Response to ESMA consultation on package orders for which there is a liquid market

3 January 2017

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 66 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.

About FIA

FIA is the leading global trade organisation for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct.

Executive Summary

ISDA and FIA welcome the opportunity to respond to ESMA's consultation on "Draft RTS on package orders for which there is a liquid market".

Whilst we have made every effort to respond to this consultation to the best of our ability, this has been limited by the short consultation period over the Christmas break. Accordingly, our thinking is still developing on this topic. We are mindful of the tight deadlines that ESMA faces, and so would be eager to continue a dialogue with ESMA following the formal close of the consultation.

From our members' experience trading packages, we believe that no package should be considered liquid as a whole unless it meets the following general criteria. We believe that these points should be central to considering when a package is liquid.

- All components are denominated in the same currency.
- The package order has no more than three components (or four where all the components are equity derivatives).
- All components come from the same asset class and same RTS 2 sub-asset class.
- All components are liquid (or in any event they should not fall in to the "Other Derivative" bucket of their respective RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid).

- All components are below large in scale.
- All components are traded on the same trading venue.

In addition to the specific points made below, ISDA and FIA consider that:

- ESMA should take a cautious approach to identifying package orders that should be considered as having a liquid market as a whole. This is a complex area given the very large range of different types of package order, which may combine any number of components of almost any type of instrument across the same or different asset classes. In addition, ESMA has not yet been able to undertake any market impact analysis of its proposals. The CFTC was able to use no action letters to modify and delay the application of the trading obligation to packages. There would be no similar flexibility in relation to the pre-trade transparency under MiFIR if the RTS identify a broad class of package orders that should be considered as having a liquid market as a whole.
- In particular, the amendments to MiFIR require ESMA to assess whether packages are "standardised and frequently traded" when developing the methodology for determining whether there is a liquid market for a package order as a whole. We believe that ESMA's proposed methodology would treat as liquid a very large number of packages that are bespoke and very infrequently traded. For example, the proposal would cover combinations of any number and any kind of OTC derivatives that are subject to the clearing obligation, just so long as one or more of them is subject to the trading obligation. In particular, there are packages which are standardised but infrequently traded.
- Therefore, the RTS should initially only specify a narrow range of package orders that should be considered to have a liquid market as a whole. ESMA can subsequently evaluate the practical experience of Member State competent authorities in granting the waiver and consult on amendments to the RTS to reflect that experience and a fuller impact analysis. In particular, packages should only be considered liquid if they are denominated in a single currency and have only a very limited number of components.
- In line with this approach, the RTS should also not address cross-asset class package orders. The RTS should only treat packages as liquid if all components come from the same asset class and sub-class as defined in RTS 2. Cross-asset class (or sub-class) packages should be dealt with at a later stage in the light of practical experience of applying the waiver regime. We do, however, note that there is a basis for discussion on whether bund futures spreads, assets swaps and invoice spreads should be considered as liquid. However we have concerns regarding the practical consequences of such a determination. We have provided more details and reasoning in our responses to questions 5, 8 and 23.
- The intention of the legislators was to tailor the scope of pre-trade transparency to take account of the special characteristics of package orders. Therefore, ESMA's analysis should recognise the general principle that pre-trade transparency should not apply to a package order when none of the components would have been subject to pre-trade transparency if executed separately. This may be because of one or a combination of the following reasons:

    - all the individual components are financial instruments not within the scope of the pre-trade transparency regime (for example, because they are not traded on a trading venue);

    - for package orders executed outside a trading venue, the investment firm responding to the request for quote is not a systematic internaliser in relation to all the components and the components for which it is a systematic internaliser are instruments that do not have a liquid market or are above the size specific to the instrument.

- In addition, we consider that the RTS should specify that a package cannot be regarded as liquid as a whole if one or more of its individual components is not liquid or is large in scale. We consider that it would be difficult to demonstrate that, as a factual matter, a package is "standardised and frequently traded" when one or more of its components is illiquid or large in scale. We do not rule out the possibility that, in the future, there may be practical experience and data that demonstrate that some kinds of packages that include illiquid or large in scale components are "standardised and frequently traded". However, at this stage, there is no such experience or data that could support that conclusion.
- Similarly, we consider that it is not practical for a venue to give pre-trade transparency for a package order as a whole unless all the components can be executed through the same venue. In particular, there are practical issues in relation to pre-trade transparency for packages that consist of an exchange traded derivative and a derivative (such as an OTC derivative) which cannot be executed on the same exchange.
- Furthermore in relation to packages comprising OTC derivatives, we are concerned that ESMA's general criteria would treat packages as liquid as whole even though the parties will not be required to or even actually intending to submit one or more of the components for clearing. We set out below our concerns in relation to treating packages of OTC derivatives as liquid when some of them are not subject to the trading or clearing obligation.
- We also describe below some cases where the inclusion of certain components in a package indicates that the RTS should specify that the package is not liquid as a whole. In particular, packages that contain options, exchange traded certificates or notes, securitised derivatives or structured finance products or financial instruments that fall outside the scope of Article 8 or 18 of MiFIR (e.g, equities) should not be regarded as liquid as a whole (at least at this stage).
- The MIFID Level 1 ‘Quickfix’ text defined an EFP as a ‘transaction in a derivative contract or other financial instrument contingent on the simultaneous execution of an equivalent quantity of an underlying physical asset’, waiving pre-trade transparency for such assets. As ESMA has recognised in the consultation paper, it is not clear, from literal reading of this text, what ‘physical asset’ refers to. ISDA would welcome clarification in this regard.

Q1: Do you agree with ESMA's proposal to apply the SI obligations at the package order level where the investment firm is an SI in at least one component instrument of the package order? If not, please explain why and propose an alternative

We understand that ESMA's analysis of the new Article 18(11) is that the obligation to publish firm quotes under Article 18(1) MiFIR applies in relation to a case where a systematic internaliser (SI) is prompted for a quote in relation to a package order if:

- At least one component of the package order is an instrument to which Article 18 applies (because it is a bond, structured finance product, emission allowance or derivative traded on a trading venue) and for which the investment firm is an SI; and
- The package order is considered to have a liquid market as a whole under the proposed RTS being developed under Article 9; and
- At least one of the components of the package order is at or below the size specific to the instrument (SSTI).

In such a case, the SI must publish its quote for the package order as a whole under Article 18(1).

In addition, we understand that ESMA also considers that if the package order is not considered to have a liquid market as a whole under the proposed RTS, then the obligations in Article 18(2) apply if the other conditions stated above are met.

We are concerned that this will result in an SI having to provide pre-trade transparency for package orders in cases where pre-trade transparency would not have applied to all components if the client had requested separate quotes for the components. We do not consider that this was the intention of the co-legislators as this would broaden the scope of pre-trade transparency obligations. In addition, it may adversely affect client interests as clients would have an incentive to seek separate quotes to avoid the consequences of pre-trade transparency when it is in the client's interest to seek a quote for a package order.

First, ESMA should make clear that the obligations in Article 18 only apply if all the components of the package are instruments to which Article 18 applies. For example, we consider that the obligations in Article 18 should not apply if one of the components of a package is an equity or is a bond, structured finance product, or derivative that is not traded on a trading venue. These packages are inherently illiquid.

In addition, we consider that the Article 18(11) means that the package as a whole must be one that is traded on a trading venue. ESMA should also make clear that Article 18 does not apply to a package order in circumstances where the same package order cannot be traded on a trading venue such that it would fall within the scope of pre-trade transparency under Article 8.

Secondly, ESMA should make clear that the obligations in Article 18 only apply if the investment firm is an SI for all the components of the package. Otherwise it would be required to give pre-trade transparency for (and commit to trade in) instruments which it does not trade in significant volume.

Thirdly, ESMA should make clear that the obligations in Article 18 do not apply to an investment firm that is an SI if any of the components of the package are above SSTI. We do not consider that ESMA should infer from Article 9(1)(e)(iii) that SIs are only exempted from obligations under Article 18(1) and (2) if all components of a package are above SSTI.

