ISDA Safe, Efficient Markets

ISDA RESPONSE TO

ESMA'S MiFID II/MiFIR CONSULTATION PAPER OF DECEMBER 19, 2014

I. Executive summary

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC 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 including exchanges, 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. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – shows the strong commitment of the Association toward its primary goals of building robust, stable financial markets and a strong financial regulatory framework.

ISDA welcomes its continued engagement with ESMA on MiFID II and MiFIR. Our response to this consultation, and to all consultations on MiFID, reflects the composition of our members and therefore focuses on the operation of the derivatives market in the EU and globally. We hope that ESMA will continue its dialogue with ISDA and the industry as it develops its draft technical advice.

An overarching concern of our membership, is ESMA's limited ability to move quickly to recalibrate the transparency framework when MiFID II / MiFIR comes into force from the start of 2017. The potential implications of this limitation are particularly acute, as ESMA does not have the power to grant relief to any one or set of market participants from compliance with MiFID II/MiFIR requirements in any intervening period. Consequently, not only is it absolutely necessary to build in a recalibration of the framework, given that liquidity may change with the implementation of MiFID II/MiFIR, but ESMA will need to provide solid evidence, in the first instance, that it has got the calibration right.

II. Issues and recommendations arising from ISDA's response

Given the range of issues introduced by the December 2014 consultation paper (the Consultation Paper) and draft RTS, we would like to take this opportunity to highlight key issues of concern and recommendations. Our detailed responses to the questions posed by ESMA are contained in the Annex to our response.

i. Best execution

We are concerned with ESMA's proposal relating to the quality of execution data to be published in accordance with Article 27(3) MiFID II. In particular, we note that the proposed RTS 6 would expose systematic internalisers, market makers and liquidity providers to significant commercial risk, by providing the market with a significant amount of sensitive information, which will not help inform execution decisions by market participants. Systematic internalisers provide liquidity to the market and need certain risk-position protections to be in place, in order to ensure that they can adequately hedge such risk. The inclusion of market makers and liquidity providers should be considered out of

scope, considering the provision of all such information by the venues on which these market makers and liquidity providers are active and the inability of market participants to directly interact with them outside a venue.

ii. Transparency

a) Ambiguity of scope and data sources

It is essential that ESMA clearly identify within RTS 9 those liquidity/SSTI/LIS tables that apply only to transactions occurring in exchange-traded derivatives versus those that would apply to transactions in OTC derivatives. Exchange-traded derivatives are standardised and fungible whereas OTC derivatives are bilaterally negotiated. We would therefore expect that where the liquidity assessments are based on trading venue data alone, that none of the tables itemising liquid classes apply to OTC derivative contracts unless ESMA undertakes the type of analysis, at a comparable level of granularity, to that currently performed for interest rate swaps.

b) Quality of the underlying data and day count

The data sets used to assess liquidity are too short – three months of data is insufficient and does not take into account changes in trading patterns due to seasonality. Also, using trade repository data from the period shortly after the EMIR reporting requirement came into effect raises concerns about the quality of the dataset given the widely publicised challenges that this reporting requirement presented to the industry. For example, that ESMA's fixed-floating single currency USD swap data - across tenors - has more trades and larger notional amounts than the DTCC data (resulting from reporting under CFTC Part 43 requirements) we used in our analysis.

c) Determining the appropriate level of granularity is essential

It is essential that ESMA calibrate COFIA in such a way that the taxonomy applied to instrument classes under consideration is appropriately granular. To do otherwise risks illiquid instruments being classified as liquid instruments which could have adverse consequences on the ability to transact such contracts. Our analysis of swaptions makes this point clearly; delineating this class in terms of currency is insufficient and at very least, the tenor of the option, the tenor of the underlying and the underlying index must also be considered. This issue is also very important for equities and commodities derivatives. For equity derivatives we argue that the underlying stock or index must be considered in any analysis as liquidity is concentrated in only a small number of underlyings. For each commodity class, we suggest taxonomies that can be used as the basis for such an assessment.

d) Getting the liquidity calibration right

There is general concern in our membership in relation to the parameters that ESMA has used to calibrate liquidity for interest rate, equity and commodities derivatives. We have sought in the response to illustrate that ESMA's approach, as applied to its data sets, has yielded too many false positives – i.e. instruments being designated as liquid when they are, in fact, illiquid.

e) Transparency: Calibrating SSTI and LIS and realising their potential interplay with liquidity determinations.

The relevant LIS/SSTI thresholds need to be set at a level appropriate to the liquidity (or illiquidity) of an instrument. The proposed 50% SSTI/LIS ratio is arbitrary and we are concerned that it assumes a linear relationship between SSTI and LIS. For interest rate derivatives and equity derivatives we propose two possible ways forward: SSTI be calibrated as the median trade size in a given class, or that a lower SSTI/LIS ratio of 10% be used. For commodity derivatives, market participants have inadequate data to propose LIS and SSTI thresholds, but would welcome the opportunity to work with ESMA on the calibration of appropriate thresholds once the data is available. For all derivatives classes, if ESMA's intention is to compensate for illiquid instruments being incorrectly classified as liquid then the relevant LIS and/or SSTI thresholds need to be set at a sufficiently low level.

f) The expressions of the thresholds need to be aligned to how the instrument trades

Whilst we appreciate that for the purposes of making an initial assessment of liquidity, it was expedient for ESMA to put all swaps in terms of Euros, the LIS and SSTI thresholds in the RTS should be written in local currency units. Equally, for commodities, the expression of these thresholds by reference to a notional amount in euros is not aligned to the manner in which these commodities trade (i.e. mostly US dollars) and irrespective of the currency, thresholds should be expressed by reference to open interest and units of commodities.

iii. Package transactions: a specific treatment

In ISDA's view, it is essential that the MiFID II/MiFIR framework and standards include a specific treatment for package transactions to ensure these transactions (i) benefit from the transparency waivers and deferrals available to the transactions that make up their component parts and (ii) can continue to execute in their entirety (particularly where some, but not all of the transactions are in scope of the derivatives trading obligation). If ESMA fails to provide for the appropriate trading of packages, end investors will be required to trade the components independently, resulting in increased transaction costs and increased execution risks, which would seem to conflict with the objectives of MiFIR. We include our proposals for ESMA's consideration and hope that ESMA will engage with us on refining one of these for its inclusion in the upcoming RTS.

iv. The determination whether a class of derivatives is sufficiently liquid for the trading obligation

We recommend that the "sufficiently liquid" test should be applied at a more granular level than is utilised for the general test of liquidity.

v. ESMA's approach to position limits for commodities raises a number of issues

ISDA's members (which includes commodity producers/suppliers and commodity end-users as well as financial institutions and buy-side firms) are very concerned that the ESMA's proposed position limits regime may adversely impact the real economy (food and car manufacturers, airlines, refiners etc.) due to the combination of inappropriate baseline limits, an excessively narrow definition of economically equivalent OTC contracts and netting and inappropriate aggregation principles. To ensure real economy impacts are minimised, ESMA must ensure that its position limits framework gives appropriate recognition to OTC hedging instruments that are correlated to exchange traded contracts as this will be critical to the continued provision by financial institutions of efficient

commodity end-user hedging intermediation. As financial entities do not benefit from the hedging exemption, it is essential that the netting rules and the concept of economic equivalence for OTC contracts allow legitimate offsets that recognise existing and entrenched hedging practices and the global nature of the commodity markets. We also propose that ESMA publish its calculation methodology for deliverable supply and work closely with exchanges and trade repositories to provide deliverable supply estimate. Without these data points, it will be extremely challenging for market participants to opine on whether the proposed baseline limits and adjustment mechanism are appropriate.

vi. Data and Reporting: a golden source, UPI and alignment

ISDA's members welcome the clarity provided by the revised Transaction and Execution definitions in draft RTS 32. Nonetheless, we highly recommend the creation of a "golden source" listing all instruments which are in scope for transaction reporting. The absence of one could result in inconsistent reporting and over reporting of transaction data which we note is not allowed under MiFIR. In addition, any classification approaches for instruments which do not have an ISIN, such as OTC derivatives, should be focused on the endorsement of a globally consistent Unique Product Identifier (UPI). ISDA is already engaged in the work of CPMI-IOSCO on this topic. Furthermore, where possible MiFIR transaction reporting field names, definitions and formats should match those of EMIR and other regimes in EEA and beyond. Re-use of the datasets for MiFID Transaction Reporting will be a crucial implementation consideration.

vii. Post-trade:

a) Indirect clearing

ISDA welcomes the proposed draft RTS 38 as a positive development in establishing criteria for indirect clearing structures which seek to acknowledge legal and commercial realities, whilst continuing to deliver choice and transparency of protection to users of clearing infrastructure, and endorse the response of FIA Europe as to further revisions to that draft. Whilst ISDA strongly support similar reconsideration of indirect clearing as it applies in the context of the EMIR clearing obligation, we do not believe it will be possible simply to copy across the settled form of the MiFID RTS as part of the EMIR Review for reasons discussed in our detailed response. We expect this topic to be addressed for OTC client clearing as part of an open and transparent consultation process under the EMIR Review, once that formally commences.

b) STP

In ISDA's view, it is imperative that existing processes developed for clearing under CFTC rules (i.e. ping/push) should be available in Europe. Therefore we recommend that RTS 37 avoid being overly prescriptive on suitable pre-trade credit check mechanisms. We also underline that efficient and timely process is a key objective for market participants, so we are concerned that the RTS 37, as proposed, may lead to contractual uncertainties. In particular, it is imperative that the consequences of a rejected trade reflect the potential time a trade may take to reach the rejected state. Market participants should not be exposed to unnecessary market risk as a result of processing latency outside of their direct control. Any trade that is not cleared and is not rejected for clearing on a real-time basis should not be void.

ISDA Safe, Efficient Markets

Annex: ISDA's response to selected questions

1. Foreword to annex

The questions and responses listed in the Annex follow the organisation of the ESMA 19 December 2014 MiFID II/MiFIR consultation paper and response form, but are only concerned with those questions that the ISDA membership have answered. As such, the question numbers listed in this document correspond to the numbering in the December consultation paper, but only the questions that the ISDA membership have responded to appear. So, for example, Section 2 of this Annex aligns with Section 2 of ESMA's MiFID II/MiFIR consultation paper but only lists the questions associated with sub-section 2.4 of ESMA's consultation paper. Similarly, Section 3 aligns with Section 3 of ESMA's consultation paper, but again, only those sub-sections and questions that the ISDA membership has responded to are listed.

ISDA has also submitted its response to ESMA's MiFID II/MiFIR consultation paper using the response form supplied, and the text contained in this Annex replicates the text submitted. In some instances, a response to one question might be repeated in the response to another related question. Text from the key messages section of this document is also repeated. This repetition is necessary as ESMA has deployed several specialist teams to review the submissions from all stakeholders and these specialist teams are being asked to focus on particular questions only.

Contents

2. Investor protection

2.4 Information relating to execution of orders

Q30. Do you agree with the approach taken by ESMA? Would a different period of measurement be more useful for the published reports?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We believe that the proposed approach requires significant re-consideration to lead to a workable and beneficial outcome. Members consider that there are instances where the reporting data is

duplicative of otherwise publically available market data. It is felt the level of detailed information proposed is overly complex and poses a serious risk that the intended consumers will simply not invest in the effort to understand it. Moreover the sheer number of metrics and complex structure will make it costly for regulators to ensure that the data is being produced in a consistent way that allows for valid comparisons. This will further undermine confidence in its utility. In addition, the information required to be made public under RTS 6 would lead in certain circumstances to commercially sensitive information being disclosed. As we will see below, the information that ESMA is proposing to be make public would, in particular for less liquid instruments, comprise in effect of transaction-level information providing details of all systematic internalisers' positions and trading strategies in a machine-readable format.

We provide below some further concerns we have regarding the proposals as they stand and we also provide some proposals which reflect the current market practices and aid in the enhancement of valuable transparency.

Objective

To put our views in context we would like to begin by setting out the way in which we understand that the resulting information will be consumed and put to use by investment firms.

We understand that the information should be used both by buy and sell side firms to inform venue selection strategy. In this context it is useful to explain further our understanding of *venue selection.*

Our members may typically carry out venue selection as a two stage process:

Stage 1: Investment firms may consider which venues should be included in their execution policy. This is a longer term process which involves deciding which venues the firm should retain a capability to access in order to be able to provide the best possible result for clients when orders are actually executed.

Stage 2: As orders are executed, investment firms will assess, on a dynamic basis, which venue(s) to which they have access can best be used to fulfil orders. In this stage of venue selection firms may use the most up-to-date (and usually real time) market data available to ensure that selection decisions are optimised at the time of routing. It is felt that the data proposed by ESMA to be disclosed will be stale and therefore redundant for any market participant for the purpose of stage 2.

We are of the opinion that the proposed information to be published by execution venues is primarily used in the first stage of venue selection. Specifically it should inform investment firms as to whether the portfolio of execution venues to which a firm has access is sufficient to meet best execution or conversely if there is a likelihood that venues to which the firm does not have access can provide opportunities to materially improve the quality of execution.

We note below areas of concerns with regards to ESMA's proposal:

1) **Definition of 'execution venue':**

We are opposed to ESMA's view that market makers and other liquidity providers should be considered as execution venues as the terms "market makers" and "liquidity providers" are defined in MiFID 2 in a way that is inconsistent with principal OTC advancements of liquidity. Both terms relate to the provision of liquidity to trading venues and therefore their data will constitute part of

the data that the trading venue publishes. In their capacity as market makers, firms interact with clients directly only when they trade away from a trading venue, either as an SI or OTC. It may have been ESMA's intention to capture those firms which may still execute as an SI or OTC in instances where the trading obligation does not apply. In that case, the obligations for such firms should be calibrated appropriately and that any language referring to market making or liquidity provision be deleted.

We also, believe that Systematic Internalisers or firms trading OTC must not be treated in the same vein as trading venues for the purpose of RTS 6 for the application of disclosing data or execution of orders. MiFID 2 Level 1 Article 27 (10) (a) clearly requires ESMA to take into account the special features of each venue and this has been overlooked in the requirements of RTS6, by subjecting Systematic Internalisers to the same requirements as a trading venues. We propose that the disclosure requirements of RTS 6 be removed for Systematic Internalisers and replaced by a separate set of requirements calibrated appropriately with high enough aggregation of data to match the risk profile of the venue.

Furthermore, there is a distinction in the Level 1 text which is not reflected in draft RTS 6. Article 27 (3) of MiFID II refers to best execution reporting requirements applying to trading venues and systematic internalisers in relation to financial instruments subject to the trading obligations under articles 23 and 28 of MiFIR, and to 'execution venues' for all other financial instruments. RTS 6 sets out reporting requirements applying to all 'execution venues', not recognising the distinction between financial instruments subject to the trading obligation and those that are not, as required under Level 1. In this regard, we believe that ESMA has exceeded its mandate in broadening the application of the reporting requirements to venues beyond those specified in Level 1 in relation to financial instruments subject to the trading obligation and therefore RTS 6 should be amended to reflect Level 1.

We recommend that the definition of 'other liquidity providers' used in RTS 34 (2) (e) as per the below is adopted in RTS 6 for clarity:

"*Other liquidity providers are persons, other than person's pursuing a market making activity as referred to in Articles 17 and 48 of Directive 2014/65/EU, that under a formal agreement with an issuer, hold themselves out on the financial markets on a continuous basis as willing to deal by buying and selling financial instruments.*"

2) 'Point-in-time information' (RTS 6 – Article 3(4))

We do not believe that point in time information should be used to demonstrate quality of execution, rather aggregated information should be used. Point in time information is not an appropriate metric as this will lead to sensitive information being disseminated which would be very harmful to firms and will disincentives them to provide liquidity to the market.

Negative consequences for SIs: ESMA proposes under Article 3(4) of RTS 6 execution venues to make public 'point-in time' information on executed transactions 4 times a day, including prices and sizes, for each financial instrument. There is an assumption that this information is already/or will be made publicly available through MiFID post-trade reporting. However, there is one major difference between post-trade transparency information and the information that ESMA is proposing to make public under this RTS. Under post-trade reporting, the identity of SIs is not required to be disclosed, whereas for best execution the identity of SIs has to be disclosed. This is a fundamental difference between the two types of reporting which needs to be taken into consideration.

For less liquid instruments, particularly for fixed-income instruments, the information proposed to be reported under Article 3(4) of RTS 6, would effectively lead to a transaction by transaction-level/position-level information providing detailed information on all positions and trading strategies of all systematic internalisers' in a machine-readable format. For example, for instruments that are merely traded a few times a week or a day, this requirement will lead to all trades being made public.

The information proposed to be reported under Article 3(4) of RTS 6, would, for non-equities, effectively lead to a transaction by transaction-level/position-level information providing detailed information on all positions and trading strategies of all systematic internalisers' in a machine-readable format. For example, for instruments that are merely traded a few times a week or a day, this requirement will lead to all trades being made public.

SI performs a significant and valuable function by providing liquidity in specific instruments. The reports under Article 3(4) will, for less-liquid instrument, unveil to third parties the risk that particular SIs are taking in particular instruments and consequently adversely affect their ability to manage and unwind that risk. Such information is commercially sensitive and should not be mandated to be exposed to the public: doing so will discourage SIs from performing their function in the market. In this Consultation Paper (page 217, paragraph 7), ESMA agrees that the identity of the SIs should not be disclosed in post-trade reporting considering the risks that this could cause to them. By imposing the information under article 3(4) of RTS 6 to be made public, ESMA will completely undermine the risks they are trying to for SIs under post-trade reporting.

Misleading non-value adding information: We believe that the intention of the point-in-time observations is to provide investment firms with a way to assess whether some venues may provide opportunities to trade at more advantageous prices than others. However, in most cases this will not be an effective metric. For example, systematic internalisers will provide quotes based on commercial policies (e.g. inventory availability, counterparty risk, settlement risk etc). Comparison of point-in-time information across SIs would therefore be meaningless and potentially misleading as, prices would have been quoted/provided based on their commercial policies. We also understand that under ESMA's proposal disclosure should reflect that actual transactions executed by the venue immediately after the reference times indicated. If our understanding is correct then these prices would provide a poor means of comparison as the times of the relevant transactions may vary significantly between the different venues. The result will be that the data are simply "noise" and therefore not actionable. This is true of all asset classes but, in the case of non-equities in particular, such transactions might take place hours later after the point-in-time. In other words, the point-in-time observations don't provide a valid means of identifying whether there might have been a missed opportunity to execute a trade at a superior price.

A more valid approach (which would also work for quote-driven markets and Systematic Internalisers) would be to disclose the best quotes available. However, this information is already readily available, free of charge (with 15 minutes delay for both equities and non-equities) to any firm with a market data terminal.

We believe that a simpler and more accessible assessment of pricing quality can be made by simply referring to the non-point-in-time spread metrics already contained within the proposal. We believe that these will adequately remove the previously referred-to "noise" and provide metrics which are easy to digest and can point toward opportunity costs in terms of price. We would note that the information in this RTS is intended to be a "minimum" and would not preclude an investment firm from performing further analysis based on the data available to it.

3) Timing

We do not support ESMA's proposal to require information to be aggregated on a daily basis. We do not think that such granular data will actually be used by investment firms to make decisions as to the quality of execution of venues. Information on trends at an aggregated level over a broader period of time provides information on the quality of execution in a meaningful and appropriate format. We would therefore urge ESMA to require information to be provided on a 3 months aggregated basis. This information should be made public on a quarterly basis within 'three months of each quarter end' instead of within one month of each quarter end. This is still in line with the Level 1 text which requires the information to be made public at least on an annual basis.

4) Identification of financial instruments (Article 3(2)):

We believe that financial instruments should be identified by unique identifiers such as ISIN codes when available. We therefore believe that all the information that can be derived from the ISIN (such as put/call; strike price; option style; maturity date etc) should not be required to be made public. With regards to OTC derivatives instruments who do not have an ISINs, we believe it would be very challenging for best execution information to be provided instrument by instrument. As stated by ESMA in the Final Report on ESMA's technical advice to the Commission on MiFID II/R (page 225, paragraph 32), the concept of 'financial instrument' although being relatively clear for bonds and SFP (where the ISIN code can be used as a proxy), is less practical for derivatives. We do not think it would be practical for best execution information to be published for each OTC derivative contract and we would therefore suggest for the information to be published based on derivatives buckets. For consistency, we would suggest ESMA to adopt the same buckets as defined for SIs. We believe this would make the information easier to read and analyze and provide more meaningful information to the public.

5) Volume of data:

The extreme large amount of data (ESMA is asking for daily information) will make it very difficult/near impossible for firms to use this data in a meaningful way. Moreover the sheer number of metrics and complex structure will make it costly for regulators to ensure that the data is being produced in a consistent way that allows for valid comparisons.

6) Execution costs and competition issues

It is important to note that costs and charges for RMs, MTFs and OTFs are legally subject to public access, due to the requirement that trading venues should treat all participants and prospective participants on identical terms. However SI's are only required to have commercial policies, and are allowed to 'tier' their clients based on these policies as long as they are non-discriminatory. The costs of an SI would disclose how an investment firm approaches its client base costs. Information of such nature is proprietary and confidential and must not be shared between competitors, so as not to encourage collusive behaviour between them in terms of pricing. Therefore, we are surprised with the recommendation that SIs should be publishing information on their costs, as this is diametrically opposed to long-standing principles of European Union law in the field of competition. We strongly believe that this requirement should be deleted. DG Competition will also have an interest in this issue, if the RTS is put in place as proposed.

7) Treatment of market model (Article 4 & Article 5):

ESMA acknowledges in the preamble of RTS 6 (recital 2) that differences in the execution venue, as well as the market mechanism, trading model and transaction type should be considered for purposes of requiring different validation and monitoring data. In that context, our members welcome that ESMA proposed different provisions for order-driven and quote-driven execution venues. However, our members feel that the application of this differentiation is not clear throughout the ESMA proposals.

- Data referred to as being relevant to "quote-driven markets" appear to relate in fact to "request for quote" (RFQ) markets. The correct treatment of order-driven markets in the way in which we understand them (and in the way in which they are referred to elsewhere in MiFID2/MiFIR) is therefore unclear. We are also concerned that there is no differentiation between voice and electronic for RFQ systems.

- As mentioned above, Systematic Internalisers (SIs) are not differentiated from other venues. We feel it is necessary to treat SIs under a separate set of obligations to reflect the fact that under MiFID, an SI is a firm which engages in bilateral trading with its clients in specific instruments rather than a public trading venue offering the opportunity for counterparties to match their trades.

Our proposal

Below we present our alternative proposal in which we retain the elements of ESMA's proposal which we believe can add the most value to the process.

We have analysed the ESMA proposals against the four market models which we believe are necessary to provide functional rules:

- Order driven markets (trading venues)
- Quote driven markets (trading venues)
- Request for Quote Markets (Electronic and Voice) (trading venues); and
- Systematic Internalisers

We have analysed the individual metrics in the proposal against their ability to provide actionable, non-redundant information which is of use in the first stage of venue selection. Based on this analysis we have produced a table to indicate the metrics that we believe can be usefully applied to each market model (please see below for complete table).

(*Please note:

- **The Article references in the table below refer to the current ESMA RTS 6 drafting.**
- **Article 3.3 periodicity amended to quarterly as per suggested drafting amendments detailed towards the end of the response to this question)**

ISDA Safe, Efficient Markets

Legend: Relevant; Available Elsewhere/Market Data; Not Applicable / Unnecessary;

Identifier	Order Driven	Quote Driven	SI	RFQ Trading venue	
*Art 3.3 (Likelihood)				Electronic	Voice
(a) the number of orders or requests for quotes, both in terms of volume and value, that were received **quarterly**	(orders only)	(orders only)	(orders only)	(orders only)	Please see footnote [1]
(b) the number of transactions, both in terms of volume and value, that were executed **per quarter** on that day;					
(c) the number of orders or accepted/released quotes, both in terms of volume and value, that were cancelled **quarterly;**					
(d) the number of orders both in terms of volume and value, that were modified **per quarter**					
(e) the mean and median transaction size **per quarter**;					
(f) the mean and median transaction price **per quarter;**	No utility of this information to participants	No utility of this information to participants	No utility of this information to participants	No utility of this information to participants	No utility of this information to participants
(g) Volume weighted average price **per quarter;**	No utility of this information to participants	No utility of this information to participants	No utility of this information to participants	No utility of this information to participants	No utility of this information to participants
(h) Market makers shall also indicate the **quarterly** total value of exchange-traded product units created and redeemed at their request.	n/a	n/a	n/a	n/a	n/a
Art 3.4 (Price)					
As explained above we do not think that point-in-time information should be used to demonstrate quality of execution, but rather aggregated information should be used. **We also wish to note that liquidity plays a large part in determining whether or not it is possible to provide certain information as requested. For highly illiquid non-equitiy instruments it may not be possible to provide any data which would be of benefit to the client.**					

Art 3.5 (Cost)	Order Driven	Quote Driven	SI	RFQ Trading venue	
				Electronic	Voice

[1] From an RFQ voice perspective this is impractical due to the nature of RFQs. It is difficult to record this information without further clarification as to whether this would exclude any requests for improvement to quotes following the initial request as well as the impracticability of controlling such calibration at trade level. There exists a record of those RFQ requests executed in the market, however the initial requests made are subject to quote improvements or alternatively cancels which are challenging to calibrate in the RFQ process. In the voice system there exists a reliance on human action to record such instances and it is not an automated process (unlike electronic RFQ).

Legend: Relevant; Available Elsewhere/Market Data; Not Applicable / Unnecessary;

Identifier	Order Driven	Quote Driven	SI	RFQ Trading venue	
(a) a description of each component of the costs imposed by the execution venue;			For further reasoning please refer to 'Execution costs and competition issues' as per above point 6		
(b) the total value of any costs;	This metric should be expressed as basis points not absolute total value	This metric should be expressed as basis points not absolute total value	For further reasoning please refer to 'Execution costs and competition issues' as per above point 6		
(c) the total value of any rebate, discounts or other payment offered to the parties; and	This metric should be expressed as basis points not absolute total value	This metric should be expressed as basis points not absolute total value	For further reasoning please refer to 'Execution costs and competition issues' as per above point 6		
(d) the existence of any non-monetary benefit received by the execution venue in connection with the order.					
Art 4.1 (Order Driven)	**N/a as contingent on Art 3.4 (a) & (b)**				

Art 4.2 (Order Driven)	Order Driven	Quote Driven	SI	RFQ Trading venue	
				Electronic	Voice
(a) average effective spread;			**<u>Equities</u>** **<u>For Non-Equities</u>** Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a mid price is not something which can be provided.	Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a mid price is not something which can be provided.	Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a mid price is not something which can be provided.
(b) average realised spread;			**<u>For Equities</u>** **<u>For Non-Equities</u>** Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are	Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument	Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a

Legend: Relevant; Available Elsewhere/Market Data; Not Applicable / Unnecessary;

Identifier	Order Driven	Quote Driven	SI	RFQ Trading venue	
			instances where a mid price is not something which can be provided.	classes there are instances where a mid price is not something which can be provided.	mid price is not something which can be provided.
(c) volume-weighted average effective spread;			**For Equities** **For Non-Equities:** This is Proprietary information, people choose us based on our prices not our spreads	N/A	
(d) volume weighted average realised spread;			**For Equities** **For Non-Equities** Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a mid price is not something which can be provided.	Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a mid price is not something which can be provided.	Please note that this is dependent on liquidity from a non-equities perspective. Additionally, the majority of orders/quotes are single sided and due to the illiquid nature of certain instrument classes there are instances where a mid price is not something which can be provided.
(e) time weighted average price (TWAP);				N/A	N/A
(f) average volume at BBO;			**For Equities** **For Non-Equities:** There is n obligation for SIs to quote 'two way quotes' so this should be non applicable to SI	N/A	N/A
(g .1) TWAP average spread at BBO;			**For Equities** **For Non-Equities:** There is n obligation for SIs to quote 'two way quotes' so this should be non applicable to SI	N/A	N/A
(g .2) VWAP average spread at BBO;			**For Equities** **For Non-Equities:** There is n obligation for SIs to quote 'two way quotes' so this should be non applicable to SI	N/A	N/A

Legend: Relevant; Available Elsewhere/Market Data; Not Applicable / Unnecessary;

Identifier	Order Driven	Quote Driven	SI	RFQ Trading venue	
(h) book depth at 3 ticks, representing the total available liquidity, expressed as the product of price and volume of all bids and offers for 3 price increments (ticks) for each financial instrument from the BBO;				N/A	N/A
(i) book depth at 5 ticks, representing the total available liquidity, expressed as the product of price and volume of all bids and offers for 5 price increments (ticks) for each financial instrument from the BBO;				N/A	N/A
(j) previous day closing price;					
(k) opening price;					
(l) highest executed price of the **quarter**;					
(m) lowest executed price of the quarter;					
(n) last price before closing					
(o) the mean and median time elapsed (to the mili-second) between a—marketable order being received, by the execution venue and the subsequent execution; and					N/A
(p) average speed of execution for unmodified passive orders at first limit.	Only relevant for an order driven venue			N/A	N/A
Art 5.2 (Quote Driven)					
(a) the mean and median time elapsed between acceptance/release of a quote and execution, for all transactions in a given financial instrument; and		Acceptance/release is the function of the Participant not the responding venue	Acceptance/release is the function of the Participant not the responding venue	Acceptance/release is the function of the Participant not the responding venue	Acceptance/release is the function of the Participant not the responding venue
(b) the mean and median time elapsed between a request for a quote and provision of that quote, for all quotes in a given financial instrument when applicable.					

