are block ETD transactions formalised on MTFs or OTFs, so it is not possible for these amendments to capture the transactions they seek to include in the scope of pre-trade transparency.

Instead, they would capture pre-arranged trades in OTC instruments such as interest rate and credit default swaps, that are agreed bilaterally through voice trading and formalised on MTFs and OTFs using a request-for-quote protocol through what are known as process trades.

The MiFIR Review concluded that trading systems other than central limit order books and periodic auction trading systems 'in particular voice trading and request-for-quote systems [which] provide requestors with tailor-made quotes… have marginal informational value to other market participants', and as a result removed prices provided or advertised on request-for-quote, voice and hybrid trading systems from the scope of pre-trade transparency.

Therefore, not only do AMs 106, 112 and 113 fail to achieve their stated aim of increasing pre-trade transparency of ETDs, but the pre-trade transparency of OTC derivatives that they would provide is acknowledged by the European Commission to be of negligible benefit; while reintroducing such transparency would impose considerable additional burden on price makers.

AMs 265, 740, 809 and 811 (tabled by MEP Peter-Hanson), and AMs 269, 739, 808, 810 and 813 (tabled by MEP Doherty), appear to achieve what AMs 106, 112 and 113 were intended to. ISDA's remit does not extend to ETDs, but on principle, we oppose market structures that would impose the provision of pre-trade or real time post-trade transparency on large trades, due to the undue risk to liquidity providers this causes, and the consequent negative impact on liquidity.

- ***We strongly recommend opposing Ferber AMs 106, 112 and 113 as inherently flawed and failing to achieve their intended objective, while adding negligible value and adding disproportionate burden. We agree with their exclusion from Rapporteur Ferber's compromise MiFIR text.***
- ***We recommend opposing Peter-Hansen AMs 265, 740, 809 and 811 and Doherty AMs 269, 739, 808, 810 and 813, due to their potential negative impact on liquidity provision. We agree with their exclusion from the compromise MiFIR text.***

3. Waivers for pre-arranged transactions

ISDA opposes poorly constructed amendments with unclear effects, and which have the intention of placing trading of OTC derivatives on an unlevel playing field.

The justification for AM 812, tabled by MEP Winzig, is that derivatives trading should be encouraged to move away from OTC markets. As the global trade association representing participants in OTC derivatives markets, ISDA opposes this on principle. OTC derivatives markets are a cornerstone of the global financial system, enabling corporations, governments and financial institutions around the world to manage risk,

enhance returns, optimize liquidity and efficiently allocate capital. This creates value for users by fostering predictability, reducing costs, protecting against losses and dampening the impact of volatility on earnings – in turn, generating value for the broader economy by bringing greater stability and giving companies the confidence to borrow, invest and hire[3].

However, the more immediate problem with AM 812 is that it is poorly constructed, and it is unclear what its effects would in fact be. It appears to be based on two premises: that pre-arranged transactions which are formalised on a trading venue are in the scope of pre-trade transparency, and that trading venues have or can be given discretion when determining transparency arrangements. Neither of these assumptions are true, and as a result, AM 812 could not be successful on its own terms.

It is also unclear how AM 812 would interact with the existing framework for pre- and post-trade transparency. Therefore, there is a risk that, if AM 812 is adopted, the eventually adopted regulatory technical standards will rely on the amendment to change that framework in ways that are unhelpful and which may go beyond what might be anticipated by a narrow reading of the amendment.

Finally, we would observe that any regime that allows trading venues to have discretion when setting transparency arrangements for the same or similar instruments would diminish the comparability of data published by those trading venues. If this was to bleed into post-trade transparency, it would undermine the value of the relevant consolidated tape.

- ***We recommend opposing Winzig AM 812 as poorly constructed and unclear in its effect, and on the basis of its stated justification. We agree with its exclusion from the compromise MiFIR text.***

4. Report and justify activity on third-country trading venues

ISDA opposes amendments that would require investment firms to be able to substantiate that their use of third-country execution venues results in execution outcomes that materially improve on those available on EEA execution venues, that would require investment firms to periodically disclose the distribution of their execution across EU execution venues and third-country execution venues, and that would require ESMA to keep the use of third-country venues under review pursuant to issuing recommendations patterns of use raise concerns.