At the very least, ESMA should make clear that, if the obligations under Article 18 do apply where some of the components are instruments to which Article 18 does not apply or for which the investment firm is not an SI, the SI is not required to provide pre-transparency for the package as a whole (or its individual components) if all the components to which Article 18 applies and for which the investment firm is an SI are above SSTI.

We consider that it will be important for ESMA to articulate guidance, in line with the above, on how Article 18 applies to package orders through Q&A or other means. We would welcome the opportunity to provide further input in the formulation of that guidance.

We discuss the issues that arise where one or more of the components is an instrument for which there is not a liquid market in our response to the questions on the draft RTS below.

Q2: Do you agree with the proposed methodology? Do you consider an alternative methodology as better suited for identifying liquid package orders as a whole?

We have a number of concerns with ESMA's approach.

Waiver should be available where any of the components are large in scale

ESMA's analysis appears to suggest that a waiver is not available under Article 9(1) for a package order even if any or even all the components are large in scale compared to normal market size for the respective components. As already noted, we do not consider that the intention of the co-legislators was to broaden the scope of pre-trade transparency for package orders.

This is a particular concern for package orders executed on venues using order book systems. They cannot benefit from a waiver under Article 9(1)(e)(iii) as this is limited to cases where all the components are executed on a request for quote or voice system and are above SSTI. Accordingly, we consider that ESMA should make clear that competent authorities can grant waivers under Article 9(1) for package orders where any or all the components are large in scale compared to normal market size for the respective components, either under Article 9(1)(a) or Article 9(1)(e)(ii). We do not consider that the wording of Article 9(1)(e)(ii) was intended to prevent this.

In any event, we consider that the RTS should include provisions specifying that a package order is not considered to have a liquid market as a whole where any or all of the components are large in scale compared with the normal market size for the respective components. It is a strong indication that the package is not liquid where the size of one or more of the components is above the large in scale thresholds. In particular, we do not believe that a package which contains one or more components which are extremely large in scale can credibly be considered as liquid. We do not rule out the possibility that, in the future, there may be practical experience and data that demonstrate that some kinds of packages that include large in scale components are "standardised and frequently traded". However, at this stage, there is no such experience or data that could support that conclusion.

Package order should not be considered liquid where any of the components are financial instruments for which there is not a liquid market

Similarly, the proposed methodology does not take into account the work done by ESMA on the liquidity of the individual components. We consider that a package order should not be considered to have a liquid market as a whole if any or all the components are financial instruments for which there is no liquid market. This should be made clear in the RTS. If one of the components is illiquid, then the package *as a whole* should be regarded as illiquid. The combination of an illiquid instrument and a liquid instrument is not more liquid than the separate parts of the package.

We therefore believe that a package should only be considered as liquid *as a whole* where all components are liquid in their individual capacity. This is particularly important when executed away from an RFQ or voice system, if a waiver is not available.

Again, we do not rule out the possibility that, in the future, there may be practical experience and data that demonstrate that some kinds of packages that include illiquid components are "standardised and frequently traded". However, at this stage, there is no such experience or data that could support that conclusion.

In any event, package order should not be considered liquid where some components are large in scale while others are financial instruments for which there is not a liquid market

In any event, we consider that a package order should not be considered liquid as a whole where one or more components are large in scale compared to the normal market size and all the other components are financial instruments for which there is not a liquid market. It is difficult to see how a package consisting of large and/or illiquid components can be considered to have a liquid market as a whole, at least in the absence of evidence to this effect. This should be made clear in the RTS.

The above conditions should apply to all kinds of packages

The above conditions should apply to all kinds of packages. In particular, the above conditions should apply even in the case of packages comprising derivatives subject to the trading and clearing obligations. In such cases, at least at this stage, the fact that at least one of the components is large in scale should be taken to indicate that the package is illiquid as a whole.

RTS must take into account standardisation and frequently traded criteria

Article 9(6) requires ESMA to assess whether packages are standardised and frequently traded when developing its methodology for determining whether there is a liquid market for a package order as a whole. ESMA's methodology does not appear to take into account either of these criteria (the general criterion of standardisation of contractual terms in Article 2(1)(b) of the draft RTS only relates to the components not the package as a whole).

We understand that, in the time available, it would be difficult for ESMA to identify types of standard package and determine the actual frequency of trading. However, we consider that the criteria that are developed in the RTS should be closely connected to and directly relevant to particular types of standard transaction that are frequently traded. To an extent, the asset class specific criteria are intended to do this when they refer to spreads and butterflies. However, in other respects the criteria are in no way linked to actual examples of standardised and frequently traded packages (e.g., the criteria for mandatorily traded and cleared derivatives admit of any number of combinations – it is inherently unlikely that all such combinations are "standardised and frequently traded").

As drafted, the methodology proposed would treat as liquid packages which are bespoke and very infrequently traded. For example, the proposal would treat as liquid combinations of any number and any kind of OTC derivatives that are subject to the clearing obligation, just so long as one or more of them is subject to the trading obligation. It would also treat as liquid highly unusual combinations of different kinds of interest rate derivatives regardless of their type (e.g., a package combining a swap, forward rate agreement and a cap) just so long as they meet the general and asset class criteria. As drafted, the criteria would inevitably include a very large number of packages which are not standard and are rarely traded.

Asset class specific criteria

The draft RTS refers to specific asset classes (interest rate derivatives, equity derivatives, etc.). We assume that these are intended to be interpreted consistently with the meaning given to them in the Annexes to RTS 2. However, the RTS should make this clear.

Methodology

We propose an alternative methodology in our responses to the questions herein.

Separately, the MIFID Level 1 'Quickfix' text defined an EFP as a 'transaction in a derivative contract or other financial instrument contingent on the simultaneous execution of an equivalent quantity of an underlying physical asset', waiving pre-trade transparency for such assets. It is not clear, from literal reading of this text, what 'physical asset' refers to.

We would welcome clarification in this regard, and note that ESMA recognises the need for such guidance in paragraph 18 of the Consultation paper.

Q3: Do you agree with the general criteria for identifying package orders that may be eligible for being liquid as a whole? Do you consider necessary to add further criteria or to remove any of the criteria proposed? Please explain.

Trading on venue criterion

We agree with criterion (i) in Article 2(1)(a) of the draft RTS in so far as it requires that all components are traded on a trading venue.

However, we consider that it should be of more general application and should also apply to the circumstances described in Article 1(a) of the draft RTS (i.e. where derivative transactions are subject to the trading and/or clearing obligation). OTC derivatives should not be considered liquid unless they are tradable on a venue.

We also consider that the criterion should only apply if all the components are traded on the same trading venue. The requirement for a venue to make public the prices advertised through its system for a package order implies that the participants can execute the package order on the venue's system, i.e., that all components can be traded through the venue's system. For example, there are questions as to whether venues would only be able to pre-trade report one component of the package (a future, for example) but not others (swaps). Where the futures leg needs to be booked on the regulated market, it is unclear how the regulated market would be able to provide transparency, and indeed what the advantage of this transparency would be.

However, criterion (i) should not refer to the components being "admitted to trading". This wording is not consistent with the provisions of Article 8(1) which only refer to instruments "traded on a trading venue".

Standardisation criterion

We are concerned about the application of the criterion (ii) in Article 2(1)(a) of the draft RTS (contractual terms standardised). It is not clear what it means in relation to bonds and other securities. Nor is it clear what it means in relation to derivatives, in particular given the clearing criterion in Article 2(2) since instruments cannot be cleared unless there is a degree of standardisation. It is also not clear what criteria that market participants should apply to determine whether instruments are sufficiently standardised to meet this test.

In any event, this criterion does not respond to the mandate in new Article 9(6) of MiFIR which requires ESMA to assess whether the package is standardised (not whether its components are standardised). ESMA does not propose any test that responds to this mandate requirement.

Clearing criterion

We are also concerned about the criterion in Article 2(2) (derivative components available for clearing).

This is not limited to authorised or recognised central counterparties (CCPs). There are many CCPs across the globe and it is therefore not proportionate for ESMA to, effectively, require market participants seeking a waiver to determine the clearability of instruments on all of them.