Please note our proposed drafting for RTS 6 below. This is based on our proposals above and incorporating the table above.

Our Proposal for RTS 6: Draft regulatory technical standards under Article 27(10)(a) of MiFID II

DRAFT COMMISSION DELEGATED REGULATION (EU) No …/..

supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the data to be provided on financial instruments subject to the trading obligation in Articles 23 and 28 Regulation (EU) No 600/2014 by each trading venue and systematic internaliser and for other financial instruments each execution venue on the quality of execution of transactions on that venue.

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to Having regard Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (recast), and in particular Article 27.

HAS ADOPTED THIS REGULATION:

CHAPTER I
General

Article 1
Subject matter

This Regulation lays down the specific content, the format and the periodicity of data relating to the quality of execution to be published in accordance with Article 27(3) of Directive 2014/65/EU, taking into account the type of execution venue and the type of financial instrument concerned for the purposes of Article 27(10)(a) of Directive 2014/65/EU.

Article 2
Definitions

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

1. Execution quality means assessment of price, costs, speed, likelihood of execution and settlement or any other relevant consideration.

2. Best bid and offer (BBO) means the best bid price and the best offer price provided by an execution venue for those looking to buy and sell, respectively, a specific financial instrument for at a given time.

3. Execution venue means a regulated market, multilateral trading facility, organised trading facility and systematic internaliser.

4. Trading venues means a regulated market, an MTF or an OTF, as defined in Article 4(24) of Directive 2014/65/EU

5. Other liquidity providers are persons, other than person's pursuing a market making activity as referred to in Articles 17 and 48 of Directive 2014/65/EU, that under a formal agreement with an

issuer, hold themselves out on the financial markets on a continuous basis as willing to deal by buying and selling financial instruments

6. Costs mean all fees, commissions, taxes and regulatory levies imposed or incurred by the execution venue on behalf of the client.

7. Identifier means International Securities Identification Number (ISIN) as defined by ISO6166, AII (Alternative Instrument Identifier) or a Unique Product Identifier available under an alternative taxonomy as defined by RTS under Article 25(2) of Regulation (EU) No 600/2014.

8. Venue identifier means the Market Identifier Code (MIC) or where unavailable the Legal Entity Identifier (LEI).

9. Market mechanism means the way in which an execution venue executes orders.

10. Trading mode means continuous trading, scheduled or unscheduled auction, trading at close, trading out of main session.

11. Transaction type means transaction category as defined under taxonomy developed for post-trade transparency purposes under Article 25(2) of Regulation (EU) No 600/2014.

12. Trading systems means the type of platform the execution venue operates: electronic, voice

13. Average effective spread means execution price compared with midpoint of BBO at time of receipt.

14. Average realised spread means execution price compared with midpoint of BBO five minutes after the time of execution (if the execution time is less than five minutes before the close or a halt, the last quote before the close or the halt is used).

15. Time weighted average price (TWAP) means the average price of a security over the course of a specified period of time.

16. Volume weighted average price (VWAP) means the average price weighted by volume, it is measured by the currency value of all trading periods divided by the total trading volume for a specified period of time.

17. Average speed of execution for unmodified passive orders at first limit means the time elapsed between a limit order (that matches the BBO) being received by the execution venue, and the subsequent execution of this order, calculation shall exclude modified orders.

18. LIS is the minimum qualifying transaction size in accordance with Art 4 of the Regulation (EU) No 600/2014.

19. Standard Market Size means the Standard Market size defined in accordance with Article 14 of the Regulation (EU) No 600/2014.

Article 3

Content of information to be published by execution venues

1. The information to be published shall include for each execution venue, subject to (c) and (d) below, the following information:

(a) the instrument identifier and venue identifier or name;

(b) the date for which the information relates, ISO 8601 date format.;

(c) for trading venues only, the nature and duration of any outage or trading suspension or scheduled auctions on that day; and

(d) for trading venues only, the duration of trading interruptions as the result of any volatility auction or circuit breaker which occurred in relation to any instrument on that day;

2. For financial instruments identifiable by an instrument identifier, each financial instrument traded on each execution venue shall be identified by the instrument identification code type and the financial instrument identifier. The following information relevant to the each financial instrument shall also be identified: the currency code (ISO 4217) and, the price notation (indication as to whether the price is expressed in monetary value, in percentage or in yield);

3. For derivative instruments not identifiable by an instrument identifier, information on the quality of execution shall be made public at an aggregated level as defined for the purpose of the systematic internaliser calculations under Article x of Regulation x [forthcoming delegated acts].

4. The information to be published shall include the following information relevant to the **likelihood of execution**, when applicable:

(a) the number of orders or requests for quotes, both in terms of volume and value, that were received in that quarter;

(b) the number of transactions, both in terms of volume and value, that were executed in that quarter;

(c) the number of orders or accepted/released quotes, both in terms of volume and value, that were cancelled in that quarter;

(d) the mean and median transaction size in that quarter;

5. The information to be published shall include for trading venues the following information quarterly, relevant data to the **execution costs**:

(a) a description of each component of the costs imposed by the execution venue;

(b) the total in basis points of any costs; and

(c) the total in basis points of any rebate, discounts or other payment offered to the parties.

The information to be published shall also include for all execution venues quarterly, relevant data to the execution costs:

(a) the existence of any non-monetary benefit received by the execution venue in connection with the order.

Article 4

Additional data to be published by trading venues

1. For each financial instrument traded on each trading venue, when applicable:

(a) average effective spread;

(b) average realised spread;

(c) volume-weighted average effective spread;

(d) volume weighted average realised spread;

(e) average volume at BBO;

(f.1) TWAP average spread at BBO;

(f.2) VWAP average spread at BBO

(g) book depth at 3 ticks, representing the total available liquidity, expressed as the product of price and volume of all bids and offers for 3 price increments (ticks) for each financial instrument from the BBO;

(h) book depth at 5 ticks, representing the total available liquidity, expressed as the product of price and volume of all bids and offers for 5 price increments (ticks) for each financial instrument from the BBO;

(i) the mean and median time elapsed (to the mili-second) between a marketable order being received, by the execution venue and the subsequent execution; and

(j) average speed of execution for unmodified passive orders at first limit.

Article 5

Additional data to be published by quote driven execution venues

1. (a) the mean and median time elapsed between an **electronic** request for a quote and provision of that quote, for all quotes in a given financial instrument when applicable.

Article 6

Additional data to be published by systematic internalisers

1. For each financial instrument traded as a systematic internaliser, the fowling information shall also be made public:

(a) the mean and median time elapsed (to the mili-second) between an order being received, by the execution venue and the subsequent execution

Article 7

Format of the information to be published

1. The content set out in this Annex shall be recorded for each trading day that the execution venue is open for trading. The tables attached sets out the prescribed format for the publication of this information.

2. Execution venues shall make available the data in a consistent, usable, and machine-readable electronic format and make such reports available for downloading from an internet web site that is free and readily accessible to the public.

Article 8

Frequency of the information to be published

The reporting period shall commence on the first of each quarter to the last day of that quarter for each quarter of the year. This data shall be published without charge within three month at each quarter end.

Article 9

Entry into force

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

Done at Brussels,
For the Commission
The President On behalf of the President [Position]

Q31. Do you agree that it is reasonable to split trades into ranges according to the nature of different classes of financial instruments? If not, why?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

As per our explanation above, we believe it is neither reasonable nor effective to require point-in-time information to be made public. Therefore, as the ESMA's proposal to split trades into ranges only relates to the point-in time-information we think that the ranges should not apply.

Q32. Are there other metrics that would be useful for measuring likelihood of execution?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Further differences and considerations should be made between types of venues (e.g. multilateral vs. bilateral venues) to tailor the information that different market participants and venues are able to produce. There are relevant differences between trading infrastructures from a micro structural point of view that should be addressed in assessing the suitability of reporting the requested data.

Our members wish to highlight that for some quote-driven markets such as RFQ, it is beyond their operational capacity to provide some of the fields requested that make reference to actionable moments in time (mean and median time elapsed between requests for a quote and the provision of a quote and between the client's acceptance of a quote and its execution).

For voice trading systems, non-equity market participants consider that reporting the time in which it takes to respond for all transactions in a given instrument as required by Article 5 is impractical and onerous for the type of transaction system. In the case of electronic venues, members consider that the capacity to provide the data will be determined by the market structure and the features that are present in the trading venue.

Q33. Are those metrics meaningful or are there any additional data or metrics that ESMA should consider?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Members considered that the metrics and the data required as proposed by ESMA might be duplicative of other existing and proposed information systems such as post-trade disclosure under the MiFID transparency regime. Consistency between the various reporting systems is required for purposes of ensuring the orderly and effective functioning of the markets for market participants.

ESMA proposes in Article 7(2) of RTS 6 that execution venues should publish on an internet website, on a free and available basis, data gathered for each day that the venue opened during the quarter. For this requirement, our members wish to note the importance of any client confidentiality agreements which may be in place and the possible abuse of the information by third parties who may attempt to redistribute or exploit the information for purposes beyond the objectives of the regulation. Client confidentiality may be at risk for cases when data is presented in ways that allows the identification of the parties by looking at the orders published.

The required metrics also expose commercial information of systematic internalisers and market makers to the rest of the market and will have an adverse impact on the ability of such systems to advance risk. In addition, in equities, the exposure of the information may assist predatory trading techniques.

Q34. Do you agree with the proposed approach? If not, what other information should ESMA consider?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We do not support ESMA's proposal to require information to be aggregated on a daily basis. Our members consider that the aggregation level proposed on a daily basis is overly unnecessary and could end up being very harmful for SIs. In addition, we do not think that such granular data will actually be used by investment firms to make decisions as to the quality of execution of venues. We propose that the language as per preamble 3 in RTS 7 should be used as the basic aggregate requirement: '*To prevent potentially market sensitive disclosures, the volume of execution and the number of executed orders shall be expressed as a percentage of the investment firm's total execution volumes and number of trades rather than as an absolute value'.*

Information on trends at an aggregated level over a broader period of time provides information on the quality of execution in a meaningful and appropriate format. We would therefore urge ESMA to require information to be provided on a 3 months aggregated basis. This information should be made public on a quarterly basis within 'three months of each quarter end' instead of within one month of each quarter end. This is still in line with the Level 1 text which requires the information to be made public at least on an annual basis.

Q35. Do you agree with the proposed approach? If not, what other information should ESMA consider?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

RTS 7(4), in the lists of instruments there should be an additional "Other" subcategory for instruments not caught by explicit references, e.g. under Commodity Derivative and Other Derivatives.

Q36. Do you agree with the proposed approach? If not, what other information should ESMA consider?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We do not fully agree with ESMA's proposed RTS 7.
Article 27(6) of MIFID II requires investment firms who execute client orders to summarise and make public on an annual basis, the top five execution venues in terms of trading volumes where they executed client orders in the preceding year and information on the quality of execution obtained.

We believe that ESMA's draft RTS 7 Article 6 completely goes beyond the Level 1 text.

Our proposition is that Article 6 should only apply to the quality of execution obtained in relation to the five execution venues (and not the quality of execution obtained by an investment firm more broadly on all execution venues).

Therefore, Article 6(1) (b) of RTS 7 should be deleted as this is only required for the top 5 execution venues and this is already covered under Article 5(5) to 5(12) of RTS 7. Our rationale for this may be summarised as follows:

- The construction of Article 27(6) suggests that the information on the quality of execution obtained must be linked to the executions on the top five trading venues (i.e. if the EC had intended to require firms executing client orders to provide information on quality of execution obtained independently of the top five trading venues, arguably it would have included the requirement more explicitly and independently of the top-5 disclosure).

- This is mirrored in recital 97 of the MiFID 2, which requires firms to make public their top five venues – there is no mention of broader information on all venues being needed (as would be the case if article 6(1)(b) were interpreted broadly).

In addition, under Article 6(1) (a) of RTS 7, ESMA also proposes firms to make public a 'summary of the analysis and conclusions' drawn by the investment firm on the quality of execution obtained on the execution venues. Again here, we believe that the word summary in the level 1 text only applies to the top 5 execution venues and not to ALL execution venues. This should also be reflected under Article 3(2) of RTS 7.

Finally, with regards to Article 6 (2) (c) to (e), we believe that ESMA has no mandate to require these further summaries to be reported. Here again, we believe these requirements go beyond the level 1 text. In addition, we do not see how these additional summaries would add any value to the information already made available.

With regards to Article 5 of RTS 7, we have the following proposals and we would suggest this article to be redrafted as follows:

- RTS 7, Article 5 (1): The information to be published for all client orders of each class of financial instrument, executed by the investment firm, *excluding any orders directed by the client to such venue*, in each month of the year shall include the following:

- ~~o~~ RTS 7, Article 5(5): 'For each of the top five execution venues the percentage of ~~passive and aggressive~~ *liquidity-added, liquidity-removed or traded-in-auction* ~~orders executed on that execution venue~~'

- RTS 7, Article 5(6) for each of the top five execution venues the breakdown of the percentage of client orders between retail clients, professional clients and *eligible counterparties which have elected to receive best execution*, respectively.

- RTS 7, Article 5(7): ~~For each of the top five execution venues the percentage of client order that was directed by the client to be executed on that execution venue~~

- RTS 7(9): ~~For each of the top five execution venues the existence and monthly value of any payments, discounts or rebates received from the execution venue together with a description of the nature of any non-monetary benefits;~~

  Reasoning for deletion of Article 5 (9): the payment structure of venues is already publically available and should not be disclosed by the investment firm as it may give the impression that it is a factor in the choice of venue. If such payment or rebate structures are problematic, regulators should not approve the structures.

3. Transparency

3.5 Liquid market definition for non-equity financial instruments

- **Securitised derivatives**

Q59. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer per asset class identified (investment certificates, plain vanilla covered warrants, leverage certificates, exotic covered warrants, exchange-traded-commodities, exchange-traded notes, negotiable rights, structured medium-term-notes and other warrants) addressing the following points:

(1) Would you use additional qualitative criteria to define the sub-classes?

(2) Would you use different parameters or the same parameters (i.e. average daily volume and number of trades per day) but different thresholds in order to define a sub-class as liquid?

(3) Would you qualify certain sub-classes as illiquid? Please provide reasons for your answer.

ISDA's members do not agree with the liquidity parameters proposed by ESMA for securitised derivatives.

We do not believe that the presence of one market maker should be sufficient for a sub-class of securitised derivatives to be deemed liquid:

- As ESMA itself has noted in paragraph 62 of page 112 of the Consultation Paper, whilst 98% of securitised derivatives analysed by ESMA had a dedicated market maker, these instruments only make up 29% of total trades and 39% of total volume traded. It is clear therefore that the presence of a market maker does not equate to liquidity. Therefore, additional factors must be taken into account to determine which sub-classes of securitised derivatives are liquid.

- The definition of "liquid market" in Article 2(17)(a) of MiFIR requires there to be "ready and willing buyers and sellers on a continuous basis". This requires there to be more than one buyer or seller in a market for a particular sub-class of instruments for that sub-class to be determined liquid.

In our view, additional liquidity parameters must be used by ESMA to conduct a more thorough liquidity analysis of each of the sub-classes identified by ESMA in paragraph 60 of page 112 of the Consultation Paper (i.e. investment certificates, plain vanilla covered warrants, leverage certificates, exotic covered warrants, exchange-traded-commodities, exchange-traded-notes, negotiable rights, structured medium-term-notes and other warrants).

Q60. Do you agree with the definition of securitised derivatives provided in ESMA's proposal (please refer to Annex III of the RTS)? Please provide reasons for your answer.

We are concerned that the proposed definitions of "securitised derivatives" and "bond" do not sufficiently identify those instruments which should be treated as securitised derivatives and those instruments that should be treated as bonds, particularly the treatment of securitised debt. There should be no overlap between the two definitions, otherwise there is a risk that different trading

venues and investment firms will treat the same instruments in different ways for transparency purposes.

We would therefore propose the following amendments to the definitions in Sections 1 (Bonds and structured finance products) and 2 (Securitised derivatives) of Annex III of RTS 9:

- A new definition of "structured debt security" should be included, as follows:

  "'Structured debt security' means a transferable security falling within Article 4(1)(44)(b) of Directive 2014/65/EU with an embedded derivative which is not a convertible bond."

- The definition of "convertible bond" should be amended, as follows:

  "'Convertible bond' means an instrument consisting of a bond or a securitised debt instrument with an ~~i~~embedded ~~derivative, such as an~~ option to ~~buy the underlying equity~~ acquire shares of an issuer or a member of the issuer's group."

- The definition of "bond" should be amended, as follows:

  "'Bond' means a transferable security ~~that is constituted by an order, promise, engagement or acknowledgement to pay on demand, or at a determinable future time, a sum in money to, or to the order of, the holder of one or more units of the security. It includes depositary receipts representative of bonds~~ falling within Article 4(1)(44)(b) of Directive 2014/65/EU which is not a structured finance product or a structured debt security."

- The definition of "securitised derivatives" should be amended, as follows:

  "'Securitised derivatives' means a structured debt security or a transferable security ~~as defined in~~ falling within Article 4(1)(44)(c) of Directive 2014/65/EU ~~different from~~ which is not a structured finance product~~s~~."

- Recital (11) should be amended, as follows:

  "For the purposes of this Regulation, plain vanilla covered warrants, leverage certificates, exotic warrants, exchange-traded-commodities, exchange-traded-notes, negotiable rights and structured medium-term-notes (and other structured debt securities) should be considered securitised derivatives. This is not meant to be an exhaustive list of securitised derivatives."

➢ **Interest rate derivatives**

Q61. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer for each of the asset classes identified (FRA, Swaptions, Fixed-to-Fixed single currency swaps, Fixed-to-Float single currency swaps, Float -to- Float single currency swaps, OIS single currency swaps, Inflation single currency swaps, Fixed-to-Fixed multi-currency swaps, Fixed-to-Float multi-currency swaps, Float -to- Float multi-currency swaps, OIS multi-currency swaps, bond options, bond futures, interest rate options, interest rate futures) addressing the following points:

(1) Would you use different criteria to define the sub-classes (e.g. currency, tenor, etc.)?

(2) Would you use different parameters (among those provided by Level 1, i.e. the average frequency and size of transactions, the number and type of market participants, the average size

of spreads, where available) or the same parameters but different thresholds in order to define a sub-class as liquid (state also your preference for option 1 vs. option 2, i.e. application of the tenor criteria as a range as in ESMA's preferred option or taking into account broken dates. In the latter case please also provide suggestions regarding what should be set as the non-broken dates)?

(3) Would you define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)? Please provide reasons for your answer.

ISDA's response to this question relates only to ESMA's proposals in respect of the liquidity of OTC interest rate derivatives (i.e. ESMA's analysis as set out on pages 120 to 125 of the Consultation Paper). We do not comment on ESMA's proposals in respect of the liquidity of exchange-traded interest rate derivatives (i.e. ESMA's analysis as set out on pages 115 to 120 of the Consultation Paper).

We note that the terms "criteria", "parameters" and "thresholds" are used inconsistently in the Consultation Paper. In our response we use the term "criteria" to refer to the qualitative criteria used by ESMA to define sub-classes (e.g. underlying, tenor, notional currency or currency pair), the term "liquidity parameter" to refer to the elements of the liquid market definition which are used by ESMA to assess the liquidity of a sub-class (e.g. average frequency of transactions, average size of transactions, the number and size of market participants, and/or the average size of spreads) and the term "liquidity threshold" to refer to the quantitative level set for each relevant liquidity parameter (e.g. if one of the chosen liquidity parameters for a sub-class is "trades per day" the liquidity threshold is the number of trades per day). Where, in our response, we refer to the large-in-scale (LIS) and size specific to the instrument (SSTI) waivers for pre-trade transparency and the LIS and SSTI deferrals for post-trade transparency, we refer to the quantitative level at which each waiver/deferral is set as the "LIS threshold" and the "SSTI threshold".

ISDA's members do not agree with ESMA's proposal for the definition of a liquid market for OTC interest rate derivatives, and instead recommend that ESMA:

- Refines the assessment of liquid classes as follows:

    i. By analysing swaptions at a greater degree of granularity in order to ensure that each sub-class against which liquidity is assessed contains reasonably homogenous derivatives. This can be achieved by using additional criteria to define the sub-classes of swaptions.

    ii. By utilising higher liquidity thresholds which accord better with the MiFIR definition of a liquid market (that is one where there are ready and willing buyers and sellers on a continuous basis).

    iii. By refining its data analysis methods, including the classification of swaps which do not have whole year tenors, and ensure that the dataset used is accurate.

    iv. By clarifying the illiquid status of exotic interest rate derivatives, which do not currently appear in the interest rate derivatives taxonomy of RTS 9. Under ISDA's taxonomy, exotics are a product distinct from options, cross-currency swaps, caps, floors, forward rate agreements (FRAs), or interest rate swaps; so creating (as ESMA has done for equity and commodity derivatives and bonds) an "others" category for interest rate derivatives in RTS 9 will further align ESMA's taxonomy with ISDA's and

clarify the status of these derivatives. Given the heterogeneity of derivatives in this class, we expect it to be considered illiquid.

- Seek to achieve its policy objective of ensuring transparency at the aggregate level of the interest rate derivatives asset class, and not attempt to find at least some liquid sub-classes in as many classes of interest rate derivatives as possible. Some classes are simply very illiquid or extremely heterogeneous. Appropriate and consistent use of liquidity thresholds across sub-classes when defined with comparable levels of granularity will ensure that illiquid classes are not incorrectly identified as liquid. If ESMA wishes to assess whether or not it has "captured" a sufficiently broad range of derivatives as liquid instruments, it should make this assessment at the aggregate level of the interest rate derivatives asset class, rather than at the level of each class or sub-class.

- Recognise package transactions as a distinct class of financial transactions and ensure that they are adequately provided for in the RTS.

ISDA is concerned that ESMA's proposed taxonomy for interest rate derivatives does not clearly distinguish between exchange-traded interest rate derivatives (i.e. those contracts, including futures and listed options, which generally have highly standardised terms, and are made available for trading on exchanges, and are centrally cleared) and what market convention refers to as OTC interest rate derivatives (i.e. those contracts, including swaps and swaptions, whose terms are negotiated and non-standardised, which are sometimes available for central clearing and can be traded on trading venues). For example, it is not clear from RTS 9 that the futures and option classes described in Tables 5 to 12 of Section 1 of Annex III only include exchange-traded derivatives. The liquidity assessment conducted by ESMA to produce these tables was based solely on data from trading venues and therefore ESMA should clearly indicate that only exchange-traded interest rate derivatives fall within the sub-classes included within these tables.

ISDA recommends that ESMA pay due regard to the assessment of liquidity and the calibration of the LIS and SSTI thresholds for derivatives that have comparable economic terms but are transacted in different forms. By way of example:

- The 10 year Euro Swapnote listed in Table 5 of Annex III of RTS 9 is economically similar to a 10 year Euro fixed-float swap listed in Table 23 of the same annex. The former is proposed to have an LIS threshold of EUR 10 million, whilst the latter is proposed to have an LIS of EUR 165 million.

- Three month Euribor interest rate futures listed in Table 7 of Annex III of RTS 9 are economically similar to 3 month Euribor FRAs listed in the first 5 rows of Table 15 of the same annex. The former is proposed to have an LIS threshold of EUR 10 million, whilst the latter is proposed to have an LIS of EUR 525 to 1,000 million depending on tenor. We also note that, in Table 11, options (which we presume to be exchange-traded options, although RTS 9 is unclear on this) on 3 month Euribor futures are proposed to have an LIS of EUR 15 billion.

- 5 year Sterling swapnotes, shown in Table 11 on page 117 of the Consultation Paper to be illiquid, are found to be illiquid and proposed to have an LIS threshold of EUR 10 million. These are economically similar to 10 year GBP fixed-float swaps listed in Table 23 of Annex III of RTS 9 as liquid with an LIS threshold of EUR 90 million.

ISDA's reading of the RTS gives us an impression that different classes were addressed by different teams or individuals, and we do not get a sense of consistency between different classes, or sometimes between subsets of different classes.

(i) Issues with ESMA's proposal for the definition of liquid market for interest rate derivatives

ISDA's members are concerned that ESMA has classified many illiquid instruments as liquid, due to:

- The use of liquidity thresholds which are inappropriately low and do not accord with the MiFIR definition of a liquid market, being one with ready and willing buyers and sellers on a continuous basis. Specifically, two trades, or in some cases one trade per day, cannot be considered consistent with this definition.

- Inconsistent use of liquidity thresholds between classes which are of equivalent granularity in order to label some sub-classes within each interest rate derivatives class as liquid. Different liquidity thresholds are only appropriate where the granularity of the sub-classes is not the same. Where sub-classes are identified at equivalent levels of granularity, equivalent liquidity thresholds should be used. In practice, this will mean that few/no sub-classes of some interest rate derivatives classes will be deemed liquid, which we consider correct because some swap classes (e.g. multi-currency swaps, inflation swaps) are simply not liquid.

- The difficulties encountered in factoring in two of the key elements of the definition of liquid market, specifically the number and type of market participants, and the average size of spreads. We understand why ESMA has encountered difficulty incorporating these liquidity parameters, and therefore recommend that ESMA compensate for the potential misclassification of illiquid sub-classes as liquid through higher liquidity thresholds for those liquidity parameters actually used (i.e. average frequency and average size of transactions), than would otherwise have been possible had all liquidity parameters been considered.

- The fact that the "number of days traded greater to or equal to 80% of the available trading days in the period" used in stage 1 of ESMA's analysis of OTC interest rate derivatives (described on pages 120-125 of the Consultation Paper) was not carried through to stage 2 of the analysis. Had ESMA applied the 80% liquidity threshold in stage 2, sub-classes such as the 4 to 6 year RUB-USD multi-currency swaps which were deemed liquid by ESMA (page 160 of the Consultation Paper) would not have been deemed liquid. ESMA should either reinstate this test in stage 2, or else compensate through higher liquidity thresholds for the average frequency and average size of transactions liquidity parameters.

- An error in ESMA's classification of swaps without whole year tenors (see section on the Market Recommended Year Fraction below).

- The classification of swaptions at a grossly insufficient level of granularity resulting in many illiquid swaptions being labelled liquid. Swaptions as a class are far less liquid than swaps, and although ESMA might identify certain liquid sub-classes, it will be extremely damaging for liquidity in truly illiquid sub-classes if they are incorrectly labelled liquid. ESMA should use additional criteria to define sub-classes of swaptions.

- The use of data to assess liquidity is from the period very shortly after the EMIR trade reporting requirement came into effect. The challenges that this reporting requirement presented to the industry have been widely publicised, and we are concerned that this dataset may, for example, contain duplicate trades or other erroneous data. ESMA may not

wish to place full reliance on this dataset, or could compensate through the use of higher liquidity thresholds for the average frequency and average size of transactions than might otherwise have been appropriate. Alternatively, ESMA could repeat its analysis on more recent trade repository data, which might be more accurate. Additionally, use of a dataset covering a longer period of time may produce more representative results, potentially less distorted by seasonal or short-term factors.