[3] The Value of OTC Derivatives: Empowering Organizations to Manage Risks, Enhance Returns and Optimize Liquidity

AMs 852 and 853, tabled by MEP Pietikäinen, appear intended to promote the use of EEA execution venues for the trading of EEA shares. They propose to insert two new articles into MiFIR (Articles 23b and 23c).

AM 852 (new MiFIR Article 23b) would require investment firms to be able to, upon request, to substantiate that their use of execution venues outside the EEA results in execution outcomes that materially improve on those available on EEA venues; and would require ESMA to keep the use of third-country execution venues under review and would give it the power to issue recommendations where patterns of use raise concerns regarding regulatory consistency or market integrity.

AM 853 (new MiFIR Article 23c) would require investment firms to annually disclose, in a harmonised format, the distribution of their activity across EU trading venues, EU systematic internalisers and third-country execution venues, along with key indicators reflecting the quality of execution achieved within each category of venue; and mandates ESMA to develop technical standards for the content, format and comparability of those disclosures.

ISDA notes that the apparent underlying motivation for these amendments, to promote the trading of EU shares on EU execution venues, is already effectively addressed by the share trading obligation (STO) under MiFIR Article 23, despite the STO's different policy intent. This would appear to make these amendments unnecessary for the purpose for which they have been tabled.

We also note that these AMs under their current drafting would not apply only to shares and other equity-like instruments, but also (apparently unintentionally) to non-equity instruments, including derivatives. Just as the STO ensures that EU shares are traded on EU execution venues, the derivatives trading obligation (DTO) under MiFIR Article 28 ensures that derivatives subject to the clearing obligation for which sufficient liquidity exists on EU venues must be traded only on such venues, or venues granted equivalence under MiFIR Article 28(4). By extension, those derivatives not subject to the DTO must have greater liquidity available on non-EU trading venues and through bilateral execution with both EU and non-EU counterparties than that which is available on EU trading venues.

ISDA considers that mechanisms that would cause EU investment firms to face burdensome requirements to report on and justify activity executed away from EU trading venues, thereby attempting to impel them to trade derivatives that are not subject to the DTO on EU trading venues, would harm the competitiveness of those EU investment firms and result in worse outcomes for their clients.

We also note that the reporting required by these amendments would be very similar to that previously required by Commission Delegated Regulation (EU) 2017/575 ("RTS

27") and Commission Delegated Regulation (EU) 2017/576 ("RTS 28"). We note further that RTS 27 reporting was suspended until 28 February 2023 under Directive (EU) 2021/338, with Recital 9 of that Directive stating that these reports did "not enable investors and other users to make any meaningful comparisons on the basis of the information they contain". ESMA subsequently issued a public statement in December 2022, instructing NCAs to deprioritise supervisory actions on the obligation to publish RTS 27 reports until they were finally fully removed from the revised MiFID II under Directive (EU) 2024/790, and until that was transposed into national legislation[4].

Likewise, the MiFID II Review also removed the obligation to report under RTS 28, with Recital 8 stating that both the RTS 27 and RTS 28 reports did "not enable investors or other users of those reports to make meaningful comparisons based on the information provided in them". ESMA issued a public statement instructing NCAs to deprioritise supervisory actions on the obligation to publish RTS 28 reports until the revised MiFID II entered into force and was transposed into national legislation[5].

ISDA strongly believes that AMs 852 and 853 would result in the imposition of significant cost burden similar to that caused by RTS 27 and RTS 28, while likewise producing information of no meaningful use to investors.

- ***We strongly recommend opposing Pietikäinen AMs 852 and 853 as adding burden disproportionate to the utility of the reports they would require, unintentionally impacting asset classes they are not intended to address, and being likely to adversely impact the competitiveness of EU investment firms.***

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[4] ESMA35-43-3444
[5] ESMA35-335435667-5871