Even if the clearability criterion was linked to the derivative components being available for clearing through an authorised or recognised CCP, this would present a significant monitoring burden for market participants to determine the clearablity of products at those CCPs. For certain obligations (G4 Rates) there are over 10 authorised and recognised CCPs that clear such products. This means that firms need to monitor the product offering of all CCPs (even those they are not members of or have no clearing arrangements with) on a daily basis in order to determine whether certain swaps or product characteristics have become clearable. This is an extremely intensive monitoring exercise, even for large firms, let alone smaller financial counterparties. There is no industry standard format for CCPs' lists of clearable instruments, no standard as to where CCPs should publish their lists of clearable instruments and no minimum notice period that a CCP should provide prior to extending their clearing to a new instrument. (See also our response to Q25)

We agree with the statement in paragraph 51(ii) that there might be technical challenges associated with pre-trade transparency for packages comprising uncleared and cleared derivatives, but note that Article 2(2) does not actually limit the scope of liquid packages to those where derivative components are actually cleared (for instance, derivative components that can potentially be cleared but which are not intended to be cleared in the context of a package order would not be excluded from the scope of liquid packages under the current drafting).

We would propose that market participants should be able to refer to a centralized static list of derivative components that are available for clearing at authorized or recognized CCPs on the date that the RTS takes effect, if this is to be a criterion for deeming packages as liquid. Were this not to be the case, investment firms would be required to monitor which financial instruments are available for clearing on a daily basis. As well as the significant resource burden this would involve, and the costs of changing systems when additional products become subject to clearing, it is likely that the absence of a single list would lead to inconsistent application of the rules across investment firms and Member States.

In this event, Article 2(2) could be amended to refer to "the derivative components of a package order shall be derivatives that would be available for clearing, on the date this RTS takes effect, through a central counterparty that is authorized or recognized under EMIR on the date this RTS takes effect."

We propose that ESMA is well placed to provide a list of the derivatives meeting this criterion, and in doing so would provide assurance to investment firms that they are correctly applying the requirements. ESMA could amend the RTS and update the list where it feels that the list no longer reasonably represents the financial instruments which are available to be cleared through a central counterparty. Such a list would be likely to have other uses in the context of EMIR, as well as for market participants and end users more broadly.

In the absence of such a list, we would propose amending Article 2(2) to provide that "the derivative components of a package order shall be derivatives concluded on a regulated market that are to be cleared by a CCP in accordance with Article 29 of [MiFIR]. OTC derivatives that belong to a class of derivatives that has been declared subject to the clearing obligation under [EMIR] or OTC derivatives that are available for clearing through and the parties have agreed are to be cleared at a central counterparty authorized or recognized or recognized under [EMIR]." Whether a trade in OTC derivatives is intended to be centrally cleared will be agreed and priced in to the trade in advance of execution, and so this is a binary indicator that will be known to market participants up front.

Additional criteria

See our response to Q3 as regards the inclusion of criteria linked to the question of whether components are large in scale or illiquid. These criteria should apply to all package orders not just those referred to in Article 1(b) of the draft RTS.

Alternative approach to the general criteria

In order to improve the proposal, we think it is helpful to define the universe of possible instruments available in package orders. In particular we think the well established distinction between those derivatives that are traded on a regulated market and those traded OTC is a helpful base for the criteria. We think it is possible to define it as follows:

- OTC derivatives defined under Regulation (EU) No 648/2012 (EMIR) not subject to the clearing obligation / trading obligation;

- OTC derivatives defined under Regulation (EU) No 648/2012 (EMIR) subject to the clearing obligation but not the trading obligation;

- OTC derivatives defined under Regulation (EU) No 648/2012 (EMIR) subject to the trading obligation;

- Derivatives that are not OTC derivatives defined under Regulation (EU) No 648/2012 (EMIR) (i.e. derivatives on regulated markets);

- Cash instruments (such as cash bonds).

This approach to categorization has significant symbiosis with other extant regulation. It is based on a workable and fully understood definition of the scope of what an "OTC derivative" is under EMIR. It also integrates standardization and liquidity assessment under the clearing and trading obligation. Taking these broad categories it is possible to create a two-way matrix showing all the possible combinations across the two types of instruments listed above:

	Derivatives on a regulated market	**OTC derivatives not subject to CO/TO**	**OTC derivatives subject to CO**	**OTC derivatives subject to TO**	**Cash instruments**
Derivatives on a regulated market	Standardized and potentially liquid but further asset class specific liquidity assessment needed.	Not liquid on the basis the OTC component is not liquid.	Standardized and potentially liquid on the basis the OTC component is sufficiently standardized to be subject to the CO, but further asset class specific liquidity assessment needed.*	Standardized and potentially liquid on the basis the OTC component is sufficiently standardized and liquid enough to be subject to the TO, but further asset class specific liquidity assessment needed.*	Not liquid**
OTC derivatives not subject to CO/TO		Not liquid on the basis the OTC components are not sufficiently standardized or liquid.	Not liquid on the basis the OTC components are not sufficiently standardized or liquid.	Not liquid on the basis the OTC components are not sufficiently standardized or liquid.	Not liquid**

OTC derivatives subject to CO			Standardized and potentially liquid on the basis the OTC components are standardized enough to be subject to the CO, but further asset class specific liquidity assessment needed.	Standardized and potentially liquid on the basis the OTC components are sufficiently standardized and liquid enough to be subject to the CO/TO, but further asset class specific liquidity assessment needed	Not liquid**
OTC derivatives subject to TO				Standardized and potentially liquid on the basis the OTC components are sufficiently standardized and liquid enough to be subject to the TO, but further asset class specific liquidity assessment needed.	Not liquid**
Cash instruments					More analysis needed**

* As indicated above, we are concerned that there are practical difficulties with treating as liquid packages comprising derivatives on a regulated market and OTC derivatives when all the components of the package cannot be executed on a single trading venue.

*We do not believe that cross-asset class packages should be considered as liquid. However, there are some examples of periodically frequently traded packages which include components from different asset classes, which we discuss in our responses to questions 5 and 8, some which raise practical difficulties in providing pre-trade transparency.

Unlike the current proposal, this approach would allow ESMA to "assess whether packages are standardised and frequently traded" as required by MiFID article 9(6)(c). The fundamental premise underpinning the matrix is that for a package order to be considered liquid as a whole, the *individual legs* must first have a proven degree of standardization and liquidity. This stands to reason: a package order comprising of individual legs has been made more specialized and bespoke by virtue of being traded simultaneously and contingently (either as a basis trade or as a hedge trade), so a package order cannot therefore be considered liquid as a whole without proven standardization and liquidity first in the individual legs.

Accordingly the matrix results in the package order being considered liquid only when there is a nexus between:

- OTC legs subject to the clearing and/or trading obligation; and

- Exchange traded legs

(subject to certain asset-class specific criteria).

This matrix table should therefore be used as **general criteria** to assess whether a package is considered liquid as a whole in addition to the following points:

- For a package order to be considered liquid as a whole it must contain **no more than 2 of the 5 instrument classifications** in the matrix table. A package order containing 3 or more types of instrument classifications would by definition by bespoke and highly customized, and therefore not liquid.

- For a package order to be considered liquid as a whole it must contain no more than 3 legs in total (or 4 for equity derivatives). The greater number of legs, the greater the possible combinations across maturities and contracts. Package orders with more legs cannot reasonably be assessed as liquid.

- Only packages where all the legs are traded in a single currency should be deemed liquid and standardized. The current draft Article 3(1)(b) would treat a multi-currency package order as liquid so long as all the components have a notional currency in EUR, USD or GBP, and are liquid and below LIS on an individual basis.

- Cross-asset class package orders should be excluded on the basis that these are more specialized, complex trades and unlikely to liquid (subject to the ** above). Certain other cross-asset class package orders could be brought into scope at a later stage in the light of further assessment and practical experience of applying the waiver regime.

The general criteria should be a first step in scoping whether a package order could be deemed standardized or liquid. Failure to pass the general criteria stage means the package should not be considered liquid as a whole.