These concerns are heightened by the fact that ESMA does not propose to recalibrate the liquidity assessment at all. In the May 2014 Discussion Paper, ESMA stated (on page 125, paragraph 44) that "the liquidity of the sub-categories needs to be re-assessed periodically". Instead, it is now clear that ESMA proposes no such re-assessment. This decision also implies that ESMA has chosen not to utilise the market data that MiFIR will make available to facilitate recalibration, which is an incomprehensible waste of the opportunity to refine the liquidity classification over time (particularly given the concerns over the EMIR trade repository data noted above). This static determination is a serious weakness of ESMA's approach which implies that an incorrect initial assessment of liquidity will have permanent implications. We encourage ESMA to reconsider whether the COFIA can be recalibrated more regularly, as improved market data becomes available and to better reflect changing liquidity conditions. In the absence of regular and accurate recalibration, we urge ESMA to compensate through both a more conservative initial assessment of liquidity, and by calibrating the LIS and SSTI thresholds at lower levels (see ISDA's response below to question 78).

Upon examining ISDA's analysis, we encourage ESMA to re-run its liquidity assessments for interest rate derivatives and are keen to assist ESMA in this work.

(ii) Summary of ISDA's research backtesting and approach

The above concerns and ISDA's access to public CFTC data obtained from the DTCC US Swap Data Repository[2] (DTCC) prompted ISDA to backtest ESMA's liquidity assessment of sub-classes of interest rate derivatives using data from the same 3-month period (1 March 2014 to 31 May 2014) used by ESMA, in order to validate ESMA's results and, in particular, the liquidity parameters and liquidity thresholds used by ESMA to arrive at its liquidity determinations as set out in Annex 3.5.2 of the Consultation Paper.

We were unable to use the European trade repository data used by ESMA as this is not publicly available. We acknowledge that the DTCC data may not exactly match ESMA's dataset (for instance, we believe that it overweights trades in USD, and underweights trades in EUR and GBP), but we hope our analysis demonstrates how ESMA can apply our recommendations and methods to ESMA's own dataset. Since the trade repository data is not generally transparent at the trade level and this level of detail is needed to perform the analysis, the ISDA research department used the public CFTC data.

The swap classes from Annex 3.5.2 of the Consultation Paper that ISDA focused on were:

- Swaptions (Table 30).
- Single-currency fixed-to-float (Table 36).
- Single-currency OIS (Table 38).

[2] CFTC data from DTCC includes the following price-forming transactions: new trades, terminations and novations.

- Single-currency float-to-float swaps (or basis) (Table 39).
- Multi/cross-currency fixed-to-float (Table 32).
- Multi/cross-currency float-to-float (or basis) (Table 33).

When running the backtest ISDA also estimated "trades captured" and "notional captured" and looked at these vis-à-vis ESMA's estimates of coverage set out in Table 17 on page 124 of the Consultation Paper.

Note that we did not incorporate the "concentration" condition described in paragraph 119, page 149 of the Consultation Paper into our analysis, i.e. that a sub-class meeting the thresholds for only one (or few) maturities was not deemed to be liquid. We simply determined a class to be liquid if the number or notional of trades per day exceeded the relevant liquidity threshold.

ISDA was not able to undertake any backtesting in respect of the LIS computations (pages 239–304 of the Consultation Paper). The DTCC data is volume-capped at the CFTC block thresholds, so it is not possible to get a perfect view of the cumulative notional at the upper percentiles of trades sorted by volume.

(iii) Issues with ESMA's classification of swaps which do not have whole year tenors, and the Market Recommended Year Fraction

When back-testing ESMA's approach using the DTCC data, ISDA sought to replicate and correct ESMA's approach to the classification of swaps which do not have whole year tenors. ESMA's approach, outlined on pages 124-5 of the Consultation Paper, fails to take into account: (i) that swaps in some currencies have, by market convention, effective dates of T+2; and (ii) leap years. The practical consequence of this is that a swap of 3,652 days (e.g. 1 January 2014 to 1 January 2024, a swap of exactly 10 years maturity) is classified as an 11 year swap, resulting in some sub-classes being incorrectly identified as liquid and incorrect calibration of the LIS and SSTI thresholds.

The following mark-up of paragraph 79 subparagraphs iv and v, pages 124-125 of the Consultation Paper would correct ESMA's approach:

iv. Tenor = "1 year" when the difference between the maturity date and the execution date is greater than or equal to 182 days and smaller than or equal to ~~365~~370 days.

v. Tenor = "X years" where X is the number obtained by rounding up ~~the ratio of days between maturity and execution date and 365~~ [1+ (maturity date - execution date - 370)/365.25] to the next whole number. In other words, whenever ~~the ratio of days to maturity and 365 is~~ [1+ (maturity date - execution date - 370)/365.25] is 2.7 then, the tenor is "3 years"."

We refer to this alternative classification of swaps in the remainder of our response to this question as the Market Recommended Year Fraction. It is important to note that use of the Market Recommended Year Fraction does not affect the coverage ratio of the liquid sub-classes, although it does reduce the set of liquid sub-classes to a more appropriate list (e.g. 6 year, 11 year and 31 year tenors in some currencies would no longer be liquid) which reflects the current market in these tenors.

The following table has been prepared to illustrate what this correction to day count looks like in practice. (It assumes a swap whose effective date = execution date, as is the convention in GBP.)

Table 1: Day count adjustment to align with the Market Recommended Year Fraction						
Execution Date	**Maturity Date**	**Total days**	**ESMA fraction**	**ESMA years**	**Market Recommended Year Fraction**	**Market years**
01-Jan-14	01-Jan-15	365	1.000	1	0.986	1
01-Jan-14	02-Jan-15	366	1.003	2	0.989	1
01-Jan-14	03-Jan-15	367	1.005	2	0.992	1
01-Jan-14	04-Jan-15	368	1.008	2	0.995	1
01-Jan-14	05-Jan-15	369	1.011	2	0.997	1
01-Jan-14	06-Jan-15	370	1.014	2	1.000	1
01-Jan-14	07-Jan-15	371	1.016	2	1.003	2
01-Jan-14	01-Jan-16	730	2.000	2	1.986	2
01-Jan-14	01-Jan-17	1096	3.003	4	2.988	3
01-Jan-14	02-Jan-17	1097	3.005	4	2.990	3
01-Jan-14	03-Jan-17	1098	3.008	4	2.993	3
01-Jan-14	04-Jan-17	1099	3.011	4	2.996	3
01-Jan-14	05-Jan-17	1100	3.014	4	2.999	3
01-Jan-14	06-Jan-17	1101	3.016	4	3.001	4
01-Jan-14	01-Jan-18	1461	4.003	5	3.987	4
01-Jan-14	02-Jan-18	1462	4.005	5	3.990	4
01-Jan-14	03-Jan-18	1463	4.008	5	3.992	4
01-Jan-14	04-Jan-18	1464	4.011	5	3.995	4
01-Jan-14	05-Jan-18	1465	4.014	5	3.998	4
01-Jan-14	06-Jan-18	1466	4.016	5	4.001	5
01-Jan-14	01-Jan-19	1826	5.003	6	4.986	5
01-Jan-14	01-Jan-20	2191	6.003	7	5.986	6
01-Jan-14	01-Jan-21	2557	7.005	8	6.988	7
01-Jan-14	01-Jan-22	2922	8.005	9	7.987	8
01-Jan-14	01-Jan-23	3287	9.005	10	8.986	9
01-Jan-14	01-Jan-24	3652	10.005	11	9.986	10

The table below illustrates the difference between the number of liquid sub-classes and the coverage ratio if the Market Recommended Year Fraction method is applied to the dataset instead of the ESMA year fraction. To produce Rows A, C, E, G and I of the table below ESMA's year fraction methodology and proposed liquidity thresholds were applied to the CFTC data. Rows B, D, F, H and J of the table below incorporate the Market Recommended Year Fraction. We have used ESMA's proposed liquidity thresholds for the purposes of producing this table to ensure that the table only reflects the impact of adopting the Market Recommended Year Fraction. However, we do not agree with the level of these liquidity thresholds and we discuss later in our response to this question our recommended liquidity thresholds.

Table 2: Comparison of liquid classes and coverage ratios using the ESMA and Market Recommended Year Fraction methods									
	Swap Type	**Class**	**Calculation Basis**	**1. Total number of sub-classes with at least one trade**	**2. Liquid sub-classes**	**3. Trades per day**	**4. Notional per day €mm**	**5. % of trades captured**	**6. % of notional captured**
A	Single Currency	Fixed - Float	CFTC data with ESMA year fraction	632	103	2	100	84.0%	92.8%
B	Single Currency	Fixed - Float	CFTC data with Market Recommended Year Fraction	616	98	2	100	83.9%	92.6%
C	Single Currency	Float-Float	CFTC data with ESMA year fraction	127	11	1	50	66.1%	75.9%
D	Single Currency	Float-Float	CFTC data with Market Recommended Year Fraction	126	10	1	50	64.3%	75.3%
E	Single Currency	OIS	CFTC data with ESMA year fraction	187	26	1	50	66.8%	89.7%
F	Single Currency	OIS	CFTC data with Market Recommended Year Fraction	182	26	1	50	69.9%	89.6%
G	Multi Currency	Fixed - Float	CFTC data with ESMA year fraction	326	10	1	10	59.1%	62.6%
H	Multi Currency	Fixed - Float	CFTC data with Market Recommended Year Fraction	250	10	1	10	62.0%	63.1%
I	Multi Currency	Float-Float	CFTC data with ESMA year fraction	497	11	1	100	26.4%	36.4%
J	Multi Currency	Float-Float	CFTC data with Market Recommended Year Fraction	341	8	1	100	28.9%	42.0%

The list below illustrates the sub-classes of swaps that fall into or out-of-scope of what is deemed liquid through use of the Market Recommended Year Fraction. The table shows the differences between rows A and B in Table 2 above. It should be clear that many of the classes found to be illiquid are the year immediately beyond major benchmark tenors (e.g. 11 years, 16 years, 31 years).

Table 3: Sub-classes of swaps that fall into or out-of-scope of what is deemed liquid through the use of the Market Recommended Year Fraction	
Sub-classes that are liquid in row B but not row A	**Sub-classes that are liquid in row A but not row B**
FIXED-FLOATING__AUD__1 year	FIXED-FLOATING__AUD__11 years
FIXED-FLOATING__CLP__1 year	FIXED-FLOATING__CAD__11 years
FIXED-FLOATING__EUR__15 years	FIXED-FLOATING__CNY__3 years
FIXED-FLOATING__EUR__20 years	FIXED-FLOATING__EUR__13 years
FIXED-FLOATING__EUR__30 years	FIXED-FLOATING__EUR__16 years
FIXED-FLOATING__GBP__9 years	FIXED-FLOATING__EUR__21 years

FIXED-FLOATING__GBP__30 years	FIXED-FLOATING__GBP__31 years
FIXED-FLOATING__JPY__20 years	FIXED-FLOATING__NZD__4 years
FIXED-FLOATING__NZD__5 years	FIXED-FLOATING__SEK__2 years
FIXED-FLOATING__USD__25 years	FIXED-FLOATING__SEK__3 years
	FIXED-FLOATING__SEK__6 years
	FIXED-FLOATING__USD__14 years
	FIXED-FLOATING__USD__21 years
	FIXED-FLOATING__USD__26 years
	FIXED-FLOATING__ZAR__3 years

(iv) ISDA's proposals for swaps

ISDA welcomes ESMA's granular classification of swaps, and the attempts to incorporate many of the elements recommended in ISDA's response to the May 2014 Discussion Paper. A granular classification is critical in order to bucket derivatives into homogenous sub-classes and to correctly identify those derivatives that are truly liquid. For the general test of liquidity ISDA does not recommend more granularity for swaps, except for inflation swaps (where ESMA must more clearly distinguish between different inflation indices). However, for the enhanced test of "sufficiently liquid" (which is the test for the derivative trading obligation), ESMA must use further degrees of granularity, as we set out in response to Question 89.

It is imperative that the liquidity thresholds used to determine whether a sub-class of interest rate derivatives is liquid are set at very different levels to those proposed by ESMA. ISDA suggests that the liquidity thresholds for interest rate derivatives should be set at 15 trades per day and a notional of EUR 500 million.

The table below deals with single-currency fixed-to-float swaps. Row A corresponds to the first row of Table 17 on page 124 of the Consultation Paper. To produce Row B, ESMA's year fraction methodology and ISDA's proposed liquidity thresholds of 15 trades per day and a notional of EUR 500 million (ISDA threshold 2) were applied to ESMA's data. To produce Row C, ESMA's year fraction methodology and higher liquidity thresholds of 40 trades per day and a notional of EUR 1000 million (ISDA threshold 3) were applied to ESMA's data. Row D incorporates the Market Recommended Year Fraction and applies ISDA's proposed liquidity thresholds of 15 trades per day and a notional of EUR 500 million to the CFTC's data.

Table 4: ESMA & DTCC liquidity calibration
Single currency fixed-floating under various scenarios

	Swap Type	Class	Calculation Basis	1. Total number of sub-classes with at least one trade	2. Liquid sub-classes	3. Trades per day	4. Notional per day €mm	5. % of trades captured	6. % of notional captured
A	Single	Fixed -Float	ESMA CP data	829	247	2	100	90.4%	96.6%

Table 4: ESMA & DTCC liquidity calibration Single currency fixed-floating under various scenarios									
	Swap Type	**Class**	**Calculation Basis**	**1. Total number of sub-classes with at least one trade**	**2. Liquid sub-classes**	**3. Trades per day**	**4. Notional per day €mm**	**5. % of trades captured**	**6. % of notional captured**
	Currency								
B	Single Currency	Fixed -Float	ESMA CP data with ISDA threshold 2	829	114	15	500	78.9%	89.4%
C	Single Currency	Fixed -Float	ESMA CP data with ISDA threshold 3	829	56	40	1000	65.7%	78.5%
D	**Single Currency**	**Fixed -Float**	**CFTC data with Market Recommended Year Fraction & ISDA threshold 2**	**616**	**27**	**15**	**500**	**58.2%**	**72.0%**

This analysis reveals the following.

- A reduction in the number of sub-classes deemed as liquid to a more appropriate set does not lead to an equivalent drop in the percentage of trades captured or notional captured. By consolidating to a more reasonable set of liquid sub-classes, through slightly higher and more consistent liquidity thresholds across all swap types (i.e. 15 trades per day and a notional per day of EUR 500 million), the overall capture ratio does not decline significantly.
- For some swap types, ISDA's proposed liquidity thresholds reduce the coverage ratio significantly. In particular, Table 5 below illustrates that we find no liquid sub-classes in the multi-currency fixed-to-float and multi-currency float-to-float swap classes where ISDA's proposed liquidity thresholds take the coverage to zero. We consider this correct because these classes of swaps are simply illiquid.
- ESMA's dataset appears to be larger than the CFTC dataset. In certain currencies this does not surprise us; we recognise that the DTCC data is US centric and may under-represent trading volumes in certain currencies, particularly EUR and GBP. However, an examination of the CFTC data shows that ESMA's dataset includes more USD trades than the CFTC data, which is particularly surprising to us given that we would expect the majority of USD swap trades to be reported under the CFTC's Part 43 reporting requirement given the dominance of US institutions in the USD swap market. As an example, the DTCC dataset has 5,439 trades in 10 year USD single currency fixed-float swaps (using the ESMA year fraction), whilst ESMA's dataset has 15,574 trades, a very surprising discrepancy.

Below we present results for the other classes of swaps that we analysed. We emphasise that, for each swap class, we use the same liquidity thresholds for "trades per day" (15) and "notional per day" (EUR 500 million) in the fourth row of that class (rows H, L, P, T and X), rather than varying the liquidity thresholds by sub-class. We consider this appropriate given that the sub-classes are of equivalent granularity. Rows E to H, present the results for single-currency float-to-float swaps. Rows I to L present the results for OIS swaps. Rows M to P present the results for multi-currency fixed-to-float swaps. Rows Q to T present the results for float-to-float multi-currency swaps. Rows U to X present a summary view across swap types.

Table 5: ESMA & DTCC liquidity calibration All swap sub-classes under various scenarios									
	Swap Type	**Class**	**Calculation Basis**	**1. Total number of sub-classes with at least one trade**	**2. Liquid sub-classes**	**3. Trades per day**	**4. Notional per day €mm**	**5. % of trades captured**	**6. % of notional captured**
E	Single Currency	Float-Float	ESMA CP data *	290	48	1	50	71.8%	81.0%
F	Single Currency	Float-Float	ESMA CP data with ISDA threshold 2	290	0	15	500	0.0%	0.0%
G	Single Currency	Float-Float	ESMA CP data with ISDA threshold 3	290	0	40	1000	0.0%	0.0%
H	**Single Currency**	**Float-Float**	**CFTC data with Market Recommended Year Fraction & ISDA threshold 2**	**126**	**0**	**15**	**500**	**0.0%**	**0.0%**
I	Single Currency	OIS	ESMA CP data	282	32	1	50	69.5%	87.5%
J	Single Currency	OIS	ESMA CP data with ISDA threshold 2	282	7	15	500	39.9%	52.9%
K	Single Currency	OIS	ESMA CP data with ISDA threshold 3	282	1	40	1000	9.5%	8.1%
L	**Single Currency**	**OIS**	**CFTC data with Market Recommended Year Fraction & ISDA threshold 2**	**182**	**0**	**15**	**500**	**0.0%**	**0.0%**
M	Multi Currency	Fixed - Float	ESMA CP data	597	22	1	10	74.3%	45.9%
N	Multi Currency	Fixed - Float	ESMA CP data with ISDA threshold 2	597	1	15	500	14.7%	13.5%
O	Multi Currency	Fixed - Float	ESMA CP data with ISDA threshold 3	597	0	40	1000	0.0%	0.0%
P	**Multi Currency**	**Fixed - Float**	**CFTC data with Market Recommended Year Fraction & ISDA threshold 2**	**250**	**0**	**15**	**500**	**0.0%**	**0.0%**
Q	Multi Currency	Float-Float	ESMA CP data	711	39	1	100	55.2%	64.6%
R	Multi Currency	Float-Float	ESMA CP data with ISDA threshold 2	711	2	15	500	7.9%	11.1%
S	Multi Currency	Float-Float	ESMA CP data with ISDA threshold 3	711	0	40	1000	0.0%	0.0%
T	**Multi Currency**	**Float-Float**	**CFTC data with Market Recommended Year Fraction & ISDA threshold 2**	**341**	**0**	**15**	**500**	**0.0%**	**0.0%**
U	Swaps	All	ESMA CP data	2709	388	As per CP	As per CP	87.8%	92.9%
V	Swaps	All	ESMA CP data with ISDA threshold 2	2709	124	15	500	72.2%	76.5%
W	Swaps	All	ESMA CP data with ISDA threshold 3	2709	57	40	1000	58.7%	60.6%
X	**Swaps**	**All**	**CFTC data with Market Recommended Year Fraction & ISDA threshold 2**	**1515**	**27**	**15**	**500**	**52.0%**	**43.6%**

* NB Table 17 on CP page 124 specifies 100mm as the notional threshold for OIS, whereas Table 38 on pages 195-199 uses 50mm

We therefore encourage ESMA to carefully review whether or not its dataset is accurate, that trade numbers and volumes are not inflated, and that consequently sub-classes are not being incorrectly

labelled as liquid. We would be prepared to assist ESMA in this work. We encourage ESMA to recreate ISDA's table above – using the Market Recommended Year Fraction and ISDA's recommended liquidity thresholds (15 trades per day and EUR 500 million notional). We recognise that with its larger dataset ESMA may identify more liquid sub-classes than the total of 27 that ISDA has identified in the CFTC data, but recommend the enhancements in our approach.

We also recommend that ESMA define the term "tenor" in the context of Tables 15 to 31 in Annex III of RTS 9. We consider the appropriate definition to be the time period from trade date to maturity date. Failure to do so will leave unclear the classification of forward starting or backward starting swaps.

(v) ISDA's proposals for swaptions

ISDA members consider that ESMA's classification of swaptions is inadequately granular to classify swaptions into homogenous classes. The consequence of this is that many swaptions are incorrectly labelled by ESMA as liquid, which will have serious consequences for the ability of investors to transact. ESMA labelling as liquid all swaptions in 5 currencies regardless of underlier cannot be correct; under ESMA's proposal, options of 50-year Euro swaps would be liquid whereas the underlier is illiquid. At a minimum, given that swaptions are less liquid than their underliers, ESMA must account for the fact that a swaption cannot be considered liquid if its underlier is illiquid.

Swaptions are a very diverse class of derivatives, far more diverse than swaps, and even comparable levels of granularity to that used by ESMA for swaps are unlikely to fully capture relevant differences. For instance, we list below the major differences between swaptions that could impact the liquidity of swaptions and which could, therefore, be used as the basis of a taxonomy:

i. Currency.
ii. Underlying index (LIBOR, EURIBOR, OIS, Inflation, Bond etc).
iii. Tenor of underlier (including accounting for broken-dated or whole year tenors).
iv. Tenor of option (including accounting for broken-dated or whole year tenors).
v. Style of option exercise (e.g. American, European, cash settled, physically settled, binary, etc).
vi. Strike price.
vii. Day-count fractions.
viii. At-market coupon ("par" swaps) or non-par coupons with the exchange of a fee.
ix. Other bespoke terms (e.g. payment convention, compounding basis, variable notionals).

ESMA must, at the very least, incorporate (ii) the underlying index, (iii) the tenor of the underlier and (iv) the tenor of the option into its taxonomy. Elements (i), (ii), (iii) and (iv) are the critical elements for swaptions, and we are concerned that ESMA has only incorporated element (i). Elements (v) and (vi) are also relevant, although may be difficult to identify accurately and could therefore be compensated for through the use of higher liquidity thresholds (i.e. higher number of trades per day and notional per day) for swaptions than for swaps once elements (ii), (iii) and (iv) have been incorporated.

In order to derive homogenous swaption sub-classes, we therefore recommend that ESMA defines sub-classes for swaptions using the following taxonomy:

- Currency.
- Underlying index (LIBOR, EURIBOR, OIS, Inflation, etc).
- Tenor of underlier, classifying using the same classes used for interest rate swaps.
- Tenor of option, broken down into at least six sub-classes per currency, index and underlier:
    - 0 – 6 months;
    - 6 months – 1 year;
    - 1 year – 2 years;
    - 2 years – 5 years;
    - 5 years – 10 years; and
    - Over 10 years.

ESMA must also ensure that caps, floors and exotic options (including simple exotics like binary options) are distinguished from swaptions in its dataset. In order to assist ESMA to appropriately classify swaptions, ISDA has produced a comparable analysis to that provided above for swaps, using the same DTCC dataset, at a comparable degree of granularity. All of the data necessary for ESMA to recalibrate its liquidity assessment for swaptions as described above is available at EU trade repositories.

As the table below shows, the impact of introducing this granularity is significant. The number of liquid sub-classes drops significantly using ESMA's recommended liquidity thresholds. We accept that introducing more granularity could provide a basis to lower the liquidity thresholds for "trades per day" and "notional per day". There is a strong case, however, to maintain higher liquidity thresholds because this approach still has not accounted for elements (v) style of exercise and (vi) strike from the above list. Nevertheless, we have illustrated the impact of using liquidity thresholds of 15 trades per day and notional of EUR 500 million, consistent with those proposed by ISDA for swaps. Doing so reveals coverage of 12.13% of trades captured and 7.73% of volume, entirely appropriate given the diversity and general illiquidity of the swaptions class compared to swaps.

Table 6: Single currency swaptions and the impact of introducing granularity

Criteria	Calculation basis	1. Total number of sub-classes with at least one trade	2. Liquid sub-classes	3. Trades per day	4. Notional per day €mm	5. % of trades captured	6. % of notional captured
– Currency	ESMA CP data	24	5	10	2000	90.40%	96.60%
– Currency – Swap tenor – Option tenor	CFTC data with ESMA year fraction	486	1	10	2000	14.29%	7.98%
– Currency – Swap tenor – Option tenor	CFTC data with **Market Recommended Year Fraction**	398	0	10	2000	0.00%	0.00%
– **Currency** – **Swap tenor** – **Option tenor**	**CFTC data with Market Recommended Year Fraction**	**398**	1	**15**	**500**	**12.13%**	**7.73%**

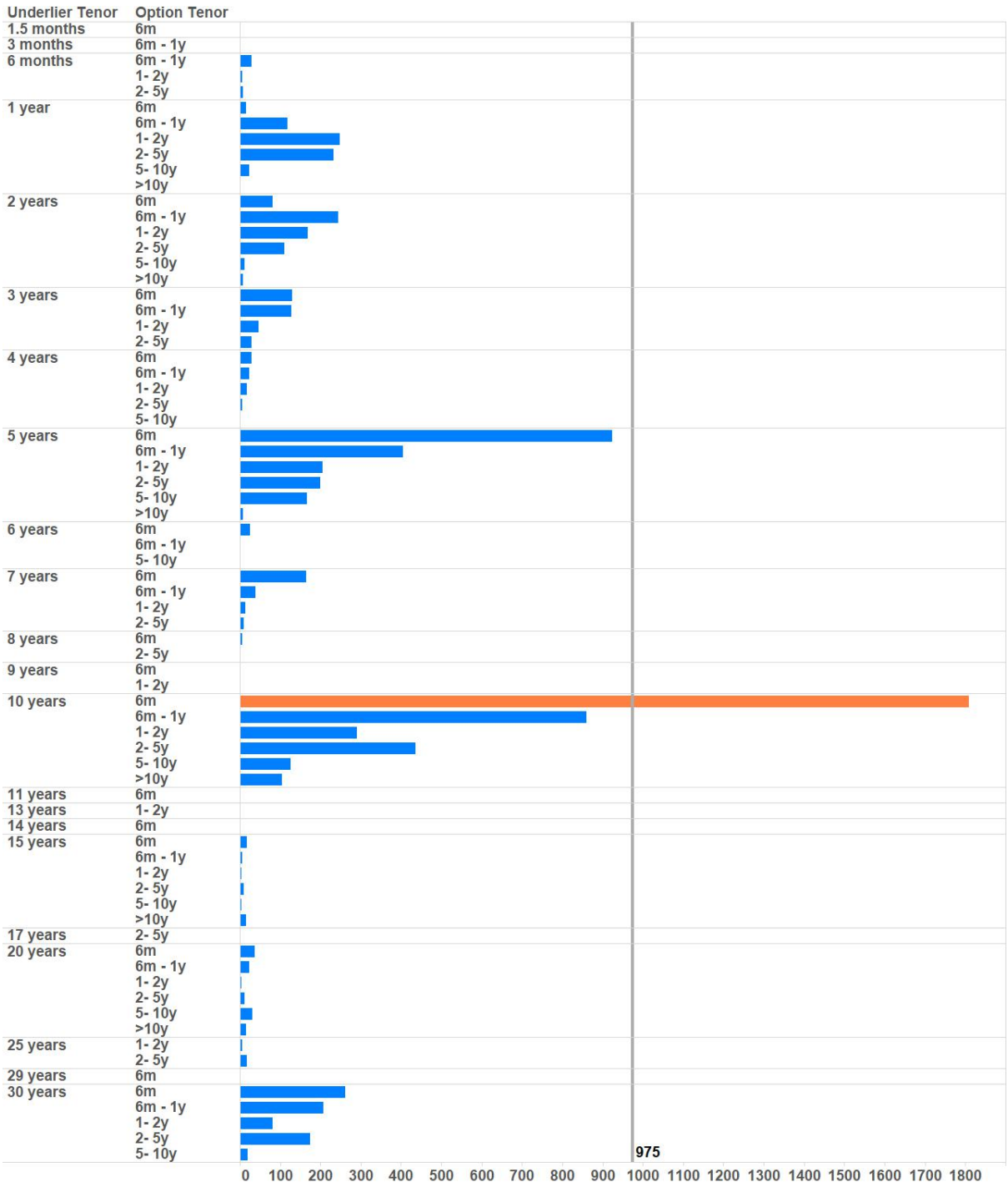
The chart below underscores the importance of breaking down swaptions by tenor of underlier and tenor of option. It shows the trade counts for USD swaptions in the DTCC dataset using the more

granular classification (we have illustrated this using USD swaptions because this is, in our view, the most comprehensive sub-class of swaptions in the DTCC dataset for ESMA's purposes). It is clear that the vast majority of liquidity is in short-dated options (0 – 1 year expiries) with LIBOR swap underliers of short- to medium tenors (1 to 10 years). Long-dated options (expiries > 2 years) or options with underliers longer than 10 years are extremely illiquid, which we think is reflective of the market for swaptions. The grey vertical line on the chart assumes ISDA's recommended liquidity thresholds of 15 trades per day and EUR 500 million notional per day are applied. Based on these liquidity thresholds, we have only identified one sub-class of USD swaptions as liquid (6 month option with a 10 year underlier). The CFTC data upon which the chart has been prepared includes off-the-run strikes. It is possible that, if these are removed from the dataset, the number of liquid sub-classes could decrease further.

Given that options with different option tenors or tenors of underlier have extremely different risk properties, cannot be readily used to hedge each other, and have vastly different degrees of liquidity, they should not be comingled in the same sub-class. We also observed no USD swaptions with inflation underliers during the same period, reinforcing their illiquidity and the need for ESMA to classify them separately from swaptions with LIBOR swap underliers.

ISDA therefore urges ESMA to reassess its approach to swaptions and to adopt ISDA's approach in its reassessment. ISDA would welcome the opportunity to assist ESMA in any of its research.

Table 7: USD Swaptions based on CFTC data and ISDA's proposed granularity



(vi) ISDA's proposals for inflation swaps

ISDA has not undertaken an analysis of inflation swaps, because they are not prevalent in the DTCC dataset. ESMA has failed to distinguish between different inflation indices, which have different degrees of granularity. We encourage ESMA to re-run their liquidity assessment, taking account of the inflation index, and to amend RTS 9 to clarify which EUR inflation indices are deemed liquid. We understand that only two inflation indices trade at least once a day, these being: (i) Eurostat Eurozone HICP Ex Tobacco (CPTFEMU Index in Bloomberg); and (ii) France CPI Ex Tobacco (FRCPXTOB Index). All other inflation indices trade infrequently and, therefore, we would not expect these inflation indices to be deemed liquid for the purposes of the MiFIR transparency regime.

(vii) Summary of ISDA's proposed changes to the liquidity parameters proposed by ESMA

The liquidity parameter "number of days traded equal to 80% of the available trading days in the period" should be used in the first and second stage of the liquidity assessment for OTC interest rate derivatives to ensure consistency in ESMA's data analysis across the two stages. If this liquidity parameter is not used in the second stage, ESMA should compensate through higher liquidity thresholds for trades per day and notional per day.

We recognise the practical difficulties involved in utilising liquidity parameters for the number and type of market participants, and the average size of spreads, and understand why ESMA has chosen not to use them. However, ESMA should compensate through using higher liquidity thresholds for trades per day and notional per day.

(viii) Broken dated swaps

In ISDA's view Option 2 is preferable for the general determination of liquid markets (and therefore the MiFID II/MiFIR transparency framework). However, ISDA stresses that Option 2 is critical in the assessment of "sufficiently liquid" classes for the purposes of the derivative trading obligation. Adopting Option 2 for the trading obligation would help to align MiFID II/MiFIR to US regulation (since the CFTC MAT product set only contains integer tenors and a limited number of forward-starting USD swaps). ISDA's analysis and back testing of ESMA's approach to determining the liquid market definition for interest rate derivatives reflects this position.

(ix) Other bespoke terms

ESMA's taxonomy for swaps, and ISDA's proposed revised taxonomy for swaptions, do not make distinction for: (i) different day-count fractions; (ii) whether swaps have an at-market coupon ("par swaps") or non-par coupons with the exchange of a fee; (iii) forward starting swaps; and (iv) other bespoke terms (e.g. payment convention, compounding basis, variable notionals, zero-coupon swaps). Although these elements do result in differences in liquidity between swaps, we accept that they may be a degree of granularity beyond that required for the general test of liquidity. However, as with broken-dated swaps, we recommend (in our response to Question 89 below) that ESMA incorporate this greater degree of granularity into the test for those derivatives sufficiently liquid to be subject to the trading obligation.

(x) Summary of ISDA's assessment of liquid sub-classes

ISDA's research indicates that ESMA's analysis leads to a number of sub-classes being deemed liquid when they are not (i.e. false positives). In sections (a) and (b) below we summarise the results of our research in respect of: (a) single-currency swaps and OIS swaps; and (b) multicurrency swaps. For these categories of instruments we present those currencies and tenors for which ISDA agrees with ESMA's determination of a liquid market. ISDA does not agree with ESMA's finding of a liquid market for any sub-classes which are not included in the tables below.

For swaptions, we have presented in section (c) below the list of those currencies and tenors that ISDA has assessed to be liquid. ISDA reiterates that ESMA's assessment of swaptions has not been undertaken at a sufficient degree of granularity to be acceptable.

a) Single currency swaps and OIS

In Table 8 below we summarise the results of our analysis for single-currency interest rate swaps and OIS. They are based on ISDA's: (i) proposed use of the Market Recommended Year Fraction; and (ii) recommended liquidity thresholds of 15 trades per day and a notional amount of EUR 500 million per day. The table lists, by currency and tenor, the 26 sub-classes of single-currency interest rate swaps and OIS for which ISDA agrees with ESMA's determination of a liquid market. ISDA identified a further sub-class (BRL 2 year single currency fixed-floating swaps) as liquid based on the relevant thresholds, although we note that ESMA determined this class to be not liquid using the "concentration condition" logic described in paragraph 119 of page 149 of the Consultation Paper, providing a total of 27 classes identified in row X of Table 5, above. In addition to these 26 classes, ISDA expects that ESMA may find other single currency swap classes to be liquid once ISDA's recommendations (i.e. use of the Market Recommended Year Fraction, and higher and consistently applied thresholds) are applied to ESMA's dataset. These classes will be amongst the 124 classes that appear in row V of Table 5 above, although we cannot fully assess these without access to ESMA's dataset.

Table 8: Single currency fixed float swaps assessed as liquid with CFTC data, Market Recommended Year Fraction, and thresholds set at 15 days per day and EUR 500 million per day

Product	Currency	Tenor	Number of trades	Number of trades per day	Number of days traded	Notional	Notional per day
InterestRate:IRSwap:FixedFloat	AUD	3 years	1085	16.69	63	67,107,079,142	1,032,416,602
InterestRate:IRSwap:FixedFloat	EUR	1 year	1650	25.38	60	200,024,058,236	3,077,293,204
InterestRate:IRSwap:FixedFloat	EUR	2 years	987	15.18	60	159,881,669,084	2,459,717,986
InterestRate:IRSwap:FixedFloat	EUR	3 years	1309	20.14	61	180,911,979,741	2,783,261,227
InterestRate:IRSwap:FixedFloat	EUR	4 years	1257	19.34	59	154,682,484,814	2,379,730,536
InterestRate:IRSwap:FixedFloat	EUR	5 years	2156	33.17	62	191,706,285,972	2,949,327,476
InterestRate:IRSwap:FixedFloat	EUR	6 years	1464	22.52	61	93,621,088,350	1,440,324,436
InterestRate:IRSwap:FixedFloat	EUR	10 years	2382	36.65	61	99,789,504,406	1,535,223,145
InterestRate:IRSwap:FixedFloat	EUR	11 years	1527	23.49	61	60,635,933,853	932,860,521
InterestRate:IRSwap:FixedFloat	GBP	5 years	1133	17.43	60	83,193,888,951	1,279,905,984
InterestRate:IRSwap:FixedFloat	GBP	10 years	1291	19.86	61	50,362,867,146	774,813,341
InterestRate:IRSwap:FixedFloat	JPY	10 years	1164	17.91	60	32,531,852,316	500,490,036
InterestRate:IRSwap:FixedFloat	MXN	2 years	1640	25.23	62	40,608,374,208	624,744,219
InterestRate:IRSwap:FixedFloat	USD	1 year	2329	35.83	63	237,206,972,150	3,649,338,033
InterestRate:IRSwap:FixedFloat	USD	2 years	4533	69.74	63	598,895,049,749	9,213,769,996

InterestRate:IRSwap:FixedFloat	USD	3 years	8640	132.92	63	882,393,383,061	13,575,282,816
InterestRate:IRSwap:FixedFloat	USD	4 years	5290	81.38	64	562,840,150,714	8,659,079,242
InterestRate:IRSwap:FixedFloat	USD	5 years	16893	259.89	63	1,146,341,595,796	17,636,024,551
InterestRate:IRSwap:FixedFloat	USD	6 years	4536	69.78	63	245,274,386,692	3,773,452,103
InterestRate:IRSwap:FixedFloat	USD	7 years	6241	96.02	64	338,971,487,861	5,214,945,967
InterestRate:IRSwap:FixedFloat	USD	8 years	1897	29.18	63	86,747,314,286	1,334,574,066
InterestRate:IRSwap:FixedFloat	USD	9 years	1351	20.78	63	62,836,890,000	966,721,385
InterestRate:IRSwap:FixedFloat	USD	10 years	15644	240.68	63	575,339,687,907	8,851,379,814
InterestRate:IRSwap:FixedFloat	USD	11 years	4321	66.48	63	160,196,263,857	2,464,557,905
InterestRate:IRSwap:FixedFloat	USD	15 years	1037	15.95	62	35,163,956,100	540,983,940
InterestRate:IRSwap:FixedFloat	USD	30 years	6130	94.31	63	115,217,367,465	1,772,574,884

b) Multi-currency interest rate swaps

We did not assess any multi-currency interest rate swaps to be liquid.

c) Swaptions

The below table, sets out the one class of swaptions, when classified by currencies, underliers, option tenors and underlier tenors, that ISDA has assessed as liquid. In ISDA's view, ESMA's assessment of swaptions has not been undertaken in sufficient detail to be accurate, so its determination – as set on page 149 of the Consultation Paper – that all AUD, EUR, GBP, JPY and USD swaptions are liquid is inaccurate and point to numerous swaptions incorrectly classified as liquid.

Table 9: Swaptions assessed as liquid with CFTC data, Market Recommended Year Fraction, and thresholds set at 15 days per day and EUR 500 million per day. All other classes are illiquid

Product	Currency	Underlying	Tenor of swap	Tenor of option	Number of trades	Number of trades per day	Number of days traded	Notional	Notional per day
Swaption	USD	USD-LIBOR-BBA	10 years	6m	1,809	27.83	63	115,139,164,286	1,771,371,758

(xi) Package transactions

a) Overview

ISDA would like to propose that ESMA considers specific and tailored treatment for package transactions as the Consultation Paper does not address how these transactions might be treated

under the new framework. In response to the May 2014 Discussion Paper, ISDA included a number of detailed comments on the nature of package transactions which we draw ESMA's attention to. We reiterate the points made in that response and put forward a proposal which we hope ESMA will find workable and flexible enough to apply for venue and SI transparency obligations and the derivatives trading obligation. This will preserve the market for package transactions and ensure that pricing and liquidity is not negatively impacted for end investors.

We believe that Level 1 is flexible enough to empower ESMA to specify how package transactions are treated in order to determine if such transactions are liquid or "traded on a trading venue" (both for determining whether transparency obligations apply as well as determining whether the derivatives trading obligation applies). The Level 1 text clearly sets the foundation for the pre- and post-trade transparency regimes in non-equities by defining the asset classes – "bonds, structured finance products, emission allowances and derivatives" – on which the Level 2 measures must be built. However, ESMA has flexibility to define how, within these broad asset classes, to identify whether specific financial instruments (or combinations thereof) are to be considered "liquid" or "traded on a trading venue". ESMA has chosen to adopt COFIA as the basis for determining whether a liquid market exists – which suggests to us that ESMA is also empowered to tailor this approach to instruments which fall within one of the specified classes, but are part of a package transaction.

b) Advantages of package transactions to clients

Package transactions allow clients to reduce their transaction costs (i.e. a single transaction is less expensive to execute than multiple transactions) and manage their execution risk (i.e. a single execution alleviates timing and other mechanical/process type risks). They are tailored to provide risk-return characteristics in the form of a single transaction in an efficient and cost-effective manner to clients.

c) Challenges to trading package transactions without a tailored proposal

Below are some very realistic fact patterns which hopefully demonstrate that unless there is tailored treatment for package transactions which recognises that package transactions should be considered in their entirety when being assessed as subject to transparency requirements and/or the derivatives trading obligation, there is a significant risk that such transactions may no longer be available to clients in the EU. This will be due to the individual components being treated differently and inconsistently vs. each other when they are assessed against the relevant requirements which would negate the advantages highlighted above of trading package transactions. These challenges are likely to be particularly acute where one or more of the components of a package transaction includes derivatives subject to the trading obligation:

- If some components of a package transaction are traded on a trading venue but others are not.
- If some components of a package transaction are deemed liquid but others are not.
- If some components of a package transaction are above the relevant LIS or SSTI thresholds but others are not.
- If the components of a package transaction are below the relevant LIS or SSTI thresholds but together they behave similarly to a single transaction above the LIS or SSTI.
- If the package transaction contains a listed derivative which trades on a different trading venue to other components.

If ESMA fails to provide for the appropriate trading of packages, end investors will be required to trade the components independently, resulting in increased transaction costs and increased execution risks, which would seem to conflict with ESMA's policy objectives.

d) ISDA proposal

We would be keen to assist ESMA with the development of a workable regime for package transactions. We consider that the following proposals could both address the challenges we have described above. We have provided both proposals for ESMA's consideration as we recognise that, whilst Option 1 is a simpler proposal, Option 2 is more accurate.

Option 1:

1. Subject to point 3 below, if each component of a package transaction is liquid:

    a. The package transaction should be considered liquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

    a. The package transaction should be considered illiquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

Option 2:

1. Subject to point 3 below, if each component of a package transaction is liquid:

    a. The package transaction should be considered liquid; and

    b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the packaged transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

    a. The package transaction should be considered illiquid; and

b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

The percentage threshold approach aims to, in a simple manner, replicate the package of instruments into a single instrument to test whether it would indeed be above the threshold (SSTI or LIS purposes) or not if it were traded as a single instrument.

Example: if an investor wishes to hedge cash flows at 5-year and 15-year points using EUR interest rate swaps, to create an accurate hedge the investor would trade a package of two EUR swaps at 5-year and 15-year maturities. Alternatively, the investor could enter into a single swap with an average 10-year maturity to try to replicate the risk profile but with less accuracy.

However, whilst the individual swaps in the package of swaps could each be below the relevant threshold, the equivalent single swap would have a larger notional and could therefore be above the threshold, as illustrated below. Given the 5-year and 15-year swaps are economically similar in nature, the pricing of one swap is likely to impact the pricing of the other. By not recognising this, ESMA could create an incentive for the market to trade in the equivalent single average instruments, rather than the package of instruments that provide a more accurate hedge: the result would be to provide a less perfect hedge, thereby retaining risk in the system.

The suggested percentage threshold approach provides a way to calibrate this and ensures that package transactions are not disproportionately disadvantaged.

The below table illustrates the example described above.

Table 10: Example of how the percentage threshold approach (Option 2) operates

	More accurate hedge		**Less accurate hedge**
	EUR 5yr swap	**EUR 15yr swap**	**EUR 10yr swap**
Notional	60m	60m	120m
Threshold (SSTI or LIS)	100m	100m	100m
Percentage Threshold	60%	60%	120%

If ESMA would prefer to represent our proposals in a table format, we set out in our responses to Questions 70, 78(1) and 89 tables reflecting the application of Option 1 to various package transaction combinations for pre-trade transparency, post-trade transparency and the trading

obligation. These tables could easily be adapted for Option 2 if this is ESMA's preferred option and we would be happy to prepare these tables if requested.

e) Safeguarding against avoidance

ISDA is aware that ESMA and national competent authorities may be concerned that adoption of our proposal may lead to market participants creating packages of instruments purely for the purposes of avoiding the transparency regime or the derivatives trading obligation. ISDA recognises these concerns and suggests that this could be achieved by defining a package and including, within the MiFID II/MiFIR framework, a mechanism that would support the monitoring (and therefore supervision) of the trading of packages. ISDA would welcome the opportunity to discuss these safeguards with ESMA in more detail.

1. Definition of package transaction

ISDA recommends that a "package transaction" be defined as a transaction comprising two or more components, each of which is a *bond, structured finance product, emission allowance or derivative* where:

(i) The components are priced as a "package" with simultaneous execution of all such components;

(ii) The execution of each component is contingent on the execution of the other components;

(iii) Each component must be able to stand alone and must be able to bear economic risk; and

(iv) Either:

i. the components are economically similar in nature such that the pricing of one component can affect the pricing of the other component; or

ii. the components must have a reasonable degree of correlation.

2. Post-trade transparency flag

With a view to assisting the monitoring of package transactions by supervisors, and as stated in our response to Question 74, ISDA recommends that an additional flag to be reported on trades that are components of package transactions be added to the list of flags set out in Table 2 of Annex II of RTS .

We would also draw attention to our response to Question 218 where we suggest that ESMA may wish to consider including a "link ID" field in transaction reports (for the purposes of the Article 26 MiFIR transaction reporting regime). In ISDA's response to ESMA's recent consultation paper on the review of reporting technical standards under EMIR, we recommended the inclusion of a "link ID" field to link together trade reports of components of the same package. ESMA may wish to consider whether to incorporate such a field in the transaction reports required under the MiFIR transaction reporting regime as this would give supervisors greater visibility in respect of the usage of package transactions.

Q62. Do you agree with the definitions of the interest rate derivatives classes provided in ESMA's proposal (please refer to Annex III of draft RTS 9)? Please provide reasons for your answer.

(i) Amendments to clarify the treatment of exchange-traded interest rate derivatives

A failure to readily and clearly identify the sub-classes into which particular derivatives fall will cause confusion, and make supervision of activity challenging.

ISDA is therefore concerned that ESMA's proposed taxonomy for interest rate derivatives does not clearly distinguish between interest rate derivatives which are exchange-traded derivatives within the meaning of Article 2(1)(32) of MiFIR (i.e. those contracts, including futures and listed options, which generally have highly standardised terms, and are made available for trading on exchanges, and centrally cleared) and what market convention refers to as OTC interest rate derivatives (i.e. those contracts, including swaps and swaptions, whose terms are negotiated and non-standardised, which are sometimes available for central clearing and can be traded on trading venues). For example, it is not clear from RTS 9 that the futures and option classes described in Tables 5 to 12 of Section 4 of Annex III only include exchange-traded interest rate derivatives. The liquidity assessment conducted by ESMA to produce these tables was based solely on data from trading venues and therefore ESMA should clearly indicate that only exchange-traded interest rate derivatives fall within the sub-classes included within these tables.

To reflect this, we would recommend the following amendments to the definitions set out in Sections 3 (Contract type definitions) and 4 (Interest rate derivatives) of Annex III of RTS 9:

- The definition of "Futures" should be amended, as follows:

  "'Futures' means a contract to buy or sell a commodity or financial instrument in a designated future date at a price agreed upon at the initiation of the contract by the buyer and seller~~. Every futures contract~~ and which has standard terms that dictate the minimum quantity and quality that can be bought or sold, the smallest amount by which the price may change, delivery procedures, maturity date and other characteristics related to the contract. "

- A provision should be added after the definition of "Bond futures class not having a liquid market" to clarify that Tables 5 and 6 only apply to interest rate derivatives which are exchange traded derivatives, as follows:

  "Tables 5 and 6 only apply to interest rate derivatives which are exchange-traded derivatives."

- A provision should be added after the definition of "Interest rate futures class not having a liquid market" to clarify that Tables 7 and 8 only apply to interest rate derivatives which are exchange-traded derivatives, as follows:

  "Tables 7 and 8 only apply to interest rate derivatives which are exchange-traded derivatives."

- A provision should be added after the definition of "Bond option class not having a liquid market" to clarify that Tables 9 and 10 only apply to interest rate derivatives which are exchange-traded derivatives, as follows:

  "Tables 9 and 10 only apply to interest rate derivatives which are exchange-traded derivatives."

- Tables 9 and 10 (Bond options) should be relabelled as "Options on Bond Futures" so that it is clear what products are covered by these tables. The current labelling does not sufficiently reflect that these products are exchange-traded derivatives with bond futures underliers (as opposed to cash bond underliers, which would generally be considered as Debt Options).

- A provision should be added after the definition of "Interest rate option class not having a liquid market" to clarify that Tables 11 and 12 only apply to interest rate derivatives which are exchange-traded derivatives, as follows:

  "Tables 11 and 12 only apply to interest rate derivatives which are exchange-traded derivatives."

- Tables 11 and 12 (Interest rate options) should be relabelled as "Options on interest rate futures" so that it is clear what products are covered by these tables. The current labelling does not sufficiently reflect that these products are exchange-traded options with interest rate futures as underliers. The "underlying" column should also be amended so that it is clear that the underlier is a futures contract.

- ESMA should define the term 'time to maturity' in the context of Tables 5 to 12 of Annex III of RTS 9. For futures contracts (Tables 5 to 8) we consider the appropriate definition to be the time period from trade date to expiry of the futures contract (as distinct from the maturity of the underlier). For option contracts (Tables 9 to 12) we consider the appropriate definition to be the time period from trade date to expiry of the option contract (again, as distinct from the expiry of the underlier). We would propose the addition of the following wording in section 4 of Annex III of RTS 9:

  "For the purposes of Tables 5 and 7, 'time to maturity' means the time period from trade date to the expiry of the futures contract. For the purposes of Tables 9 and 11, 'time to maturity' means the time period from trade date to the expiry of the option contract."

(ii) Amendments to ensure the accuracy of the contract types described

We recommend that the following amendments and additions are made to the definitions in Sections 3 (Contract type definitions) and 4 (Interest rate derivatives) of Annex III of RTS 9 to ensure the accuracy of the contract types described:

- The definition of "Swap" should be amended so that the reference to "financial instrument" is removed. It is not necessary for the exchanged cash flows to relate to a financial instrument. For example, a swap could simply involve the exchange of cash flows relating two different interest rates. The definition should be amended as follows:

  "'Swap' means a contract in which two parties agree to exchange cash flows ~~in one financial instrument for another~~ at a certain future date or dates."

- The definition of "Forward agreement" should be amended to adequately distinguish it from a futures contract, as follows:

  "'Forward agreement' means a ~~private agreement~~ contract that is not a futures contract between two parties to buy or sell a commodity or financial instrument at a designated future date at a price agreed upon at the initiation of the contract by the buyer and seller."

- The definition of "Swaption" should be amended to ensure that it captures cash-settled contracts i.e. swaptions which are settled at expiry of the period of optionality based on the market value or rate of underlying swap (without resulting in the two parties to the swaption entering into a swap). The existing definition only refers only to a physically-delivered swaptions. The definition should be amended as follows:

"'Swaption' means a contract that gives the owner the right, but not the obligation, to enter into a swap at or up to a certain future date or exercise date. In some cases the swaption may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise."

- ESMA should define the term 'tenor' in the context of Tables 15 to 31 in Annex III of RTS 9. We consider the appropriate definition to be the time period from trade date to maturity date. Failure to do so will leave unclear the classification of forward starting or backward starting swaps. We would propose the addition of the following wording in Section 4 of Annex III of RTS 9:

  "For the purposes of Tables 15 to 31, 'tenor' means the time period from trade date to maturity date of the contract."

- The definition of 'Interest rate derivatives' should be amended, as follows:

  "'Interest rate derivatives' means any contract as defined in Annex I, Section C(4) of Directive 2014/65/EU whose underlying is an interest rate, a bond, a loan, a swapnote, any basket, portfolio or index including an interest rate, a bond, a loan, a swapnote or any other product representing the performance of an interest rate, a bond, a loan~~,~~ or a swapnote."

- The definition of 'Swaption liquid class' should be amended, as follows:

  " 'Swaption liquid class' means an interest rate swaption contract whose notional amount is denominated in one of the currencies specified in each row of Table 13 Swaptions – liquid classes."

- The definition of 'Swaption class not having a liquid market' should be amended, as follows:

  "'Swaption class not having a liquid market' means an interest rate swaption which is not a swaption liquid class."

- The definition of 'Forward rate agreement (FRA)' should be amended, as follows:

  "'Forward rate agreement (FRA)' means a forward rate agreement contract on an interest rate."

- The definition of 'Multi-currency swaps' or 'cross-currency swaps' should be amended, as follows:

  "'Multi-currency swaps' or 'cross-currency swaps' means a swap where two parties exchange cash flows denominated in different currencies where the cash flows are determined by interest rates."

- The definition of 'Overnight Index Swap (OIS)' should be amended, as follows:

  "'Overnight Index Swap (OIS)' means a swap related to a published index of a daily overnight reference interest rate."

- The definition of 'Single-currency swap' should be amended, as follows:

"'Single-currency swap' means a swap where two parties exchange cash flows denominated in the same currency where the cash flows of at least one leg are determined by interest rates."

- The definition of 'Inflation single-currency swap' should be amended as follows:

  "'Inflation single-currency swap' means a ~~single-currency swap~~ a swap where the two parties exchange cash flows denominated in the same currency where the cash flows of at least one leg are determined by an inflation rate."

- If ESMA agrees with ISDA's proposal in response to Question 61 that swaptions should be classified, more granularly, ESMA will need to define the terms 'option tenor' and 'tenor of underlier'. We propose the following definitions:

  - "'Option tenor' means the time period from trade date to expiry date of the option."

  - "'Tenor of underlier' means the time period from the expiry date of the option until the maturity of the underlier."

(iii) Amendments to ensure the coverage of all types of interest-rate derivatives

It is necessary to include an "all other interest rate derivatives" class to capture interest rate derivatives which do not fall within any of the classes set out in Tables 5 to 31. For example, Tables 5 to 31 do not currently include instruments such as exotic interest rate derivatives, caps, floors and debt options. Exotics, caps and floors are products distinct from options, cross-currency swaps, FRAs, or interest rate swaps. Debt options are products distinct from exchange-traded options on bond futures underliers. Creating (as ESMA has done for equity and commodity derivatives and bonds) an "other" category for interest rate derivatives in RTS 9 will ensure that these classes of derivatives are given a liquidity determination and that appropriate SSTI and LIS thresholds are assigned. Given the heterogeneity of derivatives in this class, we expect it to be considered illiquid.

We also believe that it is necessary to introduce an "all other derivatives category" which would capture any derivatives that either:

- Do not fall within one of the specified asset classes (e.g. are not interest rate, equity, commodity, foreign exchange, credit etc derivatives classes). An example of a derivative that would fall within the first category identified is a derivative with an underlier such as financial indices or financial measures (which are listed in Annex 1, Section C (4) of MiFIDII).

- Have multiple underliers, such that they can fall within multiple classes. Complex derivatives which have multiple underliers should be assigned to the "all other derivatives category" as otherwise it is possible that different trading venues and investment firms may assign them to different asset classes. This could be significant if the different underliers have different liquidity determination or SSTI/LIS thresholds.

(iv) Other amendments

- The LIS and SSTI thresholds in all of the Tables in Section 4 (Interest rate derivatives) of Annex III should be defined in local currency terms rather than Euro (since the need to apply a currency conversion results in an additional layer of complexity, and results in inflexibility as exchange rates move). For multi-currency swaps, the LIS and SSTI thresholds should be defined in USD. For those classes deemed illiquid, the LIS and SSTI thresholds can remain defined in EUR.

- **Equity derivatives**

Q63. With regard to the definition of liquid classes for equity derivatives, which one is your preferred option? Please be specific in relation to each of the asset classes identified and provide a reason for your answer.

ISDA is concerned that ESMA has not been clear that its proposal relates only to exchange-traded equity derivative contracts, and does not apply to bilateral OTC equity derivative contracts. OTC equity derivative contracts could have very different contractual and economic terms (including, amongst others: underlying asset, expiry, strike, pay-off methodology, pricing methodology, lifecycle event scenarios and consequences, adjustment methodologies) to the equivalent exchange-traded equity derivative contracts, are not fungible and therefore have very different degrees of liquidity compared to exchange-traded equity derivative contracts.