As noted above for certain package orders that include one or more legs that are derivatives on a regulated market a further **asset-class specific liquidity assessment** is needed **<u>in respect of those legs only</u>**. This is because whilst such a leg can be considered standardized, by virtue of being listed according to a standard contract specification, the liquidity assessment depends on multiple idiosyncratic factors relevant to the specific contract. We believe that currently the asset-class specific liquidity assessment is drawn too widely and further consideration should be given the number of legs and time to maturity of the derivative and/or underlying instrument. Please see our responses to questions 5, 10 and 16.

Further, we would question whether a package can be considered as liquid where there is an options component. At least at this stage, the RTS should specify that a package containing such a component should not be regarded as liquid.

Q4: Do you consider it necessary to further specify the first criterion on the standardisation of components? If yes, which characteristics should be considered to specify the standardised components of packages?

See our response to Q3.

While we acknowledge that identifiers exist for packages do not exist at present, the existence of an identifier for a Package (at some point in the future) could be used as a criterion for the designation of a Package as liquid and standardized.

We support the inclusion of an 'other terms' field for purpose of instrument identification in relation to designation of derivatives as 'traded on a traded venue'. We believe this field should also be used to identify packages containing components which would themselves contain 'other attributes', as illiquid.

Q5: Do you agree with the proposed interest rate derivatives specific criteria? If not, please explain why and present your preferred approach. Do you consider it necessary to add further criteria? If yes, please explain.

A) A cautious approach should be taken to deeming cross-asset class packages as liquid

We understand that the proposed criteria are intended to cover cross-asset packages consisting of derivatives and other instruments. We consider that it is premature to seek to cover cross-asset packages at this stage. In any event, it would be necessary further to define such packages so as only to capture those that are genuinely standardised and frequently traded. For example, as drafted the proposal would cover a combination of an interest rate derivative and an equity instrument.

We believe that only packages containing components denominated in a single currency should be deemed liquid and standardized. The current draft Article 3(1)(b) would treat a multi-currency package order as liquid so long as all the components have a notional currency in EUR, USD or GBP. We note that no major request for quote venue offers trading in cross-currency packages.

B) Bund future spread

We consider that a 'bund futures spread' package could be liquid even though it would not qualify as such under draft Article 3(1)(c) and (6) of the RTS. This package is a the combination of the Eurex exchange-traded bund future and a EUR fixed-floating swap forward starting on the delivery date of the bund contract and ending on the final maturity of the cheapest-to-deliver cash bund. The tenor of bund futures are set by reference to the difference between the maturity and the value date (rather than the execution date) and would not generally fall within the unbroken tenors indicated, except occasionally when the bund future (and the associated swap) happens to have an unbroken tenor of 9 or 10 years.

We note, however, that a bund future spread would not fit within our proposal that cross-asset class packages should not be considered to be liquid, in particular bearing in mind our concerns about treating packages as liquid where they consist of exchange-traded and OTC derivatives that cannot be executed on a single trading venue (see our similar concerns in relation to bund futures in our response to Q8). However, we view this as an instance which we wish to highlight to ESMA for further consideration.

C) Proposed additional interest rate derivatives specific criteria

Whilst a number of factors that ESMA identifies are relevant, we think the asset-class specific criteria for interest rate derivatives have a number of shortcomings as follows:

- The language related to maturity "tenors" is specific to the OTC market and it is not certain how this applies in the context of exchange-traded derivatives (i.e. derivatives executed on regulated markets). We also think the maturities stated are too broad. We cannot agree that tenors of 3-4 years, 6-9 years and 30 years are liquid in exchange traded instruments.

- Each of the exchange-traded derivative components must fall within one of the following maturities:

a) For derivatives based on 3 month rates, contracts with a 6 month maturity or less;

b) For derivatives based on 2 year rates, front month listed contract only;

c) For derivatives based on 5 year rates, front month listed contract only;

d) For derivatives based on 10 year rates, front month listed contract only.

In addition, no package should be considered liquid unless it meets the following general criteria:

- All components are denominated in the same currency.

- The package order has no more than three components.

- All components come from the same asset class and same RTS 2 sub-asset class.

- All components are liquid (or in any event they should not fall in to the “Other Interest Rate Derivative” bucket of their RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid).

- All components are below large in scale.

- All components are traded on the same trading venue.

Q6: Do you consider that derivative components in other currencies (e.g. other EEA currencies, JPY) should be included? If yes, which ones?

No.

Q7: Do you agree that only packages derivative components with the above mentioned benchmark dates should be considered liquid? If not, please explain. Which other or additional benchmark dates do you suggest?

We consider that the tenors for package transactions should be aligned with the tenors identified as liquid in ESMA's recent paper on the trading obligation (5, 10 and 30 year for basis swaps). However, as that paper notes the liquidity characteristics of different instruments varies significantly according to the different type of instrument.

In particular, we urge ESMA to refine the criterion in Article 3(1)(c) to take account of the different liquidity properties of spot-starting and forward-starting swaps. As currently written, the criterion would bring packages including forward starting swaps into scope (e.g. a 5 year EUR swap starting in 5 years' time, or a 1 year EUR swap starting in 9 years' time, which both have unbroken tenors of 10 years). In our view, these would not be components of standardized, liquid packages. ESMA should restrict this condition to "spot starting interest rate derivatives" or "interest rate derivatives whose effective date is between trade date and 5 days after trade date".

In addition, it would be necessary to address which types of interest rate derivatives should be regarded as liquid when included in a package with these tenors. For example, it is clear that overnight interest rate swaps (OIS) have very different characteristics as do amortising swaps, swaptions or forward rate agreements. We consider that these cannot all be treated as a single class of interest rate derivatives that can be combined in a package that should be regarded as standardised and liquid.

Q8: Do you consider that for certain types of packages derivative components that have broken dates (e.g. invoice spreads) or which are traded on IMM and MAC dates (e.g. rolls) have a liquid market?

We believe that invoice spreads could be viewed as liquid, but hold some reservations about their being deemed so because of possible practical difficulties in implementing pre-trade transparency reporting for them. For example, as already noted in our response to Q5 on bund futures, there are questions as to whether venues would only be able to pre-trade report one component of the package (a future, for example) but not others (swaps). Where the futures leg needs to be booked on the regulated market, it is unclear how the regulated market would be able to provide transparency, and indeed what the advantage of this transparency would be. We are concerned that if invoice spreads are deemed liquid, and so derivative exchanges are not able to use an illiquid waiver (and a negotiated trade waiver is not available), those exchanges would be required to provide pre-trade transparency when they practically cannot, and so may cease to allow trading in that leg as part of a package.

We therefore respectfully suggest that ESMA consults with futures exchanges before proposing criteria in the RTS that could result in invoice spreads being deemed as liquid. One solution might be that for packages where one leg is executed on a trading venue, all legs must be executed on that same trading venue in order for the package to be deemed liquid. We propose this as a core criteria for a package to be considered as liquid.

Q9: Do you consider it necessary to specify criteria to take any requirements on non-derivative components of packages into account? If yes, which criteria would you suggest and why?

As already noted, we consider that it is premature to seek to cover cross-asset packages at this stage. In any event, it would be necessary further to define such packages so as only to capture those that are genuinely standardised and frequently traded. For example, as drafted the proposal would cover a combination of an interest rate derivative and a bond so long as the bond is admitted to trading or traded on a trading venue and has standardised terms (all bond terms are standardised in one sense). While the interest rate derivatives would have to meet the criteria in Article 3(1)(b) and (c), no additional criteria are specified in relation to the bonds (whether as to currency, tenor, liquidity or otherwise).

In addition, the draft RTS would treat as liquid a package composed of interest rate derivatives and equities or other instruments not covered by Article 9 MiFIR.

We consider that Article 3(1) of the draft RTS should be limited to packages composed exclusively of interest rate derivatives and that separate asset class criteria should be developed for bond/swap packages that seek to identify the main types of liquid and frequently traded packages of this kind. In particular, the bond components should display a threshold level of liquidity.

Q10: Do you agree with the proposed equity derivatives specific criteria? If not, please explain why and present your preferred approach. Do you consider it necessary to add further criteria? If yes, please explain.