ISDA urges ESMA to clarify that, based on its data analysis, its proposed classes of liquid equity derivative contracts only include exchange-traded equity derivative contracts, and not OTC equity derivative contracts.

As ESMA's analysis has only included data on exchange-traded equity derivative contracts, we limit our comments in this response to the appropriate liquid market definition for exchange-traded equity derivative contracts only.

ISDA members disagree with both options proposed by ESMA for the definition of liquid classes. In particular, we believe that ESMA's preference for Option 2 is misguided and could have adverse consequences, such as the paradoxical effect of reducing liquidity in the less liquid equity derivatives contract types. Members also believe that, although Option 1 is preferable, it is still insufficiently granular. Instead, as we propose in response to Question 64, we recommend that:

- ESMA categorise equity derivatives at a significantly greater level of granularity, more akin to that done for interest rate derivatives.

- ESMA distinguish more clearly in RTS 9 between exchange-traded equity derivatives and OTC equity derivatives, in order that there can be no confusion over which class a derivatives contract is in.

Whilst ESMA rightly identifies that trading venues currently offer voluntary pre- and post-trade transparency for all contract types, Option 2 would transform this current voluntary transparency into a mandatory transparency; this is entirely unjustified and unsupported by the data drawn from the trading venues. In our view, Option 2 goes beyond the level 1 requirements for the following reasons: (i) there is no evidence that a finding of "illiquid" for a type of equity derivatives contract would incite trading venues to reduce the current voluntary level of transparency, and (ii) the level 1 text requires ESMA to determine liquidity on the basis of the presence of ready buyers and sellers on a continuous basis and the average frequency and size of the transaction, not on the basis of any pre-existing transparency offered by trading venues. The imposition of mandatory transparency on less-liquid equity derivative contracts would prevent the emergence of alternative trading models which could be more successful in facilitating transactions on such contracts. ESMA should not close this possibility by mandating transparency where such a determination is not supported by the data.

Q64. If you do not agree with ESMA's proposal for the definition of a liquid market, please specify for each of the asset classes identified (stock options, stock futures, index options, index futures, dividend index options, dividend index futures, stock dividend options, stock dividend futures,

options on a basket or portfolio of shares, futures on a basket or portfolio of shares, options on other underlying values (i.e. volatility index or ETFs), futures on other underlying values (i.e. volatility index or ETFs):

(1) your alternative proposal

(2) which qualitative criteria would you use to define the sub-classes

(3) which parameters and related threshold values would you use in order to define a sub-class as liquid.

ISDA's view is that it is essential to distinguish between: (i) exchange-traded equity derivative contracts; and (ii) OTC equity derivative contracts.

(i) Exchange-traded equity derivative contracts

In summary, ISDA's view is that ESMA's determination of liquidity for exchange-traded equity derivatives does not appear justified by the trading venue data.

a) Futures

With regard to Futures, ESMA's own data, as evidenced in Tables 19 and 20, provide indisputable evidence that a finding of "liquid" cannot be supported for Futures on Stocks (0.78% of trades, 0.045% of notional), Basket/Portfolio (0.00% of trades, 0.00% of notional), Dividend Index (0.12% of trades, 0.19% of notional) or Others (0.62% of trades, 0.07% of notional). Only Futures on Stock Index (98.47% of trades, 99.69% of notional) could qualify for a "liquid" determination, however even this determination would need to be subject to more detailed review of individual contracts as within this category the volumes are overwhelmingly concentrated on a small number of indices.

ESMA's own data, as evidenced in Charts 13 to 15, provides indisputable evidence that a finding of "liquid" cannot be supported for any contract with a time to maturity in excess of four months (being the front-month plus roll at expiry).

Accordingly, the data only supports a finding of "liquid" for futures contract on certain stock indices, with a time to maturity of less than or equal to four months, and given the limited number of contracts and the concentration of volumes on a subset of actively-traded indices, a significantly more granular COFIA assessment (akin to interest rate derivatives) is required. In the context of this more granular COFIA assessment, the data-based determination should at a minimum distinguish between: (i) contracts with a time to maturity of less than or equal to four months and other contracts, and (ii) contracts with different underlying stock indices.

b) Options

With regard to Options, ESMA's own data, as evidenced in Tables 19 and 20, provides indisputable evidence that a finding of "liquid" cannot be supported for Options on Basket/Portfolio (0.00% of trades, 0.00% of notional), Dividend Index (0.00% of trades, 0.00% of notional) or Others (1.81% of trades, 0.08% of notional). Only Options on individual Stock (18.89% of trades, 6.06% of notional) and Stock Index (79.29% of trades, 93.85% of notional) could qualify for a "liquid" determination, however even this determination would need to be subject to more detailed review of individual contracts as within this category the volumes are overwhelmingly concentrated on a small number of actively-traded stock and index contracts within a narrow strike range.

ESMA's own data, as evidenced in Chart 12, provides indisputable evidence that a finding of "liquid" cannot be supported for any contract with a time to maturity in excess of four months.

Accordingly, the data only supports a finding of "liquid" for Options contracts on certain stocks and stock indices, with a time to maturity of less than or equal to four months, and given the limited number of contracts and the concentration of volumes on a subset of actively-traded stocks and stock indices, a significantly more granular COFIA assessment is required. In the context of this more granular COFIA assessment, the data-based determination should distinguish between: (i) contracts with a time to maturity of less than or equal to four months and other contracts, (ii) contracts with different underlying stocks and stock indices, and (iii) contracts with different strikes.

c) ISDA's alternative proposal for exchange-traded equity derivatives

ISDA suggests that, based on the evidence of the data, the following COFIA classes need to be deemed non-liquid:

(a) Stock futures.

(b) Futures on a basket or portfolio of shares.

(c) Dividend index futures.

(d) Stock dividend futures.

(e) Futures on other underlying values.

(f) Options on a basket or portfolio of shares.

(g) Dividend index options.

(h) Stock dividend options.

(i) Options on other underlying values.

The following COFIA classes need to be assessed at a significantly greater degree of granularity, akin to ESMA's assessment of exchange-traded interest rate derivatives, to inform a possible determination of liquidity:

(a) Index futures.

(b) Stock options.

(c) Index options.

In the context of this more granular COFIA assessment, the data-based determination should distinguish between contracts with a time to maturity of less than or equal to four months and other contracts and differentiate contracts with different underlying indices.

We anticipate that on this more granular COFIA assessment, the main national indices and the Eurostoxx 50 will be determined to be "liquid", as these contracts are objectively liquid, and that most sector indices will not be determined to be "liquid". We would also note that Stock and Index

Options outside of a 90/110 strike range are less liquid, and ESMA should therefore include this characteristic as part of the liquidity assessment.

(ii) OTC equity derivative contracts

In summary, ISDA is concerned that ESMA's determination of liquidity creates potential ambiguity as to the scope of application.

The data on which ESMA has based its proposed determination is drawn solely from trading venues and concerns only exchange-traded equity derivative contracts. Accordingly, any determination based solely on data applicable to exchange-traded equity derivatives should only apply to exchange-traded equity-derivatives. Exchange-traded equity derivative contracts are very different in nature and scope from equity derivative contracts traded bilaterally. These bilateral OTC contracts are not fungible with or economically equivalent to exchange-traded contracts. Their economic and contractual terms (including, inter alia: underlying asset, expiry, strike, pay-off methodology, pricing methodology, lifecycle event scenarios and consequences, adjustment methodologies) differ widely from the standard contracts listed on trading venues. Also OTC equity derivative contracts of the same type differ between firms as the documentation is not standardised. Firms negotiate different clauses into bespoke confirmations and master agreements depending on many factors including the status of the counterparty. ISDA is taking steps to introduce standardised documentation for OTC equity derivative contracts, however such standardisation will take a long time to implement for a large proportion of contract types and there will be a proportion of contract types where standardisation is not achievable.

ISDA considers that ESMA can only make a valid determination of liquidity for OTC equity derivative contracts (as distinct from exchange-traded equity derivative contracts) if it undertakes the type of analysis, at a comparable level of granularity, to that done for interest rate swaps. We consider that ESMA can do this using the data in EMIR trade repositories, as done for interest rate derivatives, and would welcome the opportunity to assist ESMA with this work given the limited time available. If ESMA is not prepared to undertake such analysis, ISDA cannot support the determination that any OTC equity derivative contracts are liquid, and request that ESMA clarify the RTS to ensure there is no ambiguity that only exchange traded equity derivative contracts are determined to be liquid.

Q65. Do you agree with the definitions of the equity derivatives classes provided in ESMA's proposal (please refer to Annex III of draft RTS 9)? Please provide reasons for your answer.

(i) Amendments to clarify the treatment of exchange-traded equity derivatives

ISDA is concerned that ESMA's proposed taxonomy for equity derivatives does not clearly distinguish between exchange-traded equity derivative contracts (i.e. those contracts which generally have highly standardised terms, and are made available for trading on exchanges, and centrally cleared) and what market convention refers to as OTC equity derivative contracts (i.e. those contracts whose terms are bilaterally negotiated and non-standardised). For example, it is not clear from RTS 9 that the futures and option classes described in Table 32 of Section 4 of Annex III only include exchange-traded equity derivatives. The liquidity assessment conducted by ESMA to produce these tables was based solely on data from trading venues and therefore ESMA should clearly indicate that only exchange-traded equity derivatives fall within the sub-classes indicated to be liquid within this table. Table 32 of Annex III of RTS 9 should be amended to clarify that only exchange-traded equity derivatives have been determined by ESMA to have a liquid market.

The definitions provided in Section 3 of Annex III of RTS 9 are insufficiently clear and contribute to the confusion described above in respect of the sub-classes of equity derivatives listed in Table 32 of Section 3 of Annex III of RTS 9. In particular, we would recommend the following amendments to the definitions set out in Section 3 of Annex III of RTS 9:

- The definition of "Futures" should be amended, as follows:

  'Futures' means a contract to buy or sell a commodity or financial instrument in a designated future date at a price agreed upon at the initiation of the contract by the buyer and seller~~.~~ ~~Every futures contract~~ and which has standard terms that dictate the minimum quantity and quality that can be bought or sold, the smallest amount by which the price may change, delivery procedures, maturity date and other characteristics related to the contract.

- A provision should be added to after the definition of "Equity derivatives not having a liquid market" to clarify that Table 32 only applies to equity derivatives which are exchange traded derivatives, as follows:

  "Table 32 only applies to equity derivatives which are exchange-traded derivatives."

We do not consider that ESMA can determine that any OTC equity derivative contracts are liquid without undertaking analysis at least comparable to that undertaken for interest rate derivatives on the appropriate trade repository data.

(ii) Amendments to ensure the accuracy of the contract types described

- A definition of "volatility index" should be added, as follows:

  "'Volatility index' means an index relating to the volatility of a specific underlying index of equities (such as, STOCC50E)."

(iii) Amendments to ensure the coverage of all types of derivatives

We believe that it is necessary to introduce an "all other derivatives category" which would capture any derivatives that either:

- Do not fall within one of the specified asset classes (e.g. are not interest rate, equity, commodity, foreign exchange, credit etc derivatives classes). An example of a derivative that would fall within this category is a derivative with an underlier such as financial indices or financial measures (which are listed in Annex 1, Section C (4) of MiFID2).

- Have multiple underliers, such that they can fall within multiple classes. Complex derivatives which have multiple underliers should be assigned to the "all other derivatives category" as otherwise it is possible that different trading venues and investment firms may assign them to different asset classes. This could be significant if the different underliers have different liquidity determination or SSTI/LIS thresholds.

(iv) Other amendments

- The LIS and SSTI thresholds in all of the tables in section 4 (equity derivatives) of Annex III of RTS 9 should be defined in local currency terms rather than Euro (since the need to apply a currency conversion results in an additional layer of complexity, and results in inflexibility as exchange rates move).

  - **Commodity derivatives – Metals**

Q66. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer detailed per contract type, underlying type and underlying identified, addressing the following points:

(1) Would you use different qualitative criteria to define the sub-classes? In particular, do you consider the notional currency as a relevant criterion to define sub-classes, or in other words should a sub-class deemed as liquid in one currency be declared liquid for all currencies?

(2) Would you use different parameters or the same parameters (i.e. average number of trades per day and average notional amount traded per day) but different thresholds in order to define a sub-class as liquid?

(3) Would you define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)? Please provide reasons for your answer.

General comments

In relation to the definition of a liquid market, we agree with the concerns raised by AFME about the potential negative impact of an inappropriately calibrated transparency regime.

To assess the liquidity of metal commodity derivatives, we understand that ESMA has analysed data collected from five trading venues. We believe this dataset is too narrow and therefore the assessments do not provide an accurate representation of liquidity in the relevant commodity markets. In our view, in order to present a more accurate reflection of liquidity in the relevant contracts, the analysis must at a minimum include data collected from the major EU trading venues (e.g., ICE Futures Europe) and the major non-EU trading venues (e.g., CME Group). In the absence of disclosure of the details regarding the underlying data sources it has not been possible to test the underlying data. However, we note at a high level that the data presented in the consultation paper is minimal, that the taxonomy presented is not as detailed as for other asset classes and as a result we have very real concerns regarding the accuracy of this data.

We also note that neither the consultation paper nor the proposed taxonomy explains how ESMA proposes to deal with new categories of commodities related contracts that will become financial instruments under the new MIFID II/R definition (for example, physically settled commodities related derivatives that are traded on an OTF that will fall within the new C(6) definition or pursuant to the scope of the C(7) category). In this regard, we are concerned that ESMA does not explain how it proposes to obtain a robust dataset for its liquidity assessment of commodities related contracts traded on an MTF or OTF. In addition to our concerns regarding the underlying dataset for existing financial instruments and obtaining a robust dataset for new categories of financial instruments, we note that liquidity in markets changes over time. Given the importance of commodities derivatives in enabling end-users to hedge exposures to underlying risks, it is vital to ensure that the liquidity assessments are appropriately calibrated and the basis on which such assessments have been made are transparent and tested.

Moreover, we note the current difficulties for market participants to access to OTC data. Although this information is reported by market participants to trade repositories under the existing reporting regimes which apply to commodity derivatives (e.g., EMIR), these details are accessible only to regulators.

In light of the above, we strongly believe that it is necessary for ESMA to conduct a further market assessment of the liquidity of the commodity derivative contracts which utilises an appropriate data

set for assessing whether the relevant derivatives which are 'traded on a trading venue' (e.g. excluding bespoke OTC transactions) are liquid for the purposes of the MiFID 2 transparency regime. Such an assessment should be based on complete data available from the major commodities trading venues (including the major non-EU venues) for trading venue contracts, and the data from trade repositories for the contracts which are currently traded OTC. We note that at the end of February 2015 ESMA published an Addendum to this consultation paper, which also covers additional commodities derivatives. However, we have similar concerns regarding the data underlying that analysis and note that there are certain sub-classes (for example, coal and iron ore) which are not addressed in either consultation paper.

Therefore, we recommend ESMA conducts (i) an in-depth analysis, similar to the one performed for other asset classes and (ii) a further consultation which provides market participants with sufficient time to respond, consider the proposals and to review the relevant data and analysis.

Approach and parameters

We note that ESMA favours a COFIA approach that may be workable for commodities derivatives. However, we do not support ESMA's current determination of the relevant sub-classes. In our view, ESMA's sub-classes should be set at a more granular level and we include our initial suggestions for metals in the illustrative assessment below.

In particular, for metals, we believe that a distinction should be made between base metals and precious metals.

We agree that it is appropriate to use the same parameters and thresholds for each sub-class of metal commodity contracts, however we believe that the proposed parameters and thresholds are inappropriate. In particular:

a) The thresholds of "one trade per day" and "€ 100.000 per day" are too low and do not give a true indication of the liquidity of a market.
b) Expression of thresholds by reference to notional amount in euros is not appropriate because metal commodity contracts are traded in US dollars. Expressing the thresholds in a currency other than the currency in which the relevant contracts are traded could lead to arbitrary and inconsistent results as contracts become liquid or illiquid based solely on movements in the relevant exchange rate.
c) Irrespective of currency, the more appropriate parameter would be open interest and units of commodities. The open-interest metric would reflect all relevant market factors relating to the trading of the relevant contract (e.g, maturity, volatility, number and size of market participants, thereby ensuring flexibility to prevailing market conditions for the relevant commodity).
d) The assessment of the liquidity of all commodity derivatives has to appropriately consider the tenor of the contracts as the liquidity of these instruments varies along the curve and, generally, they become more liquid when closer to the expiry date.

Illustrative assessment

As noted above, we believe that it is imperative that ESMA conducts a full liquidity assessment and makes its liquidity determinations on the basis of a complete set of data from trading venues and trade repositories.

We acknowledge, however, that the assessment will be an extremely complex task and we are therefore keen to assist ESMA in the development of an appropriate framework. Accordingly, we set

out below some principles for a taxonomy, which we believe ESMA may be able to use as a starting point in conducting its assessment, and an illustrative assessment of the liquidity of certain metals commodity derivatives.

The proposed tables are illustrative only and, given the absence of data, demonstrate our efforts to reflect a more appropriate framework for the definition of the liquidity of the main metals commodity derivative contracts. We would therefore stress that the taxonomy and liquidity assessments should not be adopted by ESMA without first conducting a detailed assessment of the liquidity of the commodity derivative contracts. Any assessment must utilise data from trading venues and trade repositories. For ease of reference, the tables include the following information:

- for ETD contracts, our initial analysis includes an indicative liquidity test (including thresholds) that we believe more appropriate than the proposed "one trade per day" and "€ 100.000 per day". The liquidity test is based on the publicly available data from the major trading venues.

- for OTC contracts, due to the difficulties in accessing the data noted above, we have not been able to indicate a more appropriate threshold/liquidity test. However, we have marked the various contacts which may be considered liquid or illiquid on the basis of the information which is available to us.

Tables:

1. Base metals

Table 11: Base metals

Specific Commodity	Tenor	Instrument Type	Liquidity Category	Liquidity test (applicable to ETD contracts only)
Aluminium	≤ 12 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Liquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Liquid	
	12 - 24 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Illiquid	
	> 24 months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	
Copper	≤ 12	LME Forward	Liquid	2,500 trades/day; $ 350 million/week

Table 11: Base metals				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	months	LME Option	Liquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Liquid	
	12 - 24 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Illiquid	
	> 24 months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	
Nickel	≤ 12 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Liquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Liquid	
	12 - 24 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Illiquid	
	> 24 months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	
Zinc	≤ 12 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Liquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Liquid	

Table 11: Base metals				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	12 - 24 months	LME Forward	Liquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Liquid	
		OTC Option	Illiquid	
	> 24 months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	
All other LME metals	≤ 12months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	
	12 - 24 months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	
	> 24 months	LME Forward	Illiquid	2,500 trades/day; $ 350 million/week
		LME Option	Illiquid	2,500 trades/day; $ 350 million/week
		OTC Cash Settled Swap	Illiquid	
		OTC Option	Illiquid	

2. Precious metals

Due to the fact that the precious market is predominantly OTC, there is limited publicly available data on precious metals instruments. Therefore, we have not been able to provide metrics by which liquidity for precious metal instruments can be assessed. However we are able to provide an illustrative assessment of how market participants perceive liquidity in the precious market based on trading knowledge (included in the table below) taking into account as outlined above that (i) the majority of the precious market is physically settled on a bilateral (OTC) basis; and (ii) the list of instruments noted in the table below may not be exhaustive.

We note that ESMA has made an assessment for the liquidity of gold (which in the EU is mainly traded OTC along with silver, platinum and palladium) and we would be grateful if ESMA could

disclose the data underlying these assessments. We would then review this data and provide our views on the quality of the data set including whether the source(s) is/are representative of the precious market, whether additional granularity is required and thereafter propose metrics by which liquidity can be assessed.

We offer our availability to continue the discussion with ESMA on this and all other sub-classes on the basis of the information that will be collected from trade repositories.

Table 12: Precious metals			
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**
Gold	≤ 3 months	OTC Swap	Liquid
		OTC Forward	Liquid
		OTC Option	Liquid
		LME/CME Swap physical	Illiquid
	3 - 12 months	OTC Swap	Liquid
		OTC Forward	Liquid
		OTC Option	Liquid
		LME/CME Swap physical	Illiquid
	12 - 24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	>24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
Silver	≤ 3 months	OTC Swap	Liquid
		OTC Forward	Liquid
		OTC Option	Liquid
		LME/CME Swap physical	Illiquid
	3 - 12 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid

Table 12: Precious metals			
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**
		LME/CME Swap physical	Illiquid
	12 - 24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	> 24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
Platinum	≤ 3 months	OTC Swap	Liquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	3 - 12 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	12 - 24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	>24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
Palladium	≤ 3 months	OTC Swap	Liquid
		OTC Forward	Illiquid
		OTC Option	Illiquid

Table 12: Precious metals			
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**
		LME/CME Swap physical	Illiquid
	3 - 12 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	12 - 24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid
	>24 months	OTC Swap	Illiquid
		OTC Forward	Illiquid
		OTC Option	Illiquid
		LME/CME Swap physical	Illiquid

- **Commodity derivatives – Energy**

Q67. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer detailed per contract type, underlying type and underlying identified, addressing the following points:

(1) Would you use different qualitative criteria to define the sub-classes? In particular, do you consider the notional currency as a relevant criteria to define sub-classes, or in other words should a sub-class deemed as liquid in one currency be declared liquid for all currencies?

(2) Would you use different parameters or the same parameters (i.e. average number of trades per day and average notional amount traded per day) but different thresholds in order to define a sub-class as liquid?

(3) Would you define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)? Please provide reasons for your answer.

General comments

In relation to the definition of a liquid market, we agree with the concerns raised by AFME about the potential negative impact of an inappropriately calibrated transparency regime.

To assess the liquidity of energy commodity derivatives, we understand that ESMA has analysed data collected from seven trading venues. We believe this dataset is too narrow and therefore the

assessments do not provide an accurate representation of liquidity in the relevant commodity markets. In our view, in order to present a more accurate reflection of liquidity in the relevant contracts, the analysis must at a minimum include data collected from the major EU trading venues (e.g., ICE Futures Europe) and the major non-EU trading venues (e.g., CME Group). In the absence of disclosure of the details regarding the underlying data sources it has not been possible to test the underlying data. However, we note at a high level that the data presented in the consultation paper is minimal, that the taxonomy presented is not as detailed as for other asset classes and, as a result, we have very real concerns regarding the accuracy of this data. For example, the liquidity assessment for oil related derivatives appears to imply that oil related derivatives traded in the EU are either confined to, or represented by, those traded in Romanian Leu, which is clearly not the case.

We also note that neither the consultation paper nor the proposed taxonomy explains how ESMA proposes to deal with new categories of commodities related contracts that will become financial instruments under the new MIFID II/R definition (for example, physically settled commodities related derivatives that are traded on an OTF that will fall within the new C(6) definition or pursuant to the scope of the C(7) category). In this regard, we are concerned that ESMA does not explain how it proposes to obtain a robust dataset for its liquidity assessment of commodities related contracts traded on an MTF or OTF. In addition to our concerns regarding the underlying dataset for existing financial instruments and obtaining a robust dataset for new categories of financial instruments, we note that liquidity in markets changes over time. Given the importance of commodities derivatives in enabling end-users to hedge exposures to underlying risks, it is vital to ensure that the liquidity assessments are appropriately calibrated and the basis on which such assessments have been made are transparent and tested.

Moreover, we note the current difficulties for market participants to access to OTC data. Although this information is reported by market participants to trade repositories under the existing reporting regimes which apply to commodity derivatives (e.g., EMIR), these details are accessible only to regulators.

In light of the above, we strongly believe that it is necessary for ESMA to conduct a further market assessment of the liquidity of the commodity derivative contracts which utilises an appropriate data set for assessing whether the relevant derivatives which are 'traded on a trading venue' (e.g., excluding bespoke OTC transactions) are liquid for the purposes of the MiFID2 transparency regime. Such an assessment should be based on complete data available from the major commodities trading venues (including the major non-EU venues) for trading venue contracts, and the data from trade repositories for the contracts which are currently traded OTC. We note that at the end of February 2015 ESMA published an Addendum to this consultation paper, which also covers additional commodities derivatives. However, we have similar concerns regarding the data underlying that analysis and note that there are certain sub-classes (for example, coal and iron ore) which are not addressed in either consultation paper.

Therefore, we recommend ESMA conducts (i) an in-depth analysis, similar to the one performed for other asset classes and (ii) a further consultation which provides market participants with sufficient time to respond, consider the proposals and to review the relevant data and analysis.

Approach and parameters

We note that ESMA favours a COFIA approach that may be workable for commodities derivatives. However, we do not support ESMA's current determination of the relevant sub-classes. In our view,

ESMA's sub-classes should be set at a more granular level and we include our initial suggestions for energy in the illustrative assessment below.

We agree that it is appropriate to use the same parameters and thresholds for each sub-class of energy commodity derivative contracts, however we believe that the proposed parameters and thresholds are inappropriate. In particular:

a) The thresholds of "one trade per day" and "€ 100,000 per day" are too low and do not give a true indication of the liquidity of a market.
b) Expression of thresholds by reference to notional amount in euros is not appropriate because a large number of energy commodity contracts are traded in currencies other than euros (USD, GBP). Expressing the thresholds in a currency other than the currency in which the relevant contracts are traded could lead to arbitrary and inconsistent results as contracts become liquid or illiquid based solely on movements in the relevant exchange rate.
c) Irrespective of currency, the more appropriate parameter would be open interest and units of commodities. The open-interest metric would reflect all relevant market factors relating to the trading of the relevant contract (e.g., maturity, volatility, number and size of market participants, thereby ensuring flexibility to prevailing market conditions for the relevant commodity).
d) The assessment of the liquidity of all commodity derivatives has to appropriately consider the tenor of the contracts as the liquidity of these instruments varies along the curve and, generally, they become more liquid when closer to the expiry date.

Illustrative assessment

As noted above, we believe that it is imperative that ESMA conducts a full liquidity assessment and makes its liquidity determinations on the basis of a complete set of data from trading venues and trade repositories.

We acknowledge, however, that the assessment will be an extremely complex task and we are therefore keen to assist ESMA in the development of an appropriate framework. Accordingly, we set out below some principles for a taxonomy, which we believe ESMA may be able to use as a starting point in conducting its assessment, and an illustrative assessment of the liquidity of certain energy commodity derivatives.

The proposed tables are illustrative only and, given the absence of data, demonstrate our efforts to reflect a more appropriate framework for the definition of the liquidity of the main energy commodity derivatives contracts. We would therefore stress that the taxonomy and liquidity assessments should not be adopted by ESMA without first conducting a detailed assessment of the liquidity of the commodity derivative contracts. Any assessment must utilise data from trading venues and trade repositories. For ease of reference, the tables include the following information:

- for ETD contracts, our initial analysis includes an indicative liquidity test (including thresholds) that we believe more appropriate than the proposed "one trade per day" and "€ 100,000 per day". The liquidity test is based on the publicly available data from the major trading venues.

- for OTC contracts, due to the difficulties in accessing the data noted above, we have not been able to indicate a more appropriate threshold/liquidity test. However, we have marked the various contacts which may be considered liquid or illiquid on the basis of the information which is available to us.