Our comments on proposed equity derivatives specific criteria:

- Our members agree that an equity derivative package with more than four components should not be considered as standardized and liquid.

- Our members agree with the currencies listed in criteria 2(a), however believe that all components of the package need to be denominated in the same currency in order for the package to be considered as standardized and liquid.

Our proposed additional equity derivatives specific criteria:

- Our members note that although the categories set out in Table 2 are fairly standardized equity derivatives strategies, a very high number of different packages exist within those categories (e.g. packages with differing expiries, underlyings, strikes etc.). Some ad-hoc packages that fall within those strategies may be very illiquid and only trade as a one off. The liquidity test for equity derivatives (options/futures/forwards) states that all of these sub-asset classes are liquid, therefore unlike other asset classes, for packages that comprise of these equity derivatives sub-asset classes there is no buffer to exclude packages where one or more of the components are very illiquid. Our members suggest that in order to avoid certain very illiquid packages being deemed to be liquid, the determination of a liquid package for equity derivatives is limited to equity derivatives packages that are currently listed on a venue as a whole – this would capture the packages that have a high level of standardization and be consistent with the liquidity determination of the component sub-asset classes which is based on venue listing.

- The draft RTS would seem to treat as liquid a package composed of equity derivatives and equities or other instruments. As already noted, we consider that it is premature to seek to cover cross-asset packages at this stage. In any event, it would be necessary further to define such packages so as only to capture those that are genuinely standardised and frequently traded. In addition, there would be particular practicality issues in treating a package consisting of equity derivatives and equities as liquid when equities fall outside the scope of Articles 8 and 9 MiFIR. In addition, the draft RTS would treat as liquid a package composed of equity derivatives and bonds which we would not consider to be liquid. Therefore, we consider that Article 3(2) should be limited to packages comprised exclusively of equity derivatives.

- There is currently no reference to maturities in the proposed equity derivatives specific criteria. We think this is an oversight and the maturities should be restricted to the front end of the future curve. We believe this statement **is** compatible with the fact that the liquidity assessment under RTS 2 has deemed all equity derivatives liquid; this is because the exchange traded components, when traded as a package, are not liquid all the way along the futures curve.

- As per Q12, our members believe that components of an equity derivatives package need to be in the same underlying to be considered as a liquid package as a whole.

- As per our comments on the general criteria set out under Q2, our members believe that an equity derivatives package order should not be considered to have a liquid market as a whole if any of the components are equity derivative instruments for which there is no liquid market – the combination of an illiquid equity derivative component and a liquid equity derivative component is not more liquid than the separate parts of the package (This is only relevant for equity derivatives packages containing Swaps, Portfolio Swaps or Other equity derivatives that have not been determined to have a liquid market under RTS2.)

- Similarly, the proposed methodology does not take into account the work done by ESMA on the liquidity of the individual components. We consider that a package order should not be considered to have a liquid market as a whole if any or all the components are financial instruments for which there is no liquid market. This should be made clear in the RTS. If one of the components is illiquid, then the package as a whole should be regarded as illiquid. The combination of an illiquid instrument and a liquid instrument is not more liquid than the separate parts of the package.

- As per the general criteria matrix set out under Q3, our members believe that such equity derivatives packages comprising of a combination of components that are exchange traded and OTC (where one or more OTC component is not subject to the TO and/or CO) or a combination of OTC components (where one or more OTC component is not subject to the TO and/or CO), should not be deemed to be liquid as there is currently not a high enough level of standardisation of the contractual terms of OTC equity derivatives. If an OTC equity derivative instrument becomes subject to the TO and/or CO it would indicate that a high enough level of standardization has been achieved in that instrument for a package that contains such instrument to be considered as liquid (subject to satisfying the other general and asset class specific criteria).

In summary, our revised proposal for equity derivatives specific criteria as follows:

- The package has no more than four components.

- All components of the package order have the same notional currency of either EUR, USD or GBP.

- Each of the component must be in contracts with the same underlying.

- Each of the components must have a maturity of 6 months or less.

In addition, no package should be considered liquid unless it meets the following general criteria:

- All components are denominated in the same currency.

- All components come from the same asset class and same RTS 2 sub-asset class.

- All components are liquid (or in any event they should not fall in to the “Other Equity Derivative” bucket of their RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid).

- All components are below large in scale.

- All components are traded on the same trading venue.

Q11: Do you consider that derivative components in other currencies (e.g. other EEA currencies, JPY) should be included? If yes, which ones?

No.

Q12: Do you consider it necessary to specify that all components of the package order should have the same underlying? If yes, please explain.

Our members identified certain equity derivatives strategies with components across different underlyings which some may deem as candidates for being considered liquid (such as index correlation/dispersion strategies). However it is considered that there is not a high enough level of standardization of the contractual terms for these to be deemed liquid packages.

Q13: Do you agree with the proposed credit derivatives specific criteria? If not, please explain why and present your preferred approach. Do you consider it necessary to add further criteria? If yes, please explain

Our comments on proposed credit derivatives specific criteria:

- Our members agree that a credit derivative package with more than two components should not be considered as standardized and liquid.

- As per other asset classes, the RTS should specify that all components of the package must be denominated in the same currency in order for the package to be deemed to be liquid.

- The RTS should make clear that it only covers packages where all components are credit derivatives on indices. Furthermore, all components of a credit derivatives package would need to be included in the same RTS 2 sub-asset class in order for it to be deemed standardized and liquid. Here, we highlight that we do not consider a tranched Index CDS to be liquid, despite the lack of distinction between tranched and untranched in RTS 2. Tranched Index CDS are bespoke instruments and are if included as a component in a package, would not meet the 'high level of standardization' general criteria.

- We welcome the effective limitation of packages designated as liquid in Article 3(3) of the draft RTS to 'Index CDS rolls', but stress that such a package should only be deemed liquid if <u>all</u> of its components are liquid. Illiquid/off-the-run instruments which trade by appointment are often traded against a liquid instrument. To define the entire package as liquid could have adverse consequences to liquidity in the off-the-run instrument.

We welcome the effective limitation of packages designated as liquid in Article 3(3) of the draft RTS to 'Index CDS rolls', but stress that both legs of the package should be liquid in this instance. In addition, we propose a condition that the components have the same notional, since a CDS roll package (i.e. moving from one series to another) would have equivalent notionals.

In addition, no package should be considered liquid unless it meets the following general criteria:

- All components are denominated in the same currency.

- The package order has no more than three components.

- All components come from the same asset class and same RTS 2 sub-asset class.
- All components are liquid (or in any event they should not fall in to the “Other Credit Derivative” bucket of their RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid).
- All components are below large in scale.
- All components are traded on the same trading venue.

Q14: Do you agree that derivative components in USD, EUR or GBP should be considered sufficiently liquid for the purpose of this RTS? Do you consider that derivative components in other currencies (e.g. other EEA currencies, JPY) should be included? If yes, which ones?

No index CDS are denominated in GBP. Therefore, we consider that GBP denominated packages cannot be regarded as liquid.

Packages including index or other CDS denominated in currencies other than USD and EUR should not be deemed liquid.

Q15: Do you consider it necessary to further specify the indices that are eligible? If yes, please specify which specific indices should be included. Do you consider it necessary to specify the maturity dates of the underlying indices?

We do not believe that a package containing CDS on an index containing illiquid underliers (under RTS 2) should be deemed liquid.

Apart from this, the only possible exception to the criterion in the 4th bullet of paragraph 55 (which says that the package order moves from the latest off-the-run index series into the current on-the-run series) occurs where users update tranches, rotating new to old tranches. The roll from series 24 to 26 displays momentary liquidity, once every 6 months.

Q16: Do you agree with the proposed commodity derivatives specific criteria? If not, please explain why and present your preferred approach. Do you consider it necessary to add further criteria? If yes, please explain.

We agree that a time spread/roll between two contracts is a relatively common package in certain commodity derivative markets and contracts. However, we believe the current RTS needs to provide additional criteria to ensure that only truly liquid packages are captured. As currently drafted the RTS could apply the same pre-trade transparency requirements to an order to roll from the 1st nearby future to the 2nd month future in Brent futures as it would to an order to buy/sell the December 17 contract versus the December 20 contract where liquidity is significantly lower. Likewise the current draft of the RTS would determine that an order to roll between two dates in LME Aluminium futures be subjected to the same pre-trade transparency as LME Aluminium Alloy futures which have less than 1% of the daily volume of the corresponding Aluminium futures. Additionally, given the lack of substantive analysis for commodities liquidity that ESMA was able to provide in the consultation process around RTS2 we believe it is important that ESMA proceeds with caution in the regime for packages in commodities.

Therefore we would suggest the following criteria for commodities packages to be considered liquid:

a) the package order has two components;

b) the notional currency of the derivative components is in EUR, USD or GBP;

c) both components are in the same RTS2 sub-asset class; e.g. future vs future or swap vs swap

d) both components are in the same underlying commodity; e.g. copper vs copper, crude vs crude

e) both components are in the same currency;

f) both components are deemed to be liquid (or in any event they should not fall in to the “Other Commodity Derivative” bucket of their RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid);

g) The package order moves from a contract with a specified maturity data into another contract with a different maturity date.

Q17: Do you consider that derivative components in other currencies (e.g. other EEA currencies, JPY) should be included? If yes, which ones?

No.

Q18: In which types of contracts do package orders in commodity derivatives mostly occur? Do you consider it necessary to provide for asset class specific criteria that take option and future/forward contracts into account? If yes, please explain.

See above.

Q19: Do you consider it necessary to develop criteria at a more granular level (e.g. energy derivatives, agricultural derivatives) to better reflect the particularities of package orders in the different sub-asset classes? If yes, please explain.

As previously outlined, ESMA was not able to perform the same level of detailed analysis of commodity derivative liquidity as it was for some other asset classes. Additionally, the sub-asset classes for commodity derivatives were revised quite substantially, with industry input, in the final RTS relative to the earlier draft. Given these challenges we believe that it would be difficult for ESMA to develop criteria at a more granular level, in the time available, and therefore a cautious approach to commodity derivative packages is warranted.

Q20: Do you consider it necessary to specify that all components of the package order should have the same underlying? If yes, please explain at which level this concept of "same underlying" should apply (e.g. same asset class, same sub-asset class, same sub-class – as per Annex III of RTS 2 – or at or more granular level).

We believe that that all components of a package should be denominated in the same currency in order for the package to be deemed to be liquid.

We believe it is important that it is made clear that Article 3(4) of the draft RTS only relates to "commodity derivatives" referred to in MIFID 2 Annex 1 Section C (5), (6) and (7). Article 3(4) should not cover packages including securitised derivatives referred to in point 44(c) of Article 4(1) of MiFID2 or derivatives referred to in MiFID2 Annex 1 Section C(10) even though point (30) of Article 2(1) MiFIR defines these as "commodity derivatives". In particular, MiFID2 Annex 1 Section C(10) includes derivatives with underliers – such as inflation or economic statistics – that have little to do with commodities (similar issues arose recently with respect to the scope of product coverage of the position limits under MIFID2). As stated in paragraph 57 of the consultation paper, packages including such components should not be regarded as liquid.

Further to this point, it should be made clear that inflation swaps included in packages are treated as part of the interest rate swap asset class (in line with RTS 2).

We believe there is a need for more granularity in the criteria here, in particular as regards the commodity underlying. ESMA should provide that components are drawn from the same commodity derivative sub-asset class in RTS 2 (this is the lowest level of granularity we would recommend; if not sub-asset class, then the components should be drawn from the same sub class).

Standardised, liquid 'roll' packages in the commodity derivatives asset class could include Packages including two components denominated in the same currency, in the same underlying (i.e drawn from the same sub-asset class or sub-class), moving from a contract with a specified maturity date into another contract with a different maturity date.

As discussed above, liquidity is not consistent across commodity contracts and time periods. Generally liquidity diminishes as you move down the curve i.e. the further you are from maturity the less liquid a contract becomes. The same rule would broadly apply to package orders/transactions. Given this we think it is important that ESMA considers whether the underlying components of the package order are liquid when determining whether the package as a whole is liquid.

We would make the general point that that while there is a good level of understanding apparent and due consideration has been given to packages involving interest rate and credit derivatives, more consideration is needed in relation to packages involving commodities. We suggest that a more cautious approach is appropriate in the commodities context.

Q21: Are there package orders in other derivative asset classes that are in your view standardised and frequently traded and which should be eligible for having a liquid market as a whole? If yes, what asset class specific criteria do you suggest for those?

No.

Q22: Do you agree with the approach proposed for FX derivatives or do you consider it necessary to include an asset-class specific approach for FX derivatives?

We agree that packages composed of FX derivatives should not be considered to be liquid.

Q23: How should ESMA deal with cross-asset class package orders? Should ESMA develop cross-asset class specific criteria? If yes, please specify those. Alternatively, should cross-asset class package orders be allocated to only one asset class? If yes, how?

We have consulted the Association of Financial Markets in Europe (AFME) regarding this question, and they have assisted us in developing our response.

As noted above, we consider that at this stage it is not certain that any cross-asset class package orders should be regarded as liquid. We refer you to previous comments in questions 5 and 8 on particular types of cross-asset class packages which warrant consideration to be designated as liquid, but the consequences of which would imply specific practical difficulties in terms of implementing and complying with pre-trade transparency requirements.

However, should ESMA disagree with this view, we suggest that a package order where the components include both bonds and derivatives may be considered to have a liquid market only where the components meet the following criteria:

- The package comprises no more than 2 components;
- Both components are denominated in the same currency (EUR, USD or GBP);
- The component bond is a liquid sovereign fixed coupon bond with a maturity of no more 10 years from trade date; and
- The component derivative is a single currency fixed-float interest rate swap.

In our view, a package order where all components are bonds may be considered to have a liquid market where the bonds meet the following criteria:

- All the component bonds are liquid;
- All components are denominated in the same currency (EUR, USD or GBP); and
- The package comprises no more than 3 components.

In addition, a package order that contains any of the following components should not be regarded as liquid as a whole:

- structured finance products;
- securitised derivatives;
- ECNs or ETNs; and
- instruments that are not bonds, structured finance products, emission allowances or derivatives.

Q24: Do you agree that package orders where all components are subject to the trading obligation for derivatives should be considered to have a liquid market as a whole? If not, please explain.

We prefer an approach modelled on Table 2 which would focus on packages that have characteristics that are standardised and can be described as frequently traded. ESMA's proposed approach would allow any combination of any number of mandatorily traded instruments to be treated as liquid without any evaluation as to whether they are standardised packages that are frequently traded.

In any event, the RTS should include the following additional criteria in order for such packages to be regarded as liquid:

- All components are denominated in the same currency.
- The package order has no more than three components (or four for equity derivatives).

- All components come from the same asset class and same RTS 2 sub-asset class.

- All components are liquid (or in any event they should not fall in to the "Other Derivative" bucket of their RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid).

- All components are below large in scale.

- All components traded on the same venue.

Q25: Do you consider that package orders where at least one component is subject to the trading obligation and all other components are subject to the clearing obligation should be considered to have a liquid market as a whole? If not, please explain.

We understand this question to refer to packages comprised only of OTC derivatives, as addressed in the Article 1(a) of the draft RTS.

We agree that such packages can be considered liquid but only subject to their meeting the following additional criteria:

- All components are denominated in the same currency.

- The package order has no more than three components (or four for equity derivatives).

- All components come from the same asset class and same RTS 2 sub-asset class.

- All components are liquid (or in any event they should not fall in to the "Other Derivative" bucket of their RTS 2 sub-asset class, as this would suggest that the component is not standardised and is illiquid).

- All components are below large in scale.

- All components traded on the same venue.

We note that the US rules do not impose any additional limitation on the number of components when determining the applicability of the trading obligation to packages. While we recognise the importance of possible mutual recognition arrangements involving the US, pre-trade transparency under MIFID is more burdensome than the current CFTC RFQ-3 standard. It is important that the criteria for pre-trade transparency in the EU only apply to packages that are standardised and frequently traded and thus can be regarded as liquid.