Tables:

1. Oil and Oil Products

i. Crude Oil

Table 13: Crude Oil				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Crude Oil	≤ 6 months	ICE Brent Future	Liquid	4,000 trades/day; $ 6 billion/week
		ICE Brent Option	Liquid	4,000 trades/day; $ 6 billion/week
		ICE WTI Future	Illiquid	4,000 trades/day; $ 6 billion/week
		ICE WTI Option	Illiquid	4,000 trades/day; $ 6 billion/week
		OTC Vanilla Swap	Illiquid	N/A
		OTC Vanilla Option	Illiquid	N/A
	>6 months	ICE Brent Future	Illiquid	4,000 trades/day; $ 6 billion/week
		ICE Brent Option	Illiquid	4,000 trades/day; $ 6 billion/week
		ICE WTI Future	Illiquid	4,000 trades/day; $ 6 billion /week
		ICE WTI Option	Illiquid	4,000 trades/day; $ 6 billion /week
		OTC Vanilla Swap	Illiquid	N/A
		OTC Vanilla Option	Illiquid	N/A

ii. Distillates

Table 14: Distillates				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Distillates	≤ 4 months	ICE Gas Oil Futures	Liquid	1,000 trades/day; $ 1.5 billion/week
		ICE Gas Oil Options	Illiquid	1,000 trades/day; $ 1.5 billion/week
		ICE Heating Oil Future	Illiquid	1,000 trades/day; $ 1.5 billion/week
		ICE Heating Oil Option	Illiquid	1,000 trades/day; $ 1.5 billion/week
		OTC Vanilla Swap	Illiquid	N/A
		OTC Vanilla Option	Illiquid	N/A
	> 4 months	ICE Gas Oil Futures	Illiquid	1,000 trades/day; $ 1.5 billion/week
		ICE Gas Oil Options	Illiquid	1,000 trades/day; $ 1.5 billion/week
		ICE Heating Oil Future	Illiquid	1,000 trades/day; $ 1.5 billion/week
		ICE Heating Oil Option	Illiquid	1,000 trades/day; $ 1.5 billion/week
		OTC Vanilla Swap	Illiquid	N/A
		OTC Vanilla Option	Illiquid	N/A

iii. Light ends

Table 15: Light ends				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Light ends	≤ 4 months	ICE NYH RBOB Future	Liquid	500 trades/day; $ 7.5 million/week
		ICE NYH RBOB Option	Illiquid	500 trades/day; $ 7.5 million/week
		OTC Vanilla Swap	Illiquid	N/A
		OTC Vanilla Option	Illiquid	N/A
	>4 months	ICE NYH RBOB Future	Illiquid	500 trades/day; $ 7.5 million/week
		ICE NYH RBOB Option	Illiquid	500 trades/day; $ 7.5 million/week
		OTC Vanilla Swap	Illiquid	N/A
		OTC Vanilla Option	Illiquid	N/A

2. Natural Gas

We note the difficulties in obtaining data for natural gas. It would be helpful if ESMA could provide more complete data, together with the information underlying its assessment on this product.

We would then review the data and provide our views on those including whether the source(s) is/are representative of this market and propose metrics by which liquidity can be assessed.

For the purpose of an initial discussion we set out below the results of our analysis of our datasets.

Table 16: Natural gas				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Natural Gas - UK	< 12 Months	Exchange Future	Liquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Liquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24	Exchange Future	Illiquid	50 trades/day; € 250 million/week

Table 16: Natural gas				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	Months	OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Natural Gas - Dutch	< 12 Months	Exchange Future	Liquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Liquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Natural Gas - German	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A

Table 16: Natural gas				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Natural Gas - French	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Natural Gas - Other	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial	Illiquid	N/A

Table 16: Natural gas				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		Instrument)		
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	50 trades/day; € 250 million/week

3. Electricity

We note the difficulties in obtaining data for electricity. It would be helpful if ESMA could provide more complete data, together with the information underlying its assessment on this product.

We would then review the data and provide our views on those including whether the source(s) is/are representative of this market and propose metrics by which liquidity can be assessed.

For the purpose of an initial discussion we set out below the results of our analysis of our datasets.

Table 17: Electricity				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Electricity - Nordic	< 12 Months	Exchange Future	Liquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24	Exchange Future	Illiquid	50 trades/day; € 250 million/week

Table 17: Electricity				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	Months	OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Electricity - German	<12 Months	Exchange Future	Liquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Electricity - UK	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A

Table 17: Electricity				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Electricity - France	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Electricity - Italian	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial	Illiquid	N/A

Table 17: Electricity				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		Instrument)		
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Electricity - Spanish	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
Electricity - Other	< 12 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A

Table 17: Electricity				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	12-24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A
	>24 Months	Exchange Future	Illiquid	50 trades/day; € 250 million/week
		OTC Physical Forward (If MIFID 2 Financial Instrument)	Illiquid	N/A
		OTC Swap	Illiquid	N/A
		Option (Exchange or OTC)	Illiquid	N/A

- **Commodity derivatives – Agriculture**

Q68. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer detailed per contract type and underlying (identified addressing the following points:

(1) Would you use different qualitative criteria to define the sub-classes?

(2) Would you use different parameters or the same parameters (i.e. average number of trades per day and average notional amount traded per day) but different thresholds in order to define a sub-class as liquid?

(3) Would you define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)? Please provide reasons for your answer.

General comments

In relation to the definition of a liquid market, we agree with the concerns raised by AFME about the potential negative impact of an inappropriately calibrated transparency regime.

To assess the liquidity of agricultural commodity derivatives, we understand that ESMA has analysed data collected from seven trading venues. We believe this dataset is too narrow and therefore the assessments do not provide an accurate representation of liquidity in the relevant commodity markets. In our view, in order to present a more accurate reflection of liquidity in the relevant contracts, the analysis must at a minimum include data collected from the major EU trading venues (e.g., ICE Futures Europe) and the major non-EU trading venues (e.g., CME Group). In the absence of disclosure of the details regarding the underlying data sources it has not been possible to test the underlying data. However, we note at a high level that the data presented in the consultation paper is minimal, that the taxonomy presented is not as detailed as for other asset classes and as a result we have very real concerns regarding the accuracy of this data.

We also note that neither the consultation paper nor the proposed taxonomy explains how ESMA proposes to deal with new categories of commodities related contracts that will become financial instruments under the new MIFID II/R definition (for example, physically settled commodities related derivatives that are traded on an OTF that will fall within the new C(6) definition or pursuant to the scope of C(7) category). In this regard, we are concerned that ESMA does not explain how it proposes to obtain a robust dataset for its liquidity assessment of commodities related contracts traded on an MTF or OTF. In addition to our concerns regarding the underlying dataset for existing financial instruments and obtaining a robust dataset for new categories of financial instruments, we note that liquidity in markets changes over time. Given the importance of commodities derivatives in enabling end-users to hedge exposures to underlying risks, it is vital to ensure that the liquidity assessments are appropriately calibrated and the basis on which such assessments have been made are transparent and tested.

Moreover, we note the current difficulties for market participants to access to OTC data. Although this information is reported by market participants to trade repositories under the existing reporting regimes which apply to commodity derivatives (e.g., EMIR), these details are accessible only to regulators.

In light of the above, we strongly believe that it is necessary for ESMA to conduct a further market assessment of the liquidity of the commodity derivative contracts which utilises an appropriate data set for assessing whether the relevant derivatives which are 'traded on a trading venue' (e.g., excluding bespoke OTC transactions) are liquid for the purposes of the MiFID2 transparency regime. Such an assessment should be based on complete data available from the major commodities trading venues (including the major non-EU venues) for trading venue contracts, and the data from trade repositories for the contracts which are currently traded OTC. We note that at the end of February 2015 ESMA has published an Addendum to this consultation paper, which also covers additional commodities derivatives. However, we have similar concerns regarding the data underlying that analysis and note that there are certain sub-classes (for example, coal and iron ore) which are not addressed in either consultation paper.

Therefore, we recommend ESMA conducts (i) an in-depth analysis, similar to the one performed for other asset classes and (ii) a further consultation which provides market participants with sufficient time to respond, consider the proposals and to review the relevant data and analysis.

Approach and parameters

We note that ESMA favours a COFIA approach that may be workable for commodities derivatives. However, we do not support ESMA's current determination of the relevant sub-classes. In our view, ESMA's sub-classes should be set at a more granular level and we include our initial suggestions for agricultural in the illustrative assessment below.

We agree that it is appropriate to use the same parameters and thresholds for each sub-class of agricultural commodity derivatives contracts, however we believe that the proposed parameters and thresholds are inappropriate. In particular:

a) The thresholds of "ten trades per day" and "€ 500,000 per day" are too low and do not give a true indication of the liquidity of a market.
b) Expression of thresholds by reference to notional amount in euros is not appropriate because many agricultural commodity contracts are traded in US dollars. Expressing the thresholds in a currency other than the currency in which the relevant contracts are traded

could lead to arbitrary and inconsistent results as contracts become liquid or illiquid based solely on movements in the relevant exchange rate.

c) Irrespective of currency, the more appropriate parameter would be open interest and units of commodities. The open-interest metric would reflect all relevant market factors relating to the trading of the relevant contract (e.g., maturity, volatility, number and size of market participants, thereby ensuring flexibility to prevailing market conditions for the relevant commodity).

d) The assessment of the liquidity of all commodity derivatives has to appropriately consider the tenor of the contracts as the liquidity of these instruments varies along the curve and, generally, they become more liquid when closer to the expiry date.

Illustrative assessment

As noted above, we believe that it is imperative that ESMA conducts a full liquidity assessment and makes its liquidity determinations on the basis of a complete set of data from trading venues and trade repositories.

We acknowledge, however, that the assessment will be an extremely complex task and we are therefore keen to assist ESMA in the development of an appropriate framework. Accordingly, we set out below some principles for a taxonomy, which we believe ESMA may be able to use as a starting point in conducting its assessment, and an illustrative assessment of the liquidity of certain agricultural commodity derivatives.

The proposed tables are illustrative only and, given the absence of data, demonstrate our efforts to reflect a more appropriate framework for the definition of the liquidity of the main agricultural commodity derivatives contracts. We would therefore stress that the taxonomy and liquidity assessments should not be adopted by ESMA without first conducting a detailed assessment of the liquidity of the commodity derivative contracts. Any assessment must utilise data from trading venues and trade repositories. For ease of reference, the tables include the following information:

- for ETD contracts, our initial analysis includes an indicative liquidity test (including thresholds) that we believe more appropriate than the proposed "ten trades per day" and "€ 500,000 per day". The liquidity test is based on the publicly available data from the major trading venues.

- for OTC contracts, due to the difficulties in accessing the data noted above, we have not been able to indicate a more appropriate threshold/liquidity test. However, we have marked the various contacts which may be considered liquid or illiquid on the basis of the information which is available to us.

Tables:

1. Corn

Table 18: Corn				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Chicago Corn	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week

Table 18: Corn				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A

Table 19: Maize				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Matif Maize	<3 Months	Futures	Illiquid	3,000 trades/week; € 500 million/week
		ETD Options	Illiquid	3,000 trades/week; € 500 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	3-6 Months	Futures	Illiquid	3,000 trades/week; € 500 million/week
		ETD Options	Illiquid	3,000 trades/week; € 500 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/ week; € 500 million/week
		ETD Options	Illiquid	3,000 trades/ week; € 500 million/week

Table 19: Maize				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/ week; € 500 million/week
		ETD Options	Illiquid	3,000 trades/ week; € 500 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A

2. Wheat

Table 20: Wheat				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Chicago Wheat	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Kansas Wheat	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week

Table 20: Wheat				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		Swap	Liquid	N/A
		Vanilla Options	Illiquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Minneapolis Wheat	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	3-6 Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A

Table 20: Wheat				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Milling Wheat	<3 Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A

3. Soft

Table 21: Soft				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
NY Raw Sugar	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A

Table 21: Soft				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-12Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Ldn White Sugar	<3 Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	3-6 Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week

Table 21: Soft				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Coffee (Family)	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Cocoa (Family)	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-	Futures	Liquid	3,000 trades/week; $750 million/week

Table 21: Soft				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
	12Months	ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A

4. Oil Seeds

Table 22: Oils Seeds				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Soybeans	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-12Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	>12Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A

Table 22: Oils Seeds				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
Soymeal	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	6-12Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
Soybean Oil	<3 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Liquid	3,000 trades/week; $750 million/week
		OTC Swap	Liquid	N/A
		OTC Vanilla Options	Liquid	N/A
	3-6 Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A
	6-12Months	Futures	Liquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A

Table 22: Oils Seeds				
Specific Commodity	**Tenor**	**Instrument Type**	**Liquidity Category**	**Liquidity test (applicable to ETD contracts only)**
		OTC Vanilla Options	Illiquid	N/A
	>12Months	Futures	Illiquid	3,000 trades/week; $750 million/week
		ETD Options	Illiquid	3,000 trades/week; $750 million/week
		OTC Swap	Illiquid	N/A
		OTC Vanilla Options	Illiquid	N/A

- **Emission allowances**

Q69. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer per asset class identified (EUA, CER, EUAA, ERU) addressing the following points:

(1) Would you use additional qualitative criteria to define the sub-classes?

(2) Would you use different parameters or the same parameters (i.e. average number of trades per day and average number of tons of carbon dioxide traded per day) but different thresholds in order to define a sub-class as liquid?

(3) Would you qualify as liquid certain sub-classes qualified as illiquid (or vice versa)? Please provide reasons for your answer.

General comments

In relation to the definition of a liquid market, we agree with the concerns raised by AFME about the potential negative impact of an inappropriately calibrated transparency regime.

To assess the liquidity of emission allowances commodity contracts, we understand that ESMA has analysed data collected from three trading venues. We believe this dataset is too narrow and therefore the assessments do not provide an accurate representation of liquidity in the relevant commodity markets. In our view, in order to present a more accurate reflection of liquidity in the relevant contracts, the analysis must at a minimum include data collected from the major EU trading venues (e.g., ICE Futures Europe) and the major non-EU trading venues (e.g., CME Group). In the absence of disclosure of the details regarding the underlying data sources it has not been possible to test the underlying data. However, we note at a high level that the data presented in the consultation paper is minimal, that the taxonomy presented is not as detailed as for other products and as a result we have very real concerns regarding the accuracy of this data.

We also note that neither the consultation paper nor the proposed taxonomy explains how ESMA proposes to deal with new categories of commodities related contracts that will become financial instruments under the new MIFID II/R definition (for example, physically settled commodities related derivatives that are traded on an OTF that will fall within the new C(6) definition or pursuant to the scope of the C(7) category). In this regard, we are concerned that ESMA does not explain how it proposes to obtain a robust dataset for its liquidity assessment of commodities related contracts traded on an MTF or OTF. In addition to our concerns regarding the underlying dataset for existing

financial instruments and obtaining a robust dataset for new categories of financial instruments, we note that liquidity in markets changes over time. Given the importance of commodities derivatives in enabling end-users to hedge exposures to underlying risks, it is vital to ensure that the liquidity assessments are appropriately calibrated and the basis on which such assessments have been made are transparent and tested.

Moreover, we note the current difficulties for market participants to access to OTC data. Although this information is reported by market participants to trade repositories under the existing reporting regimes which apply to commodity derivatives (e.g., EMIR), these details are accessible only to regulators.

In light of the above, we strongly believe that it is necessary for ESMA to conduct a further market assessment of the liquidity of the commodity derivative contracts which utilises an appropriate data set for assessing whether the relevant derivatives which are 'traded on a trading venue' (e.g., excluding bespoke OTC transactions) are liquid for the purposes of the MiFID2 transparency regime. Such an assessment should be based on complete data available from the major commodities trading venues (including the major non-EU venues), for trading venue contracts, and the data from trade repositories for the contracts which are currently traded OTC. We note that at the end of February 2015 ESMA published an Addendum to this consultation paper, which also covers additional commodities derivatives. However, we have similar concerns regarding the data underlying that analysis and note that there are certain products (for example, coal and iron ore) which are not addressed in either consultation paper.

Therefore, we recommend ESMA conducts (i) an in-depth analysis, similar to the one performed for other asset classes and (ii) a further consultation which provides market participants with sufficient time to respond to and consider the proposals and to review the relevant data and analysis.

Approach and parameters

We note that ESMA favours a COFIA approach that may be workable for commodities derivatives. However, we do not support the ESMA's current determination of the relevant sub-classes. In our view, ESMA's sub-classes should be set at a more granular level.

In terms of the appropriate parameters, whilst we agree that it is appropriate to use the same parameters and thresholds for each sub-class of emission allowances, we believe that the proposed parameters are inappropriate. In particular the threshold of "five trades per day" and "150,000 tons of carbon dioxide per day" is too low and does not give a true indication of the liquidity of a market.

The assessment of the liquidity of all commodity derivatives has to appropriately consider the tenor of the contracts as the liquidity of these instruments varies along the curve and, generally, they become more liquid when closer to the expiry date.

Illustrative assessment

Due to the very limited availability of publicly available data on Emission Allowances (which are financial instruments), we have not been able to provide an illustrative assessment for this category. However, we offer our availability to continue the discussion also on this sub-class with ESMA on the basis of the information that will be collected from trade repositories.

3.6 Pre-trade transparency requirements for non-equity instruments

- **Trading models**

Q70. Do you agree with ESMA's proposal with regard to the content of pre-trade transparency? Please provide reasons for your answer.

No, ISDA does not agree with ESMA's proposal. ISDA believes that:

- Package transactions need to be specifically addressed in the RTS (more detail under (i) below).
- The definition of a request for quote (RFQ) trading systems requires amendment (more detail under (ii) below).

(i) Package transactions

a) Overview

ISDA would like to propose that ESMA considers specific and tailored treatment for package transactions as the Consultation Paper does not address how these transactions might be treated under the new framework. In response to the May 2014 Discussion Paper, ISDA included a number of detailed comments on the nature of package transactions which we draw ESMA's attention to. We reiterate the points made in that response and put forward a proposal which we hope ESMA will find workable and flexible enough to apply for venue and SI transparency obligations and the derivatives trading obligation. This will preserve the market for package transactions and ensure that pricing and liquidity is not negatively impacted for end investors.

We believe that Level 1 is flexible enough to empower ESMA to specify how package transactions are treated in order to determine if such transactions are liquid or "traded on a trading venue" (both for determining whether transparency obligations apply as well as determining whether the derivatives trading obligation applies). The Level 1 text clearly sets the foundation for the pre- and post-trade transparency regimes in non-equities by defining the asset classes – "bonds, structured finance products, emission allowances and derivatives" – on which the Level 2 measures must be built. However, ESMA has flexibility to define how, within these broad asset classes, to identify whether specific financial instruments (or combinations thereof) are to be considered "liquid" or "traded on a trading venue". ESMA has chosen to adopt COFIA as the basis for determining whether a liquid market exists – which suggests to us that ESMA is also empowered to tailor this approach to instruments which fall within one of the specified classes, but are part of a package transaction.

b) Advantages of package transactions to clients

Package transactions allow clients to reduce their transaction costs (i.e. a single transaction is less expensive to execute than multiple transactions) and manage their execution risk (i.e. a single execution alleviates timing and other mechanical/process type risks). They are tailored to provide risk-return characteristics in the form of a single transaction in an efficient and cost-effective manner to clients.

c) Challenges to trading package transactions without a tailored proposal

Below are some very realistic fact patterns which hopefully demonstrate that unless there is tailored treatment for package transactions which recognises that package transactions should be considered in their entirety when being assessed as subject to transparency requirements and/or the derivatives trading obligation, there is a significant risk that such transactions may no longer be

available to clients in the EU. This will be due to the individual components being treated differently and inconsistently vs. each other when they are assessed against the relevant requirements which would negate the advantages highlighted above of trading package transactions. These challenges are likely to be particularly acute where one or more of the components of a package transaction includes derivatives subject to the trading obligation:

- If some components of a package transaction are traded on a trading venue but others are not.
- If some components of a package transaction are deemed liquid but others are not.
- If some components of a package transaction are above the relevant LIS or SSTI thresholds but others are not.
- If the components of a package transaction are below the relevant LIS or SSTI thresholds but together they behave similarly to a single transaction above the LIS or SSTI.
- If the package transaction contains a listed derivative which trades on a different trading venue to other components.

If ESMA fails to provide for the appropriate trading of packages, end investors will be required to trade the components independently, resulting in increased transaction costs and increased execution risks, which would seem to conflict with ESMA's policy objectives.

d) ISDA proposal

We would be keen to assist ESMA with the development of a workable regime for package transactions. We consider that the following proposals could both address the challenges we have described above. We have provided both proposals for ESMA's consideration as we recognise that, whilst Option 1 is a simpler proposal, Option 2 is more accurate.

Option 1:

1. Subject to point 3 below, if each component of a package transaction is liquid:

    a. The package transaction should be considered liquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

    a. The package transaction should be considered illiquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

If ESMA, for pre-trade transparency purposes, would prefer to represent this in a table format, we propose the following table which reflects the above:

Table 23: ISDA Proposal for the calibration of Package Transactions for liquidity, Large in Scale, and Size Specific to the Instrument thresholds.								
Type	**Package type comprising:**	**Example**	**1. All components above LIS**	**2. All components above SSTI**	**3. At least one component above LIS**	**4. At least one component above SSTI**	**5. All components below LIS**	**6. All components below SSTI**
A	Exclusively liquid derivatives in one derivative asset class[1]	2yr vs 10yr EUR swap	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
B	Exclusively liquid securities	2yr vs 10yr Bund switch	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
C	Liquid security(ies) and derivative(s) where the derivatives are from a single asset class[1]	Asset swap vs. cash bund	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
D	Liquid & illiquid security(ies) and derivative(s) where the derivatives are from a single asset class[1]	10yr EUR swap vs. 10yr inflation swap	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid
E	Liquid derivative(s) & any liquid exchange traded derivative(s) in the same derivative asset class [1]	EFP transaction of swap vs. future	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is below LIS and liquid[2]	Package is below SSTI and liquid[2]
F	Liquid security(ies) & any liquid exchange traded derivative(s) in the same derivative asset class [1]	Cash bund vs. Bund future basis trade	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is below LIS and liquid[2]	Package is below SSTI and liquid[2]
G	Exclusively illiquid security(ies) or derivative(s)	10yr EUR inflation vs. 30yr GBP inflation	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and Not liquid	Package is above SSTI and Not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid
H	10 or more components	Package of several swaps bundled for execution (e.g. 10yr EUR swap, 15yr EUR swap, 20yr EUR swap, 25yr EUR swap, and 30 yr EUR swap)	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid

[1] Interest Rate Derivatives, FX Derivatives, Commodity Derivatives, Equity Derivatives etc considered as distinct derivative asset classes.

[2] Assuming that ESMA agrees that, for the purposes of MiFIR articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order that the package be considered "traded on a venue". Otherwise, ESMA should deem packages including exchange traded derivatives to be not liquid. ISDA recommends that packages involving exchange traded derivatives should be executed using the wholesale trading facilities currently governed by venues' rulebooks

Option 2:

1. Subject to point 3 below, if each component of a package transaction is liquid:

   a. The package transaction should be considered liquid; and

   b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

   a. The package transaction should be considered illiquid; and

   b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

The percentage threshold approach aims to, in a simple manner, replicate the package of instruments into a single instrument to test whether it would indeed be above the threshold (SSTI or LIS purposes) or not if it were traded as a single instrument.

Example: if an investor wishes to hedge cash flows at 5-year and 15-year points using EUR interest rate swaps, to create an accurate hedge the investor would trade a package of two EUR swaps at 5-year and 15-year maturities. Alternatively, the investor could enter into a single swap with an average 10-year maturity to try to replicate the risk profile but with less accuracy.

However, whilst the individual swaps in the package of swaps could each be below the relevant threshold, the equivalent single swap would have a larger notional and could therefore be above the threshold, as illustrated below. Given the 5-year and 15-year swaps are economically similar in nature,the pricing of one swap is likely to impact the pricing of the other. By not recognising this, ESMA could create an incentive for the market to trade in the equivalent single average instruments, rather than the package of instruments that provide a more accurate hedge: the result would be to provide a less perfect hedge, thereby retaining risk in the system.

The suggested percentage threshold approach provides a way to calibrate this and ensures that package transactions are not disproportionately disadvantaged.

The below table illustrates the example described above.

Table 24: Example of how the percentage threshold approach (Option 2) operates			
	More accurate hedge		Less accurate hedge
	EUR 5yr swap	EUR 15yr swap	EUR 10yr swap
Notional	60m	60m	120m
Threshold (SSTI or LIS)	100m	100m	100m
Percentage Threshold	60%	60%	120%

Table 23, prepared for Option 1, could easily be adapted for Option 2 if this is ESMA's preferred option and we would be happy to prepare this table if requested.

e) Safeguarding against avoidance

ISDA is aware that ESMA and national competent authorities may be concerned that adoption of our proposal may lead to market participants creating packages of instruments purely for the purposes of avoiding the transparency regime or the derivatives trading obligation. ISDA recognises these concerns and suggests that this could be achieved by defining a package and including, within the MiFID II/MiFIR framework, a mechanism that would support the monitoring (and therefore supervision) of the trading of packages. ISDA would welcome the opportunity to discuss these safeguards with ESMA in more detail.

1. Definition of package transaction

ISDA recommends that a "package transaction" be defined as a transaction comprising two or more components, each of which is a *bond, structured finance product, emission allowance or derivative* where:

(i) The components are priced as a "package" with simultaneous execution of all such components;

(ii) The execution of each component is contingent on the execution of the other components;

(iii) Each component must be able to stand alone and must be able to bear economic risk; and

(iv) Either:

i. the components are economically similar in nature such that the pricing of one component can affect the pricing of the other component; or

ii. the components must have a reasonable degree of correlation.

2. Post-trade transparency flag

With a view to assisting the monitoring of package transactions by supervisors, and as stated in our response to Question 74, ISDA recommends that an additional flag to be reported on trades that are

components of package transactions be added to the list of flags set out in Table 2 of Annex II of RTS 9.

We would also draw attention to our response to Question 218 where we suggest that ESMA may wish to consider including a "link ID" field in transaction reports (for the purposes of the Article 26 MiFIR transaction reporting regime). In ISDA's response to ESMA's recent consultation paper on the review of reporting technical standards under EMIR, we recommended the inclusion of a "link ID" field to link together trade reports of components of the same package. ESMA may wish to consider whether to incorporate such a field in the transaction reports required under the MiFIR transaction reporting regime as this would give supervisors greater visibility in respect of the usage of package transactions.

(ii) Request for quote (RFQ) trading models

ESMA's proposed definition of the RFQ trading model includes the word "published" rather than "provided" (which was contained in the definition proposed in the May 2014 Discussion Paper). ISDA has the following concerns with this amendment:

- The definition of RFQ system should describe the trading system and not prescribe what should be published. Because there is no requirement for a venue operating an RFQ system to publish quotes on trades in illiquid instruments or trades above SSTI, the inclusion of the word published is inaccurate and could have the consequence of requiring all quotes to be made public despite the clear provisions of the MiFIR text. Furthermore, none of the other trading systems listed in Table 1 of Annex I of RTS 9 include the word published despite also having pre-trade transparency requirements in certain circumstances.
- This will create disincentives for liquidity providers to quote their best price in a timely manner and will exacerbate the "winner's curse" and cause execution slippage and frustration for investors seeking to transact. As outlined in Tradeweb's white paper on the subject, liquidity providers lose the incentive to return with their best price in the shortest possible time frame (i.e. disincentive to quote). Additionally, with information on the RFQ being made available to those who are not party to the RFQ, there is a significant risk that the market may move (in an adverse direction) before the trade is executed (i.e. "winner's curse"). To manage this risk, liquidity providers would be forced to widen their prices which would not be in the best interests of the market. The current functioning of an RFQ system, where the fact of the request and respondent quotes are private to the requestor incentivises market makers to quote quickly and aggressively in order to win business.

Whilst ISDA welcomes the amendment to specify that the quote is executable exclusively by the requesting member or market participant, ISDA recommends that ESMA's proposed definition of RFQ system be amended to read as follows:

> "a trading system where a quote or quotes are ~~published~~ provided in response to a request for a quote submitted by one or more other members or participants. The quote is executable exclusively by the requesting member or market participant. The requesting member or participant may conclude a transaction by accepting the quote or quotes provided to it on request."

- **Waivers for non-equity instruments**

Q71. Do you agree with ESMA's proposal with regard to the order management facilities waiver? Please provide reasons for your answer.

Yes, ISDA supports ESMA's proposal with regard to the order management facilities waiver.

Q72. ESMA seeks further input on how to frame the obligation to make indicative prices public for the purpose of the Technical Standards. Which methodology do you prefer? Do you have other proposals?

ISDA agrees with ESMA that market operators should determine what methodology to use for calculating the indicative price which is close to the price of the trading interest and that a clear and comprehensive description of the methodology should be disclosed by market operators to the public beforehand.