We also highlight that there are some practical problems associated with linking designation of packages as liquid to the clearing obligation, and we refer you to our answer to Question 3.

The classes of products subject to the EU clearing obligation are broadly defined and based on seven characteristics (type; reference index; maturity; settlement currency; settlement currency type; optionality; notional type). Market participants are required to clear products which fall within these classes through authorized or recognised CCPs. However, because of the way in which the classes are defined – in that it is agnostic to many product characteristics – if a CCP expands its product offering to include a product, which nominally falls within an existing class, but with a new characteristic (for example, a fixed to float USD swap with Beijing or Turkish holidays), that product will become subject to the clearing obligation. This means that as CCPs expand their offerings to include products with characteristics that were previously unclearable, so the clearing mandate will constantly expand in scope.

This is particularly problematic for market participants because:

- For certain obligations (G4 Rates) there are over 10 authorised and recognised CCPs that clear such products. This means that firms need to monitor the product offering of all CCPs (even those they are not members of or have no clearing arrangements with) on a daily basis in order to determine whether certain swaps or product characteristics have become clearable. This is an extremely intensive monitoring exercise, even for large firms, let alone smaller financial counterparties. There is no industry standard format for CCPs' lists of clearable instruments, no standard as to where CCPs should publish their lists of clearable instruments and no minimum notice period that a CCP should provide prior to extending their clearing to a new instrument. For more detail, please see our response to question 3.

- If a recognised CCP expands its offering to include a new product characteristic, it is likely that only a handful of EU firms are clearing members and that few other EU financial counterparties have clearing arrangements in place. In that event, many other EU counterparties will be unable to trade such product until they can set up clearing arrangements at the recognised CCP or other CCPs start to clear the products – both processes can often take at least six months.

These issues affect financial counterparties and non-financial counterparties over the clearing threshold as the clearing obligation is phased in under the clearing RTS. Therefore, we propose that packages should not be considered as liquid as a result solely of the mandatory clearing obligation during the phase-in periods under the clearing RTS. In addition, pre-trade transparency should not apply where the parties to the proposed transaction include non-financial counterparties under the clearing threshold.

Q26: Do you agree that the categories of packages above should be considered as standardised and frequently traded for the purpose of this RTS empowerment? If not, please explain.

Interest rate derivatives		**Our response**
Package category	**Description**	
IRS curves	2 IRS of different maturities where all components are benchmark contracts and traded in either EUR, USD or GBP	Yes, provided that all legs are either subject the trading obligation and/or clearing obligation and our proposed general and specific asset class criteria are met.

IRS butterflies	3 IRS of different maturities where all components are benchmark contracts and traded in either EUR, USD or GBP	Yes, provided that all legs are either subject the trading obligation and/or clearing obligation and the our proposed general and specific asset class criteria are met.
Invoice spreads	An IRS and an interest rate future on a sovereign bond where all components are benchmark contracts and traded in either EUR, USD or GBP	Yes, in principle as long as all components denominated in same currency, but please see reservations about pre-trade reporting covered in our answer to Question 8
CCP basis swaps	2 IRS cleared at different CCPs where all components are benchmark contracts and traded in either EUR, USD or GBP	Yes, as long as all components denominated in same currency, have the same value and maturity dates and the same notional values, and provided that all legs are either subject the trading obligation and/or clearing obligation and our proposed general and specific asset class criteria are met.
Rolls	Trading out of an IRS or future and buying the next longest maturity where all components are benchmark contracts and traded in either EUR, USD or GBP	Yes, provided that all legs are either subject the trading obligation and/or clearing obligation and our proposed general and

		specific asset class criteria are met.
Equity derivatives		
Package category	**Description**	
Time spread	2 equity derivatives of different maturities with the same underlying and traded EUR, USD or GBP	Yes, provided that all legs are either subject the trading obligation and/or clearing obligation and the general and specific criteria proposed in the answer to Q10 is met.
Straddle	Buy/sell Put, buy/sell call at same exercise price with the same underlying, same expiration date and traded EUR, USD or GBP.	
Butterfly	Buy/sell call (put) at a low exercise price, buy/sell call (Put) at a high exercise price, sell/buy two calls (Put) with an exercise price that is halfway between the low and the high exercise price chosen, with the same underlying and traded in EUR, USD or GBP.	
Bear spread	Buy call (Put), sell Call (Put) at lower exercise price with the same underlying, same expiration date and traded EUR, USD or GBP	
Bull spread	Buy Call (Put), sell call (Put) at higher exercise price with the same underlying, same expiration date and traded EUR, USD or GBP.	
In addition to the above, our members identified a Strangle as a standardized equity derivative strategy – buy/sell Put, buy/sell call at different strike prices with the same underlying, same expiration date and same currency (either EUR, USD or GBP).		
Credit derivatives		
Package category	**Description**	
Index CDS rolls	Moving from the penultimate version of an index CDS into the latest index version. In particular rolls referencing ITRAXX and CDX indices, in either EUR or USD.	Yes, provided that all legs are either subject the trading obligation and/or clearing obligation and our proposed general and specific asset class criteria are met.
Commodity derivatives		
Package category	Description	

Commodity derivative rolls	Moving from a commodity derivative spot-month future into a further out-month future. Only rolls where all components have the same underlying and that are in either EUR, USD or GBP are eligible.	Yes, provided that all legs are either subject the trading obligation and/or clearing obligation and our proposed general and specific asset class criteria are met.

More broadly, we suggest that a list similar to that above, outlining which packages are liquid, would be extremely useful. The current drafting of the RTS requires an assessment to be made, even where a bespoke package is constructed which has never been traded before, to determine whether the packages should be considered as liquid. In addition to the sizable operational burden this entails, it will inevitably lead to inconsistent implementation and uncertainty for investment firms and their clients.

Separate to our comments on the details of the proposed approach to determining when a package is liquid, we would strongly support an approach which provides clarity and aids consistent implementation. This is in the interest of all market participants and supervisors alike.

Q27: Are there any categories of packages missing in the above asset classes that should be considered for the purpose of this RTS empowerment? Are there in your view categories of packages in other asset classes that ESMA should consider?

No. As already noted, we consider that the RTS should not address cross-asset class packages at this stage.

Q28: Do you agree with the draft RTS in annex IV? If not, please explain.

We consider that the draft RTS should be amended to reflect the above comments. We are providing draft wording separately to ESMA.

RTS cover note[1]

We submit this drafting as an accompaniment to our response to ESMA's consultation paper on package orders for which there is liquid market.

Our response offered a number of proposals, some of which we suggested would require further analysis. For example, we believe that there is a case that some cross-asset class packages could be considered to have a liquid market, but in the absence of further analysis, we recommend that cross-asset class packages are not considered to be liquid, until such analysis is completed and have proposed amendments to the draft RTS accordingly.

The proposed drafting in this RTS takes a cautious approach, and does not include the proposals which we suggest would require further analysis. In the general criteria in article 2, this drafting requires that for a package compiled of derivatives, all of those derivatives must be OTC derivatives, or all of those derivatives must be exchange-traded derivatives, in order for the package to be liquid. We note that this approach is not fully aligned with the matrix that we propose in our response to question 3 of ESMA's consultation paper (in particular the top row of that matrix, where we refer to some reservations about deeming such packages as standardised and liquid in a footnote). Whilst we consider that matrix to be a credible and sensible approach, in the absence of further analysis of how standardized and frequently trades various packages are, a cautious approach should be taken. Subject to that analysis and consultation, ESMA could update and/or broaden the approach.

Similarly, the drafting proposes that packages containing structured finance products and financial instruments falling under article 3(1) of MiFIR (e.g. shares) are not considered to be liquid.

We have also included drafting which would allow packages comprising of emissions allowances to be liquid. This is not an area that we have commented on in our response, but have included emissions allowances as they are a distinct asset class in MiFID II. Whether this is appropriate would require input from market participants and stakeholders who are involved in the trading of emissions allowances.

The draft addresses the issue of standardisation by imposing a general condition that the package must be capable of being traded as a package on a trading venue. This may need to be amended if further data, analysis and consultation indicates that packages comprising exchange-traded derivatives and other instruments (e.g. bonds or OTC derivatives) can be regarded as liquid and that there is a way of resolving the technical issues associated with pre-trade transparency for exchange traded derivatives executed as part of a package where the other leg is being executed outside the exchange.

[1] This cover note and the proposed RTS drafting herein were submitted separately to the main response.

COMMISSION DELEGATED REGULATION (EU) .../...

of [ ]

supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to package orders

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, and in particular Article 9(6) thereof,

Whereas:

....

( ) Package orders should not be considered sufficiently standardised unless the package order can be traded as a package order under the systems of a trading venue. The systems of the trading venue should identify the package order and the components that can be traded under the systems of the venue in a way that is simultaneous and contingent upon the execution of all the other components.

...

HAS ADOPTED THIS REGULATION:

Article 0

Definitions

For the purposes of this Regulation, the following definitions shall apply:

1. 'derivative' means a derivative as defined in Article 4(1)(3) of Regulation (EU) No 648/2012 [EMIR];

   Note: In contrast to the definition of "derivatives" in Article 2(1)(29) MiFIR, this definition does not include "securitised derivatives" covered by point (44)(c) of Article 4(1) of MiFID2.

2. 'OTC derivative' means an OTC derivative as defined in Article 4(1)(7) of Regulation (EU) No 648/2012;

3. 'exchange-traded derivative' means a derivative which is not an OTC derivative;

   Note: This definition is aligned with EMIR to encompass derivatives the execution of which takes place on a regulated market or on a third country market considered equivalent to a regulated market under Article 2a EMIR. This definition differs from the definition of exchange-traded derivatives in Article 4(1)(32) MiFIR because it does *not include securitised derivatives and refers to contracts executed on markets considered equivalent to a regulated market under Article 2a EMIR rather than Article 28 MiFIR.*

4. 'commodity derivative' means a derivative referred to in point (5), (6) or (7) of Section C of Annex I to Directive 2014/65/EU [MiFID2];

   Note: This makes clear that references to "commodity derivatives" do not include references to derivatives covered by Section C(10) Annex I MiFID2 (in contrast to the definition of "commodity derivative" in Article 2(1)(30) MiFIR). This is consistent with RTS 2 which treats derivatives covered by Section C(10) separately from commodity derivatives covered by Sections C(5), (6) and (7) of Annex I MiFID2.

7. 'trade date' means, in relation to a derivative, the date on which the transaction in the derivative is executed.

   Note: We are considering further possible definitions of "tenor" in relation to OTC derivatives (in conjunction with Article 3(6)) and "front month contract" and "maturity" in relation to exchange-traded derivatives.

Article 1

Package orders for which there is a liquid market as a whole

A package order shall be considered to have a liquid market as a whole where the package order and its components meet the general criteria under Article 2 and, where applicable, the asset-class specific criteria under Article 3, except where specified in Article 3a.

Article 2

General criteria for identifying package orders for which there is a liquid market as a whole

1. The package order shall meet all of the following general criteria:

   (a) unless otherwise specified in Article 3, the package order has no more than three components; and

   (b) the package order can be traded as a package order under the systems of a trading venue.

2. All of the components of the package order shall meet all of the following general criteria:

   (a) they are traded on the same trading venue;

   (b) they are denominated in the same currency or have the same currency as their notional currency;

   (c) they are:

      (i) OTC derivatives;

(ii) exchange-traded derivatives;

(iii) bonds; or

(iv) [emission allowances;]

(d) they are all of the same class of financial instrument referred to in point (c) above;

(e) they are all of the same sub-asset class as defined in Annex III to Commission Delegated Regulation (EU) .../... [RTS 2];

(f) they are financial instruments for which there is a liquid market; and

(g) they are not large in scale compared with normal market size.

3. Where the package order includes components that are OTC derivatives, all of the components of the package order shall meet the following additional general criterion, that is, that they belong to a class of derivatives that has been declared subject to the clearing obligation for derivatives in accordance with the procedure described under Article 5 of Regulation (EU) No 648/2012.

Article 3

Asset-class specific criteria for identifying package orders for which there is a liquid market as a whole

1. A package order where all the components are interest rate derivatives falling within Part 5 of Annex III to Commission Delegated Regulation (EU) .../... [RTS 2] shall meet all of the following criteria:

(a) the notional currency of the components of the package order is EUR, USD or GBP;

(b) where the components of the package order are OTC derivatives:

(i) the OTC derivatives have a tenor of 2, 3, 4, 5, 6, 7, 8, 9, 10 or 30 years;

(ii) the effective date of the OTC derivatives is within five days of the trade date of the derivatives; and

(d) where the components of the package order are exchange-traded derivatives, the exchange-traded derivatives fall within one or more of the following categories:

(i) for derivatives based on 3 month interest rates, derivatives with a maturity of 6 months or less;

(ii) for derivatives based on 2 year interest rates, the front month contract traded on the trading venue;

(iii) for derivatives based on 5 year interest rates, the front month contract traded on the trading venue; and

(iv) for derivatives based on 10 year interest rates, the front month contract traded on the trading venue.

2. A package order where all the components are equity derivatives falling within Part 6 of Annex III to Commission Delegated Regulation (EU) .../... [RTS 2] shall meet all of the following criteria:

(a) the package order has no more than four components;

(b) the notional currency of the components of the package order is EUR, USD or GBP;

(c) the components have the same underlying financial instrument or financial instruments or index or indices of financial instruments;

(d) where the components of the package order are OTC derivatives, the OTC derivatives have a tenor of 6 months or less; and

(e) where the components of the package order are exchange-traded derivatives, the exchange-traded derivatives have a maturity of 6 months or less.

3. A package order where all the components are credit derivatives falling within Part 9 of Annex III to Commission Delegated Regulation (EU) .../... [RTS 2] shall meet all of the following criteria:

(a) the package order has two components;

(b) the components of the package order fall within the index credit default swap (CDS) sub-asset class referred to in Part 9 of Annex III to Commission Delegated Regulation (EU) .../... [RTS 2];

(c) the components of the package order have the same underlying index;

(d) the notional currency of the components of the package order is EUR or USD; and

(e) the package order moves from the latest off-the-run index series into the current on-the-run index series (by buying credit protection on one index series and selling credit protection on the other index series in each case with the same notional amount).

4. A package order where all the components are commodity derivatives falling within Part 7 of Annex III to Commission Delegated Regulation (EU) .../... [RTS 2] shall meet all of the following criteria:

(a) the package order has two components;

(b) the components of the package order have the same underlying commodity or commodities or commodity or commodities index or indices;

(c) the notional currency of the components of the package order is in EUR, USD or GBP;

(d) the package order moves from a contract with a specified maturity date into another contract with a different maturity date (by taking a long position in a contract with one maturity date and taking a short position in another contract with the other maturity date and with the same notional amount).

...

[6. For the purpose of paragraph 1(b) and 2(d), an OTC derivative shall be deemed to have a tenor of the number of years or months specified in the relevant paragraph where the termination date of the OTC derivative falls within the period commencing five days before and ending five days after the date that falls the specified number of years or months after the date of execution of the derivative.]

Article 3a

Package orders not having a liquid market as a whole

1. A package order shall not be considered to have a liquid market as a whole where the components include:

   (a) derivatives which:

      (i) fall outside those classes of derivatives specified in Article 3;

      (ii) are or include options; or

      (iii) are financial contracts for differences within point 9 of Annex I to Directive 204/65/EU; or

   (b) bonds which are:

      (i) structured finance products;

      (ii) ETCs or ETNs as defined in Table 2.4 of Annex III to Commission Delegated Regulation (EU) .../... [RTS 2]; or

      (iii). financial instruments defined in point (44)(c) of Article 4(1) of Directive 2014/65/EU.

2. A package order shall not be considered to have a liquid market as a whole where it is for the purpose of executing an exchange for physical.

Article 4

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall apply from 3 January 2018.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,