ISDA disagrees with ESMA's proposal in paragraph 34 on page 213 of the Consultation Paper that the SSTI threshold be the same for pre- and post-trade transparency. Per ESMA's request, our detailed response to ESMA's proposal for the size of the SSTI thresholds is set out in our response to Questions 78 and 80. However, we would like to recommend that SSTI/LIS ratio for pre-trade transparency purposes is reduced, with SSTI either being set at 10% of LIS or at the median trade size for the relevant sub-class. If ESMA's intention is to use LIS or SSTI thresholds to compensate for an illiquid instrument being incorrectly classified as liquid, then the relevant LIS and/or SSTI thresholds need to be set at a sufficiently low level to satisfy this intention. ESMA's proposed calibration of LIS and SSTI levels will not allow this important safeguard in the framework to function as anticipated.

3.7 Post-trade transparency requirements for non-equity instruments

- **Content and timing of post-trade transparency requirements**

Q73. Do you consider it necessary to include the date and time of publication among the fields included in Annex II, Table 1 of RTS 9? Do you consider that other relevant fields should be added to such a list? Please provide reasons for your answer.

We do consider that it is necessary to include the date and time of publication among the fields included in Table 1 of Annex II of RTS 9.

We disagree, however, with ESMA's view that the proposed "instrument identification code type" field will ever be sufficient to provide the level of transparency that MiFIR is seeking. The operational issues arising from this proposed table field are numerous and for the time being, there is no unique way to identify instruments at a sufficiently granular level across different derivative classes. ESMA appears to be significantly underestimating the feasibility of classifying every derivative sufficiently uniquely that the price terms become comparable, but not clouded by other, non-comparable derivatives. In our view, it would be more pragmatic and informative for this field to be replaced with identification of each of the terms of the trade in multiple fields. This is the solution adopted by the CFTC for the Part 43 reporting requirement for certain derivatives transactions. The role of the contract identifier should be limited to classifying derivatives at a high level to aid users of the post-trade transparency reports in identifying contracts of a particular class. Please refer to our response to Question 218 (specifically referring to Fields 53 to 56 Instrument Identification and Classification fields) where we discuss the development of a globally consistent Unique Product Identifier.

To help ESMA understand the complexities of using such an identifier for derivatives, we draw to ESMA's attention the following complexities:

- Two GBP interest rate swaps with trade date 3 March 2015 and effective date 3 March 2015, one of which has end date 3 March 2025 and one 4 March 2025 will have different market rates even if traded at the same instant using the same underlying market reference yield curve. They have different contract roll dates (payment dates of the fixed and floating cashflows), and different initial fixings. Classifying them under the same identifier will give market participants a misleading impression of the rates being traded. It would therefore be necessary to have a different identifier for each combination of days on the yield curve (effective date, maturity date). The permutations would run into the billions and it is impractical and unnecessary to attempt to do this.
- Two otherwise identical swaps, but using different day count fractions, reset periods or underlying reference indices (e.g. 3 month or 6 month LIBOR) will have different market rates. Again, the permutations run into billions for any given yield curve, and it is impractical to attempt a different identifier for each combination, but would give a misleading impression of market values should different combinations be bucketed under the same identifier.
- Cleared and uncleared swaps with otherwise the same contract terms would have different market rates.
- Swaptions will have multiple strike prices, exercise styles, underying indices, option tenors and underlier tenors. Capturing this level of detail through simply an identifier and a single price field for premium will be impractical.
- A swap transacted at a rate that is off-market together with payment of an upfront fee (as is commonly done when terminating-early bilateral derivative trades, or when trading swaps against bonds with the intention of matching the coupon cashflows from the bond) is not comparable to a swap transacted at a rate that is at market without a fee (typically called a Par swap). For the post-trade information to be useful, market participants need to be able to distinguish those swaps traded with a fee (in other words, it is insufficient to have a single field for "price"; a swap with an off-market coupon needs a rate and a fee field in order to be fully evaluated).

Given the above scenarios, and the complexity of classifying every derivative with an identifier, ISDA strongly recommends against using a single identifier field. We are concerned that the industry will undertake extensive and expensive efforts to classify derivatives under ESMA's proposal, but that it will not deliver the transparency that MiFIR is seeking, and which will cause the RTS to have to be revisited at a future date and a subsequent re-implementation of trade reporting flows. Far simpler, we consider, for the post-trade reporting fields to be sufficiently numerous as to allow identification of all economic terms of derivative transactions.

In terms of the other information proposed by ESMA to be disclosed under the post-trade transparency regime, we would make the following comments:

- Quantity Notation field: more options should be available, particularly for commodity derivatives reporting. A trade on oil, for example, will be described in barrels and not Number of units: U, Nominal value: N, Monetary value: V.
- ESMA should ensure the format and definition of fields which appear both in Table 1 of Annex II of RTS 9 match those of Table 1 Annex I of RTS 32 match.
- ESMA should provide sufficient values and formats for all instruments.

- Trading Day and Trading Time: in EMIR the Execution Timestamp field is a concatenation of the date and time of execution where as for MiFIR it is separated and called Trading Day and Trading Time. It would be preferable to have the same fields under both EMIR and MiFIR.

With regard to Article 7(6) of RTS 9 where ESMA states that "investment firm that sells the financial instrument concerned shall be responsible for making the transaction public":

- Firstly ISDA would suggest that investment firms should be allowed to decide which party will make the transaction public as the seller in certain cases may be less sophisticated than the buyer in terms of technology infrastructure.
- Secondly and applicable to situations where both parties are capable of making a transaction public, ISDA would like to note that in our response to Question 217 we have explained an important concern of ISDA's members in designating the buyer and seller on a derivative transaction. This is particularly an issue for OTC swap derivatives, where firms exchange cash flows that are each based on floating rates or prices. As MiFID expands to encompass such products, it is important that the technical standards consider such products. Examples of such trades in Interest rate markets would be basis swaps where one party pays a floating rate according to a specific index (e.g. 1-month USD LIBOR) to their counterparty whilst receiving another floating rate (e.g. 6-month USD LIBOR) from their counterparty. In commodity markets such trades, where floating rates or flows based on the prices of different commodities are exchanged by counterparties, are also common and termed spreads or spread swap trades.
- If ESMA is intent on designating a buyer and seller, ISDA's members would urge ESMA to firstly work with the industry to develop and endorse best practices and to make sure global standards are followed across jurisdictions, in order to ensure the determination of buyer and seller is done as consistently and accurately as possible. ISDA has developed best practice documents regarding determination of the reporting party for reporting in certain jurisdictions which may be applicable to this solution.

Q74. Do you agree with ESMA's proposal on the applicable flags in the context of post-trade transparency? Please provide reasons for your answer.

No. We would propose the following amendments to the flags proposed for identifying transactions carried out under a pre-trade transparency waiver:

- In line with our recommended treatment of package transactions, a flag on trades that are components of for package transactions should be added. This would assist observers of the tape to understand the basis on which certain components were priced (including why components of packages benefitted from deferred publication even if not eligible for a deferral when traded on a standalone basis) and provide regulators with visibility in respect of the usage of packages.
- Intra-group transactions should be listed under Article 9 of RTS 9, so that they are captured by the "G" identifier (non-price forming trades flag). We suggest that Article 9 of RTS 9 could read be amended as follows:

  "The obligation in Article 21(1) of Regulation (EU) No 600/2014 shall not be applied to the following:
  ...
  (g) intra-group transactions."

- Table 2 of Annex 11 of RTS 9 contains two flags identified by the identifier "G". The first is the non-price forming trades flag and the second is the daily aggregated transaction flag. To avoid confusion different identifiers should be used.
- The algorithmic trades flag (flag "H") should be deleted. We do not agree with the inclusion of an algorithmic trading flag. Such information is very commercially sensitive and price sensitive. Therefore, we do not agree such information should be made public. ESMA has stated that the objective of the flags is to improve the content of the public information and assist NCAs in monitoring the extent to which waivers from pre-trade are used. ISDA supports these objectives. However, we believe that an algorithmic trading flag does not improve the quality of the data for users of the post trade information and instead simply broadens the publication requirements to reveal sensitive information.

We have set out below our proposed amendments to Annex II, Table 2 of RTS 9:

Table 25: Proposed amendments to Annex II, Table 2 of RTS 9			
Identifier	**Name of Trade Flag**	**Venue/Publication arrangement**	**Definition**
"B"	Benchmark trade flag	RM, MTF, OTF, APA	All kinds of volume weighted average price transactions and all other trades where the price is calculated over multiple time instances according to a given benchmark.
"X"	Agency cross trade flag	RM, MTF, OTF, APA	Trades where an investment firm has brought together two clients' orders with the purchase and the sale conducted as one transaction and involving the same volume and price.
"G"	Non-price forming trades flag	RM, MTF, OTF	All types of transactions listed under Article 9 of this Regulation and which do not contribute to the price formation.
"T"	Technical trade flag	RM, MTF, OTF, APA	Category covering trades which represent non-addressable liquidity or trades where the exchange of financial instrument is determined by factors other than the current market valuation of the instrument. Non-exhaustive examples of such trades may include OTC hedges of a derivative, inter-fund transfers, non-equity hedge trades related to the creation/redemption of ETFs and Exchange for Physical trades.
"L"	Post-trade LIS flag	RM, MTF, OTF, APA	Transactions executed under the post-trade large in scale deferral.
"I"	Illiquid instrument trade flag	RM, MTF, OTF, APA	Transactions executed under the deferral for instruments for which there is not a liquid market.
"S"	Post-trade size specific flag	RM, MTF, OTF, APA	Transactions executed under the post-trade size specific deferral.
~~'H'~~	~~Algorithmic trades~~	~~RM, MTF,OTF~~	~~Transactions executed as a result of an investment firm~~

			~~engaging in algorithmic trading as defined in Article 4(1)(4~~39~~) of Directive (EU) 65/2014.~~
"C"	Cancellation flag	RM, MTF, OTF, APA	Transaction cancelled.
"A"	Amendment flag	RM, MTF, OTF, APA	Transaction amended.
"U"	Update flag	RM, MTF, OTF, APA	Transaction for which limited details have been previously published in accordance with Article 10(1)(a)(i).
"~~G~~F"	Daily aggregated transaction flag	RM, MTF, OTF, APA	Publication of daily aggregated transaction in accordance with Article 10(1)(a)(ii).
"V"	Volume publication flag	RM, MTF, OTF, APA	Transaction for which limited details have been previously published in accordance with Article 10(1)(b).
"J"	Four weeks aggregation flag	RM, MTF, OTF, APA	Publication of aggregated transactions in accordance with Article 10(1)(c) and transactions which have previously benefited from aggregated publication in accordance with Article 10(1)(c).
"K"	Indefinite aggregation flag	RM, MTF, OTF, APA	Transactions for which the publication of several transactions in aggregated form for an indefinite period of time has been allowed in accordance with Article 10(1)(d).
"W"	Consecutive volume masking flag	RM, MTF, OTF, APA	Transactions for which limited details have been previously published in accordance with Article 10(1)(b) and for which the publication of several transactions in aggregated form for an indefinite period of time has consecutively been allowed
"O"	Package transaction flag	RM, MTF, OTF, APA	Category covering transactions forming part of a package transaction

Q75. Do you agree with ESMA's proposal? Please specify in your answer if you agree with:

(1) a 3-year initial implementation period

(2) a maximum delay of 15 minutes during this period

(3) a maximum delay of 5 minutes thereafter. Please provide reasons for your answer.

We agree with ESMA's proposal for a maximum permissible delay of 15 minutes for the publication of post-trade information for an initial period of 3 years. However, it is unclear whether a 5 minute timeframe will be achievable in 3 years' time. Rather than automatically reducing the maximum permissible delay, ESMA should first undertake a review to assess the feasibility of the industry complying with a 5 minute delay. ISDA would be fully supportive of ESMA monitoring market participants for continuous improvement in this respect and then setting a time frame that is reasonable based on ESMA's review.

We note that Recital (3) of RTS 9 states that "...information should only be published close to the maximum time limit specified under Article 7(5) of this Regulation in *exceptional* cases where the

systems available do not allow for a publication in a shorter time". Whilst we agree that the industry needs to reduce the time it takes to publish post-trade information, publication within 15 minutes of the execution of a transaction will be challenging for a significant number of transaction. The reference in Recital (3) to "exceptional cases" is not realistic. Whilst trading venues and investment firms should publish information about executed transactions as quickly as possible, they should be permitted to report within the maximum permissible delay period (15 minutes) whenever systems do not allow publication in a shorter time. We would recommend that Recital (3) is amended as follows:

"...information should only be published close to the maximum time limit specified under Article 7(5) of this Regulation in ~~exceptional~~ cases where the systems available do not allow for a publication in a shorter time."

- **Application of post-trade transparency to certain OTC transactions**

Q76. Do you agree that securities financing transactions and other types of transactions subject to conditions other than the current market valuation of the financial instrument should be exempt from the reporting requirement under article 21? Do you think other types of transactions should be included? Please provide reasons for your answers.

ISDA agrees with ESMA's list of transactions in paragraph 25 on page 222 of the Consultation Paper which should be exempt from the reporting requirement under Article 21 of MiFIR. However, we believe that intra-group transactions should also be included in this list. Such transactions are typically undertaken for the purposes of transferring risk within a group and do not have any relevance to the price formation process. We suggest that Article 9 of RTS 9 is amended as follows:

> "The obligation in Article 21(1) of Regulation (EU) No 600/2014 shall not be applied to the following:
> ...
> (g) intra-group transactions."

As a general point in relation to the scope of application of the post-trade transparency regime to investment firms under Article 21 of MiFIR, ISDA would urge ESMA to include a recital to RTS 9 confirming that the post-trade transparency obligations on investment firms in Article 21 of MiFIR do not apply in respect of transactions executed on a trading venue (as this transaction would be made public by the relevant trading venue in accordance with Article 10 of MiFIR). This is important to avoid the same transaction being made public multiple times, once by the venue and once by the relevant investment firm. Whilst the operative provisions of the RTS are drafted on this basis, we believe that firms understanding of their obligations would be enhanced if this recital is included. For example, Article 7 of RTS 9 refers to "investment firms trading outside a venue and market operators and investment firms operating a trading venue...".

- **Deferred publication regimes**

Q78. Do you agree with ESMA's proposal for interest rate derivatives? Please specify, for each sub-class (FRA, Swaptions, Fixed-to-Fixed single currency swaps, Fixed-to-Float single currency swaps, Float -to- Float single currency swaps, OIS single currency swaps, Inflation single currency swaps, Fixed-to-Fixed multi-currency swaps, Fixed-to-Float multi-currency swaps, Float -to- Float multi-currency swaps, OIS multi-currency swaps, bond options, bond futures, interest rate options, interest rate futures) if you agree on the following points providing reasons for your answer and, if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

(2) size specific to the instrument threshold set as 50% of the large in scale threshold

(3) volume measure used to set the large in scale and size specific to the instrument threshold as specified in Annex II, Table 3 of draft RTS 9

(4) pre-trade and post-trade thresholds set at the same size

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1), provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2), provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed (c) irrespective of your preference for option 1 or 2 and, with particular reference to OTC traded interest rates derivatives, provide feedback on the granularity of the tenor buckets defined. In other words, would you use a different level of granularity for maturities shorter than 1 year with respect to those set which are: 1 day- 1.5 months, 1.5-3 months, 3-6 months, 6 months – 1 year? Would you group maturities longer than 1 year into buckets (e.g. 1-2 years, 2-5 years, 5-10 years, 10-30 years and above 30 years)?

(i) 48 hours deferral period

No, ISDA does not agree with ESMA's proposals. Whilst we welcome ESMA's proposal to extend the length of the deferral period for transactions that are equal to or exceed LIS, equal to or exceed SSTI (if carried out on own account other than matched principal) and in illiquid instruments, we recommend that the deferral period be set at two business days. This is to ensure that transactions that occur close to the end of trading before a weekend/bank holiday get the full benefit of the deferral period (which they may otherwise not if the 48 hour period runs over the weekend).

As we argued in our response to the May 2014 Discussion Paper, the duration of volume masking is critical. If ESMA does not accept our proposal in answer to Question 83 (that a 12 week supplementary deferral period is required for volume omission in respect of trades which are both Illiquid and LIS) then we would urge ESMA to extend the post-trade deferral period to at least 7 days for trades that are both illiquid and LIS. If a longer supplementary deferral period is permitted for volume omission, in line with our proposal in answer to Question 83, we would recommend that ESMA permits NCA's that do not adopt the supplementary deferral regime (which is within the discretion of NCAs) to allow a post-trade deferral period of at least 7 days for trades that are both illiquid and above LIS.

Even two business days may challenging for certain types and sizes of transactions and especially so if the LIS and SSTI thresholds are not appropriately calibrated in the final rules. This challenge will be significantly worsened if NCAs do not implement the supplemental volume omission regime. Whilst we appreciate that it is within the discretion of individual NCAs to determine whether to implement a supplemental volume omission deferral regime, ISDA urges ESMA to try and encourage as many NCAs as possible to adopt this regime.

(ii) Appropriate calibration of the SSTI threshold & differentiation of pre- and post-trade SSTI thresholds

ISDA disagrees with ESMA's proposals for calibrating SSTI. We believe that the proposal to set the SSTI threshold at 50% of the LIS threshold is arbitrary – there is no rationale for choosing 50% (as opposed to another percentage) and its link to the LIS threshold means that the SSTI threshold is unlikely to result in 50% of trades in a sub-class actually falling below the SSTI threshold. Use of a 50% ratio does not appear to have factored in the elements required by MiFIR under Article 9(5)(d), specifically whether liquidity providers are able to hedge their risks, and the extent of retail participation (although we recognise the practical challenges of incorporating these factors).

Furthermore, as ESMA seems to view the waiver and deferral regimes as a way to reduce the detrimental impact of an illiquid instrument being incorrectly assessed as liquid, we urge ESMA to ensure that the LIS and SSTI thresholds are set at levels sufficiently low in order to compensate for inaccuracies in the liquidity calibration.

We propose instead that the SSTI threshold should either be set at either :

- The median trade size (50th percentile of transaction sizes) for transactions in the relevant sub-class; or
- 10% of the LIS threshold for the relevant sub-class (if ESMA prefers to retain a method based on the percentage of LIS)

The appeal of using the median size is that ESMA can be sure that half of transactions in any liquid sub-class would be subject to pre-trade transparency, and would not experience deferred publication. We consider it would accord better with a normal market transaction at which liquidity providers could be reasonably expected to hedge their risks (as per MiFIR Article 9(5)(d)). Furthermore, breaking the link to LIS would prevent the SSTI being skewed by individual, large transactions (which could result under ESMA's current proposal for LIS calibration).

For the following reasons, it is most important that ESMA adopt our recommendations for the pre-trade SSTI (although we encourage ESMA to also consider doing so for the post-trade SSTI):

- The risks to firms are more significant in the pre-trade context; a firm is putting its capital at risk and pre-trade disclosure of its quoted prices increases the possibility that the market will move against the firm before it is able to execute those transactions. This would lead firms to price in these risks resulting in worse pricing for end investors.
- A 50% SSTI ratio would only permit an SI to undertake two trades before taking on risk equivalent to a Large in Scale transaction. If the policy objective is to encourage SIs to make their quotes available and executable several clients then setting the SSTI threshold at a level which takes into account multiple transactions and still being able to maintain a given quote would enable ESMA to achieve such an objective.

The risk is of a different nature in the post-trade context. At this stage, the firm has already committed its capital. The risk it faces at this stage relate to the management of its exposure (i.e. its ability to conduct a successful hedging strategy). However, again, if the ratio is set too high for post-trade purposes, the risks the systematic internaliser faces in managing its hedging strategy in relation to certain products will be reflected in wider prices being quoted to clients.

(iii) Volume measure used to set the LIS and SSTI thresholds (Table 3 of Annex 2 of RTS 9)

We agree with the proposed use of "notional amount of traded contracts" as the appropriate volume measure for interest rate derivatives.

(iv) LIS thresholds

It is essential that the LIS threshold is appropriately calibrated to ensure that end investors can continue to transact in large trade sizes. Requiring disclosure of large trades without appropriate deferrals will lead to a widening of bid-offer spreads, having a detrimental impact on investors wishing to trade at these large sizes.

ISDA is of the view that the LIS should be recalibrated on a dynamic basis. However, we do not endorse Option 2 as currently constructed. In particular, we disagree with:

- Criterion 2 (the proposed volume measure). The determination of whether a transaction is large compared to market size should not be conflated with the volume of trading in that market and instead can be derived from the distribution of trade sizes alone. The volume measure would appear to be policy driven, without any basis in a natural reading of transactions that are large compared to normal market size.
- Criterion 3 (the proposed threshold floor). We disagree with ESMA's proposal to include a "floor" in option 2 once annual recalibration commences after 2017. In our view, this is an arbitrary device intended to result in an extra-large number that is inconsistent with the definition of a large in scale transaction in MiFIR.

Therefore, we recommend using only the percentile of trades to calibrate the LIS (i.e. Criterion 1).

Whilst we agree with the use of Criterion 1, we believe that the percentile level used for the LIS threshold should be varied according to the homogeneity of the class in order to compensate for in accuracies in the liquidity determination. For homogenous classes of financial instruments (such as single-currency interest rates swaps as classified by ESMA) the proposed LIS threshold of the 90th percentile transaction size is appropriate. However, for less homogenous classes (e.g. swaptions as currently classified by ESMA), the LIS threshold should be lower than the 90th percentile transaction size, potentially as low as the 50th percentile, in order to compensate for the lack of granularity in the composition of the class.

(v) Other recommendations

The SSTI thresholds (and LIS thresholds) in all of the tables in Section 4 (Interest rate derivatives) of Annex III should be defined in local currency terms rather than Euro (since the need to apply a currency conversion results in an additional layer of complexity, and results in inflexibility as exchange rates move). For multi-currency swaps, the LIS and SSTI thresholds should be defined in USD. For "other" classes determined to be illiquid, the LIS and SSTI thresholds can remain defined in EUR. ESMA should correct its proposed rounding method which systematically rounds the LIS and SSTI thresholds higher. Instead, ESMA should adopt simple mathematical rounding to the nearest round number. In other words, Paragraph 3 of Article 11 of RTS 9 should be amended to "The threshold determined in accordance to paragraph (2) shall be rounded ~~up~~ to the ~~next~~ nearest:".

ESMA should ensure that the level of the LIS threshold is consistent for derivatives that have comparable economic terms but are transacted in different forms. By way of example:

- The 10 year Euro Swapnote listed in Table 5 of Annex III of RTS 9 is economically similar to a 10 year Euro fixed-float swap listed in Table 23 of the same annex. The former is proposed to have an LIS threshold of EUR 10 million, whilst the latter is proposed to have an LIS of EUR 165 million.

- Three month Euribor interest rate futures listed in Table 7 of Annex III of RTS 9 are economically similar to 3 month Euribor FRAs listed in the first 5 rows of Table 15 of the same annex. The former is proposed to have an LIS threshold of EUR 10 million, whilst the latter is proposed to have an LIS of EUR 525 to 1,000 million depending on tenor. We also note that, in Table 11, options (which we presume to be exchange-traded options, although RTS 9 is unclear on this) on 3 month Euribor futures are proposed to have an LIS of EUR 15 billion.

- 5 year Sterling swapnotes, shown in Table 11 on page 117 of the Consultation Paper to be illiquid, are found to be illiquid and proposed to have an LIS threshold of EUR 10 million. These are economically similar to 10 year GBP fixed-float swaps listed in Table 23 of Annex III of RTS 9 as liquid with an LIS threshold of EUR 90 million.

- The LIS and SSTI thresholds in all of the tables in section 4 of Annex 3 should be defined in local currency terms rather than Euro (since the need to apply a currency conversion results in an additional layer of complexity, and results in inflexibility as exchange rates move). For multi-currency swaps, the LIS and SSTI thresholds should be defined in USD.

ESMA should ensure that the LIS threshold are set consistently, and at a sufficiently low level, for all illiquid classes regardless of which asset class they fall into. For example, the LIS for illiquid fixed to float single-currency swaps has been set at EUR 10 million, whilst the LIS for illiquid OIS multi-currency swaps has been set at EUR 150 million. The LIS threshold for all illiquid classes should be set at EUR 10 million. For these classes deemed illiquid, the LIS and SSTI thresholds can remain defined in EUR.

The following table highlights the approximate interest rate risk a single currency Euro interest rate swap across various maturity tenors. Market participants often refer to the Present Value of a 1 basis point move of the swap curve (PV01). The second column shows the approximate PV01 sensitivity to a hypothetical EUR 10,000,000 Euro single currency at-market fixed v float interest rate swap. The table shows the risk increasing as the maturity of the swap increases; the notional remains unchanged. The third column shows the required notional for the same swap if each maturity was to have EUR 26,000 PV01. In summary, a 30 year maturity swap has approximately 13 times the risk of a 2 year maturity swap using the same notional amount.

Whilst for simplicity we support a fixed notional threshold across all maturity tenors for illiquid classes, the threshold must be low to ensure it does not adversely impact the longer dated maturity tenors.

Table 26: approximate interest rate risk a single currency Euro interest rate swap across various maturity tenors		
Euro swap tenor in years	**PV01 of a notional swap of €10,000,000**	**Notional for €26,000 PV01**
2	1,999	€ 130,000,000
5	4,986	€ 52,000,000
10	9,825	€ 27,000,000
20	18,579	€ 14,000,000
30	26,149	€ 10,000,000

Package transactions

In addition to discussing ESMA's proposed regime for deferred publication for interest rate derivatives, we would like to make a few comments in relation to the treatment of package transactions under post-trade transparency framework.

a) Overview

ISDA would like to propose that ESMA considers specific and tailored treatment for package transactions as the Consultation Paper does not address how these transactions might be treated under the new framework. In response to the May 2014 Discussion Paper, ISDA included a number of detailed comments on the nature of package transactions which we draw ESMA's attention to. We reiterate the points made in that response and put forward a proposal which we hope ESMA will find workable and flexible enough to apply for venue and SI transparency obligations and the derivatives trading obligation. This will preserve the market for package transactions and ensure that pricing and liquidity is not negatively impacted for end investors.

We believe that Level 1 is flexible enough to empower ESMA to specify how package transactions are treated in order to determine if such transactions are liquid or "traded on a trading venue" (both for determining whether transparency obligations apply as well as determining whether the derivatives trading obligation applies). The Level 1 text clearly sets the foundation for the pre- and post-trade transparency regimes in non-equities by defining the asset classes – "bonds, structured finance products, emission allowances and derivatives" – on which the Level 2 measures must be built. However, ESMA has flexibility to define how, within these broad asset classes, to identify whether specific financial instruments (or combinations thereof) are to be considered "liquid" or "traded on a trading venue". ESMA has chosen to adopt COFIA as the basis for determining whether a liquid market exists – which suggests to us that ESMA is also empowered to tailor this approach to instruments which fall within one of the specified classes, but are part of a package transaction.

b) Advantages of package transactions to clients

Package transactions allow clients to reduce their transaction costs (i.e. a single transaction is less expensive to execute than multiple transactions) and manage their execution risk (i.e. a single execution alleviates timing and other mechanical/process type risks). They are tailored to provide risk-return characteristics in the form of a single transaction in an efficient and cost-effective manner to clients.

c) Challenges to trading package transactions without a tailored proposal

Below are some very realistic fact patterns which hopefully demonstrate that unless there is tailored treatment for package transactions which recognises that package transactions should be considered in their entirety when being assessed as subject to transparency requirements and/or the derivatives trading obligation, there is a significant risk that such transactions may no longer be available to clients in the EU. This will be due to the individual components being treated differently and inconsistently vs. each other when they are assessed against the relevant requirements which would negate the advantages highlighted above of trading package transactions. These challenges are likely to be particularly acute where one or more of the components of a package transaction includes derivatives subject to the trading obligation:

- If some components of a package transaction are traded on a trading venue but others are not.
- If some components of a package transaction are deemed liquid but others are not.

- If some components of a package transaction are above the relevant LIS or SSTI thresholds but others are not.
- If the components of a package transaction are below the relevant LIS or SSTI thresholds but together they behave similarly to a single transaction above the LIS or SSTI.
- If the package transaction contains a listed derivative which trades on a different trading venue to other components.

If ESMA fails to provide for the appropriate trading of packages, end investors will be required to trade the components independently, resulting in increased transaction costs and increased execution risks, which would seem to conflict with ESMA's policy objectives.

d) ISDA proposal

We would be keen to assist ESMA with the development of a workable regime for package transactions. We consider that the following proposals could both address the challenges we have described above. We have provided both proposals for ESMA's consideration as we recognise that, whilst Option 1 is a simpler proposal, Option 2 is more accurate.

Option 1:

1. Subject to point 3 below, if each component of a package transaction is liquid:

    a. The package transaction should be considered liquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

    a. The package transaction should be considered illiquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradeable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

If ESMA, for post-trade transparency purposes, would prefer to represent this in a table format, we propose the following table which reflects the above:

Table 27: ISDA Proposal for the calibration of Package Transactions for liquidity, Large in Scale, and Size Specific to the Instrument thresholds.

Type	Package type comprising:	Example	1. All components above LIS	2. All components above SSTI	3. At least one component above LIS	4. At least one component above SSTI	5. All components below LIS	6. All components below SSTI

Table 27: ISDA Proposal for the calibration of Package Transactions for liquidity, Large in Scale, and Size Specific to the Instrument thresholds.								
Type	**Package type comprising:**	**Example**	**1. All components above LIS**	**2. All components above SSTI**	**3. At least one component above LIS**	**4. At least one component above SSTI**	**5. All components below LIS**	**6. All components below SSTI**
A	Exclusively liquid derivatives in one derivative asset class[1]	2yr vs 10yr EUR swap	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
B	Exclusively liquid securities	2yr vs 10yr Bund switch	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
C	Liquid security(ies) and derivative(s) where the derivatives are from a single asset class[1]	Asset swap vs. cash bund	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
D	Liquid & illiquid security(ies) and derivative(s) where the derivatives are from a single asset class[1]	10yr EUR swap vs. 10yr inflation swap	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid
E	Liquid derivative(s) & any liquid exchange traded derivative(s) in the same derivative asset class[1]	EFP transaction of swap vs. future	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is below LIS and liquid[2]	Package is below SSTI and liquid[2]
F	Liquid security(ies) & any liquid exchange traded derivative(s) in the same derivative asset class[1]	Cash bund vs. Bund future basis trade	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is below LIS and liquid[2]	Package is below SSTI and liquid[2]
G	Exclusively illiquid security(ies) or derivative(s)	10yr EUR inflation vs. 30yr GBP inflation	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and Not liquid	Package is above SSTI and Not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid
H	10 or more components	Package of several swaps bundled for execution (e.g. 10yr EUR swap, 15yr EUR swap, 20yr EUR swap, 25yr EUR swap, and 30 yr EUR swap)	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid

[1] Interest Rate Derivatives, FX Derivatives, Commodity Derivatives, Equity Derivatives etc considered as distinct derivative asset classes.

[2] Assuming that ESMA agrees that, for the purposes of MiFIR articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order that the package be considered "traded on a venue". Otherwise, ESMA should deem packages including exchange traded derivatives to be not liquid. ISDA recommends that packages involving exchange traded derivatives should be executed using the wholesale trading facilities currently governed by venues' rulebooks

Option 2:

1. Subject to point 3 below, if each component of a package transaction is liquid:

a. The package transaction should be considered liquid; and

b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

a. The package transaction should be considered illiquid; and

b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

The percentage threshold approach aims to, in a simple manner, replicate the package of instruments into a single instrument to test whether it would indeed be above the threshold (SSTI or LIS purposes) or not if it were traded as a single instrument.

Example: if an investor wishes to hedge cash flows at 5-year and 15-year points using EUR interest rate swaps, to create an accurate hedge the investor would trade a package of two EUR swaps at 5-year and 15-year maturities. Alternatively, the investor could enter into a single swap with an average 10-year maturity to try to replicate the risk profile but with less accuracy.

However, whilst the individual swaps in the package of swaps could each be below the relevant threshold, the equivalent single swap would have a larger notional and could therefore be above the threshold, as illustrated below. Given the 5-year and 15-year swaps are economically similar in nature, the pricing of one swap is likely to impact the pricing of the other. By not recognising this, ESMA could create an incentive for the market to trade in the equivalent single average instruments, rather than the package of instruments that provide a more accurate hedge: the result would be to provide a less perfect hedge, thereby retaining risk in the system.

The suggested percentage threshold approach provides a way to calibrate this and ensures that package transactions are not disproportionately disadvantaged.

The below table illustrates the example described above.

Table 28: Example of how the percentage threshold approach (Option 2) operates			
	More accurate hedge		Less accurate hedge
	EUR 5yr swap	EUR 15yr swap	EUR 10yr swap
Notional	60m	60m	120m
Threshold (SSTI or LIS)	100m	100m	100m
Percentage Threshold	60%	60%	120%

Table 27, prepared in respect of Option 1, could easily be adapted for Option 2 if this is ESMA's preferred option and we would be happy to prepare this table if requested.

e) Safeguarding against avoidance

ISDA is aware that ESMA and national competent authorities may be concerned that adoption of our proposal may lead to market participants creating packages of instruments purely for the purposes of avoiding the transparency regime or derivatives trading obligation. ISDA recognises these concerns and suggests that this could be achieved by defining a package and including, within the MiFID II/MiFIR framework, a mechanism that would support the monitoring (and therefore supervision) of the trading of packages. ISDA would welcome the opportunity to discuss these safeguards with ESMA in more detail.

1. Definition of package transaction

ISDA recommends that a "package transaction" be defined as a transaction comprising two or more components, each of which is a bond, structured finance product, emission allowance or derivative where:

(i) The components are priced as a "package" with simultaneous execution of all such components;

(ii) The execution of each component is contingent on the execution of the other components;

(iii) Each component must be able to stand alone and must be able to bear economic risk.

(iv) Either:

i. the components are economically similar in nature such that the pricing of one component can affect the pricing of the other component; or

ii. the components must have a reasonable degree of correlation.

2. Post-trade transparency flag

With a view to assisting the monitoring of package transactions by supervisors, and as stated in our response to Question 74, ISDA recommends that an additional flag to be reported on trades that are components of package transactions be added to the list of flags set out in Table 2 of Annex II of RTS 9.

We would also draw attention to our response to Question 218 where we suggest that ESMA may wish to consider including a "link ID" field in transaction reports (for the purposes of the Article 26 MiFIR transaction reporting regime). In ISDA's response to ESMA's recent consultation paper on the review of reporting technical standards under EMIR, we recommended the inclusion of a "link ID" field to link together trade reports of components of the same package. ESMA may wish to consider whether to incorporate such a field in the transaction reports required under the MiFIR transaction reporting regime as this would give supervisors greater visibility in respect of the usage of package transactions.

Q79. Do you agree with ESMA's proposal for commodity derivatives? Please specify, for each type of commodity derivatives, i.e. agricultural, metals and energy, if you agree on the following points providing reasons for your answer and if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

(2) size specific to the instrument threshold set as 50% of the large in scale threshold

(3) volume measure used to set the large in scale threshold as specified in Annex II, Table 3 of draft RTS 9

(4) pre-trade and post-trade thresholds set at the same size

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.

Deferral period

We believe that the transparency calibration is critical for ensuring that the Level 1 objective of increased market transparency is achieved without compromising liquidity.

Whilst we support ESMA's extension of the deferral period for LIS trades from end-of-day (as proposed in ESMA's May 2014 Discussion Paper) to 48 hours, the price deferral period remains too short, particularly for truly illiquid markets involving large trade sizes. To ensure a continuation of liquidity by market participants and to reduce the potential negative effects of the post trade transparency regime, in line with the AFME's suggestion in the Fixed Income context, we would suggest for large trades in illiquid commodity derivatives a price deferral of at least 28 days.

Setting the thresholds

As noted in our responses to Q66-69, we are extremely concerned that the current proposals for commodity derivatives are based on a dataset which is too narrow and therefore the assessments do not provide an accurate representation of liquidity in the relevant commodity markets. Therefore, we have serious concerns that these proposals are not be workable and could have significant adverse consequences if implemented.

In order to establish appropriate thresholds for the SSTI and LIS, we strongly believe that it is necessary for ESMA to conduct an appropriate market assessment of the liquidity of the contracts that will subject to the MiFID2 transparency regime based on complete data available from the major commodities trading venues (including the major non-EU venues), for on venue contracts, and the data from trade repositories for the contracts which are currently traded OTC. We do not believe that the SSTI should be linked to the LIS and reiterate the need to conduct a full analysis in order to consider the potential impact on the market. On the basis of an initial analysis that we have done in the available timeframe and by mere way of example, we would consider the following values as a more workable LIS and SSTI thresholds for an ICE Brent Future contract: LIS (200 lots, 12 USD million) and SSTI (50 lots; 3 USD million).

In terms of our preference for the system to set the thresholds, we strongly believe that an annual recalculation of the thresholds would be more appropriate.

We offer our assistance to continue the discussion for a more appropriate framework with ESMA after the end of this consultation period.

Q80. Do you agree with ESMA's proposal for equity derivatives? Please specify, for each type of equity derivatives [stock options, stock futures, index options, index futures, dividend index options, dividend index futures, stock dividend options, stock dividend futures, options on a basket or portfolio of shares, futures on a basket or portfolio of shares, options on other underlying values (i.e. volatility index or ETFs), futures on other underlying values (i.e. volatility index or ETFs)], if you agree on the following points providing reasons for your answer and if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

(2) size specific to the instrument threshold set as 50% of the large in scale threshold

(3) volume measure used to set the large in scale threshold as specified in Annex II, Table 3 of draft RTS 9

(4) pre-trade and post-trade thresholds set at the same size

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.

(i) 48 hours deferral period

No, ISDA does not agree with ESMA's proposals. Whilst we welcome ESMA's proposal to extend the length of the deferral period for transactions that are large in scale, above SSTI (if carried out on own account other than matched principal) and in illiquid instruments, we strongly recommend that the deferral period be set at two business days. This is to ensure that transactions that occur close to the end of trading before a weekend/bank holiday get the full benefit of the deferral period (which they may otherwise not if the 48 hour period runs over the weekend).

As we argued in our response to the May 2014 Discussion Paper, the duration of volume masking is critical. If ESMA does not accept our proposal in answer to Question 83 (that a 12 week supplementary deferral period is required for volume omission in respect of trades which are both Illiquid and LIS) then we would urge ESMA to extend the post-trade deferral period to at least 7 days for trades that are both illiquid and LIS. If a longer supplementary deferral period is permitted for volume omission, in line with our proposal in answer to Question 83, we would recommend that ESMA permits NCA's that do not adopt the supplementary deferral regime (which is within the discretion of NCAs) to allow a post-trade deferral period of at least 7 days for trades that are both illiquid and above LIS.

Whilst information about exchange-traded equity derivatives is typically published today on a voluntary basis at the end of the day, this is not currently the case for OTC equity derivatives. Even two business days may be challenging for certain types and sizes of transactions and especially so if the LIS and SSTI thresholds are not appropriately calibrated in the final rules. This challenge will be significantly worsened if NCAs do not implement the supplemental volume omission regime. Whilst we appreciate that it is within the discretion of individual NCAs to determine whether to implement a supplemental volume omission deferral regime, ISDA urges ESMA to try and encourage as many NCAs as possible to adopt this regime.

(ii) Appropriate calibration of the SSTI threshold and differentiation of pre- and post-trade SSTI thresholds

ISDA disagrees with ESMA's proposals for calibrating SSTI. We believe that the proposal to set the SSTI threshold at 50% of the LIS threshold is arbitrary – there is no rationale for choosing 50% (as opposed to another percentage) and its link to the LIS threshold means that the SSTI threshold is unlikely to result in 50% of trades in a sub-class actually falling below the SSTI threshold. Use of a 50% ratio does not appear to have factored in the elements required by MiFIR under Article 9(5)(d), specifically whether liquidity providers are able to hedge their risks, and the extent of retail participation (although we recognise the practical challenges of incorporating these factors).

Furthermore, as ESMA seems to view the waiver and deferral regimes as a way to reduce the detrimental impact of an illiquid instrument being incorrectly assessed as liquid, we urge ESMA to ensure that the LIS and SSTI thresholds are set at levels sufficiently low in order to compensate for inaccuracies in the liquidity calibration.

We propose instead that the SSTI threshold should either be set at either :

- The median trade size (50th percentile of transaction sizes) for transactions in the relevant sub-class; or

- 10% of the LIS threshold for the relevant sub-class (if ESMA prefers to retain a method based on the percentage of LIS).

The appeal of using the median size is that ESMA can be sure that half of transactions in any liquid sub-class would be subject to pre-trade transparency, and would not experience deferred publication. We consider it would accord better with a normal market transaction at which liquidity providers could be reasonably expected to hedge their risks (as per MiFIR Article 9(5)(d). Furthermore, breaking the link to LIS would prevent the SSTI being skewed by individual, large transactions (which could result under ESMA's current proposal for LIS calibration).

For the following reasons, it is most important that ESMA adopt our recommendations for the pre-trade SSTI (although we encourage ESMA to also consider doing so for the post-trade SSTI):

- The risks to firms are more significant in the pre-trade context; a firm is putting its capital at risk and pre-trade disclosure of its quoted prices increases the possibility that the market will move against the firm before it is able to execute those transactions. This would lead firms to price in these risks resulting in worse pricing for end investors.

- A 50% SSTI ratio would only permit an SI to undertake two trades before taking on risk equivalent to a Large in Scale transaction. If the policy objective is to encourage SIs to make their quotes available and executable for several clients then setting the SSTI threshold at a level which takes into account multiple transactions and still being able to maintain a given quote would enable ESMA to achieve such an objective.

The risk is of a different nature in the post-trade context. At this stage, the firm has already committed its capital. The risk it faces at this stage relates to the management of its exposure (i.e. its ability to conduct a successful hedging strategy). However, again, if the ratio is set too high for post-trade purposes, the risks that an SI faces in managing its hedging strategy in relation to certain products will be reflected in wider prices being quoted to clients.

(iii) Volume measure used to set the LIS and SSTI thresholds (Table 3 of Annex II of RTS 9)

No, we disagree with the proposed volume measure for equity derivative contracts. The appropriate volume measure for equity derivative contracts is as follows:

Options volume = number of contracts * contract size * strike

Futures volume = number of contracts * contract size * futures price

(iv) LIS thresholds

It is essential that the LIS threshold is appropriately calibrated to ensure that end investors can continue to transact in large trade sizes. Requiring price disclosure of large trades would lead to a widening of bid-offer spreads, which may have a detrimental impact on investors wishing to trade at these large sizes.

ISDA is of the view that the LIS should be recalibrated on a dynamic basis. However, we do not endorse Option 2 as currently constructed. In particular, we disagree with:

- Criterion 2 (the proposed volume measure). The determination of whether a transaction is large compared to market size should not be conflated with the volume of trading in that market and instead can be derived from the distribution of trade sizes alone. The volume measure would appear to be policy driven, without any direct link to LIS.
- Criterion 3 (the proposed threshold floor). We disagree with ESMA's proposal to include a "floor" in option 2. In our view, this goes beyond the Level 1 requirements.

Therefore, we recommend using only the percentile of trades to calibrate the LIS (i.e. Criterion 1).

Whilst we agree with the use of Criterion 1, we believe that the percentile level used for the LIS threshold should relate to the homogeneity of the class in order to compensate for inaccuracies in the liquidity determination. For homogenous classes of financial instruments the proposed LIS

threshold of the 90th percentile transaction size is appropriate. However, for less homogenous classes, the LIS threshold should be lower than the 90th percentile transaction size, potentially as low as the 50th percentile, in order to compensate for the lack of granularity in the composition of the class.

(v) Equity derivatives specific comments on SSTI and LIS thresholds

In our view the proposed calibration of SSTI for:

- Dividend Index Futures and Options, appears to be in line with available liquidity.
- Stock Dividend Futures and Options, appears to be high relative to available liquidity.
- For Futures and Options on Baskets/Portfolios and "Other", these products are very unusual in the context of venue-traded derivatives and would not be expected to be liquid. Accordingly, we consider that ESMA's propose calibration is too high for such listed contracts.

We are concerned that the proposed SSTI and LIS might constrain trading on Stock Futures, where typically there is no minimum block size as most of the business is negotiated off-order book. The same is true for some less-liquid Index Futures (which is why ISDA is recommending a more granular approach). However, in most cases LIS and SSTI should be manageable.

Whilst the LIS thresholds proposed for Index Options and Share Options are generally low relative to the minimum block sizes on most order book markets, we understand that the proposed thresholds aim to strike a balance with cleared-only markets (which have lower block thresholds) and should not pose a significant problem.

Stock dividend futures and options should have a lower LIS and SSTI threshold, given that a dividend point move would have a significantly larger impact on a stock dividend future/option than the Index which contains that stock.

If ESMA is to conclude that all contracts within a liquidity class are liquid (i.e. all Index Options) then the LIS threshold and SSTI thresholds need to be lower to reflect the heterogeneous nature of the class.

(vi) Other recommendations

The SSTI thresholds (and LIS thresholds) in all of the tables in section 4 (equity derivatives) of Annex III should be defined in local currency terms rather than Euro (since the need to apply a currency conversion results in an additional layer of complexity, and results in inflexibility as exchange rates move).

ESMA should correct its proposed rounding method which systematically rounds the LIS and SSTI thresholds higher. Instead, ESMA should adopt simple mathematical rounding to the nearest round number. In other words, Paragraph 3 of Article 11 of RTS 9 should be amended to "The threshold determined in accordance to paragraph (2) shall be rounded up to the next nearest:".

ESMA should ensure that the level of the LIS threshold is consistent for derivatives that have comparable economic terms but are transacted in different forms and ESMA should ensure that the LIS threshold are set consistently, and at a sufficiently low level, for all illiquid classes regardless of which asset class they fall into.

Package transactions

In addition to discussing ESMA's proposed regime for deferred publication for equity derivatives, we would like to make a few comments in relation to the treatment of package transactions under the post-trade transparency framework.

a) Overview

ISDA would like to propose that ESMA considers specific and tailored treatment for package transactions as the Consultation Paper does not address how these transactions might be treated under the new framework. In response to the May 2014 Discussion Paper, ISDA included a number of detailed comments on the nature of package transactions which we draw ESMA's attention to. We reiterate the points made in that response and put forward a proposal which we hope ESMA will find workable and flexible enough to apply for venue and SI transparency obligations and the derivatives trading obligation. This will preserve the market for package transactions and ensure that pricing and liquidity is not negatively impacted for end investors.

We believe that Level 1 is flexible enough to empower ESMA to specify how package transactions are treated in order to determine if such transactions are liquid or "traded on a trading venue" (both for determining whether transparency obligations apply as well as determining whether the derivatives trading obligation applies). The Level 1 text clearly sets the foundation for the pre- and post-trade transparency regimes in non-equities by defining the asset classes – "bonds, structured finance products, emission allowances and derivatives" – on which the Level 2 measures must be built. However, ESMA has flexibility to define how, within these broad asset classes, to identify whether specific financial instruments (or combinations thereof) are to be considered "liquid" or "traded on a trading venue". ESMA has chosen to adopt COFIA as the basis for determining whether a liquid market exists – which suggests to us that ESMA is also empowered to tailor this approach to instruments which fall within one of the specified classes, but are part of a package transaction.

b) Advantages of package transactions to clients

Package transactions allow clients to reduce their transaction costs (i.e. a single transaction is less expensive to execute than multiple transactions) and manage their execution risk (i.e. a single execution alleviates timing and other mechanical/process type risks). They are tailored to provide risk-return characteristics in the form of a single transaction in an efficient and cost-effective manner to clients.

c) Challenges to trading package transactions without a tailored proposal

Below are some very realistic fact patterns which hopefully demonstrate that unless there is tailored treatment for package transactions which recognises that package transactions should be considered in their entirety when being assessed as subject to transparency requirements and/or the derivatives trading obligation, there is a significant risk that such transactions may no longer be available to clients in the EU. This will be due to the individual components being treated differently and inconsistently vs. each other when they are assessed against the relevant requirements which would negate the advantages highlighted above of trading package transactions. These challenges are likely to be particularly acute where one or more of the components of a package transaction includes derivatives subject to the trading obligation:

- If some components of a package transaction are traded on a trading venue but others are not.

- If some components of a package transaction are deemed liquid but others are not.
- If some components of a package transaction are above the relevant LIS or SSTI thresholds but others are not.
- If the components of a package transaction are below the relevant LIS or SSTI thresholds but together they behave similarly to a single transaction above the LIS or SSTI.
- If the package transaction contains a listed derivative which trades on a different trading venue to other components.

If ESMA fails to provide for the appropriate trading of packages, end investors will be required to trade the components independently, resulting in increased transaction costs and increased execution risks, which would seem to conflict with ESMA's policy objectives.

d) ISDA proposal

We would be keen to assist ESMA with the development of a workable regime for package transactions. We consider that the following proposals could both address the challenges we have described above. We have provided both proposals for ESMA's consideration as we recognise that, whilst Option 1 is a simpler proposal, Option 2 is more accurate.

Option 1:

1. Subject to point 3 below, if each component of a package transaction is liquid:

    a. The package transaction should be considered liquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

    a. The package transaction should be considered illiquid; and

    b. If any one component is above the relevant threshold (LIS or SSTI) then the package transaction should be deemed to be above the threshold.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

If ESMA, for post-trade transparency purposes, would prefer to represent this in a table format, we propose the following table which reflects the above principles. This table was developed for interest rate derivatives, however the same principles can be applied for equity derivatives.

Table 29: ISDA Proposal for the calibration of Package Transactions for liquidity, Large in Scale, and Size Specific to the Instrument thresholds.

Type	Package type comprising:	Example	1. All components above LIS	2. All components above SSTI	3. At least one component above LIS	4. At least one component above SSTI	5. All components below LIS	6. All components below SSTI
A	Exclusively liquid derivatives in one derivative asset class[1]	2yr vs 10yr EUR swap	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
B	Exclusively liquid securities	2yr vs 10yr Bund switch	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
C	Liquid security(ies) and derivative(s) where the derivatives are from a single asset class[1]	Asset swap vs. cash bund	Package is above LIS and liquid	Package is above SSTI and liquid	Package is above LIS and liquid	Package is above SSTI and liquid	Package is below LIS and liquid	Package is below SSTI and liquid
D	Liquid & illiquid security(ies) and derivative(s) where the derivatives are from a single asset class[1]	10yr EUR swap vs. 10yr inflation swap	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid
E	Liquid derivative(s) & any liquid exchange traded derivative(s) in the same derivative asset class [1]	EFP transaction of swap vs. future	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is below LIS and liquid[2]	Package is below SSTI and liquid[2]
F	Liquid security(ies) & any liquid exchange traded derivative(s) in the same derivative asset class [1]	Cash bund vs. Bund future basis trade	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is above LIS and liquid[2]	Package is above SSTI and liquid[2]	Package is below LIS and liquid[2]	Package is below SSTI and liquid[2]
G	Exclusively illiquid security(ies) or derivative(s)	10yr EUR inflation vs. 30yr GBP inflation	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and Not liquid	Package is above SSTI and Not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid
H	10 or more components	Package of several swaps bundled for execution (e.g. 10yr EUR swap, 15yr EUR swap, 20yr EUR swap, 25yr EUR swap, and 30 yr EUR swap)	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is above LIS and not liquid	Package is above SSTI and not liquid	Package is below LIS and not liquid	Package is below SSTI and not liquid

[1] Interest Rate Derivatives, FX Derivatives, Commodity Derivatives, Equity Derivatives etc considered as distinct derivative asset classes.

[2] Assuming that ESMA agrees that, for the purposes of MiFIR articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order that the package be considered "traded on a venue". Otherwise, ESMA should deem packages including exchange traded derivatives to be not liquid. ISDA recommends that packages involving exchange traded derivatives should be executed using the wholesale trading facilities currently governed by venues' rulebooks

Option 2:

1. Subject to point 3 below, if each component of a package transaction is liquid:

a. The package transaction should be considered liquid; and

b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

a. The package transaction should be considered illiquid; and

b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant threshold (LIS or SSTI). If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant threshold (LIS or SSTI). See below for a more detailed explanation of the percentage threshold approach.

3. For the purposes of MiFIR Articles 8(1), 10(1), 18(1) and 18(2), all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

The percentage threshold approach aims to, in a simple manner, replicate the package of instruments into a single instrument to test whether it would indeed be above the threshold (SSTI or LIS purposes) or not if it were traded as a single instrument. The example described below was developed for interest rate derivatives, however the same principles can be applied for equity derivatives.

Example: if an investor wishes to hedge cash flows at 5-year and 15-year points using EUR interest rate swaps, to create an accurate hedge the investor would trade a package of two EUR swaps at 5-year and 15-year maturities. Alternatively, the investor could enter into a single swap with an average 10-year maturity to try to replicate the risk profile but with less accuracy.

However, whilst the individual swaps in the package of swaps could each be below the relevant threshold, the equivalent single swap would have a larger notional and could therefore be above the threshold, as illustrated below. Given the 5-year and 15-year swaps are economically similar in nature, the pricing of one swap is likely to impact the pricing of the other. By not recognising this, ESMA could create an incentive for the market to trade in the equivalent single average instruments, rather than the package of instruments that provide a more accurate hedge: the result would be to provide a less perfect hedge, thereby retaining risk in the system.

The suggested percentage threshold approach provides a way to calibrate this and ensures that package transactions are not disproportionately disadvantaged.

The below table illustrates the example described above.

Table 30: Example of how the percentage threshold approach (Option 2) operates

	More accurate hedge		Less accurate hedge
	EUR 5yr swap	EUR 15yr swap	EUR 10yr swap
Notional	60m	60m	120m
Threshold (SSTI or LIS)	100m	100m	100m
Percentage Threshold	60%	60%	120%

Table 29, prepared in respect of Option 1, could easily be adapted for Option 2 if this is ESMA's preferred option.

e) Safeguarding against avoidance

ISDA is aware that ESMA and national competent authorities may be concerned that adoption of our proposal may lead to market participants creating packages of instruments purely for the purposes of avoiding the transparency regime or the derivatives trading obligation. ISDA recognises these concerns and suggests that this could be achieved by defining a package and including, within the MiFID II/MiFIR framework, a mechanism that would support the monitoring (and therefore supervision) of the trading of packages. ISDA would welcome the opportunity to discuss these safeguards with ESMA in more detail.

1. Definition of package transaction

ISDA recommends that a "package transaction" be defined as a transaction comprising two or more components, each of which is a bond, structured finance product, emission allowance or derivative where:

(i) The components are priced as a "package" with simultaneous execution of all such components;

(ii) The execution of each component is contingent on the execution of the other components;

(iii) Each component must be able to stand alone and must be able to bear economic risk; and

(iv) Either:

i. the components are economically similar in nature such that the pricing of one component can affect the pricing of the other component; or

ii. the components must have a reasonable degree of correlation.

2. Post-trade transparency flag

With a view to assisting the monitoring of package transactions by supervisors, and as stated in our response to Question 74, ISDA recommends that an additional flag to be reported on trades that are components of package transactions be added to the list of flags set out in Table 2 of Annex II of RTS 9.

We would also draw attention to our response to Question 218 where we suggest that ESMA may wish to consider including a "link ID" field in transaction reports (for the purposes of the Article 26 MiFIR transaction reporting regime). In ISDA's response to ESMA's recent consultation paper on the review of reporting technical standards under EMIR, we recommended the inclusion of a "link ID" field to link together trade reports of components of the same package. ESMA may wish to consider whether to incorporate such a field in the transaction reports required under the MiFIR transaction reporting regime as this would give supervisors greater visibility in respect of the usage of package transactions.

Q81. Do you agree with ESMA's proposal for securitised derivatives? Please specify if you agree on the following points providing reasons for your answer and if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

(2) size specific to the instrument threshold set as 50% of the large in scale threshold

(3) volume measure used to set the large in scale threshold as specified in Annex II, Table 3 of draft RTS 9

(4) pre-trade and post-trade thresholds set at the same size

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.

As indicated in our response to Question 59, ISDA's members do not agree with the liquidity parameters proposed by ESMA for securitised derivatives.

We do not believe that the presence of one market maker should be sufficient for a sub-class of securitised derivatives to be deemed liquid:

- As ESMA itself has noted in paragraph 62 of page 112 of the Consultation Paper, whilst 98% of securitised derivatives analysed by ESMA had a dedicated market maker, these instruments only make up 29% of total trades and 39% of total volume traded. It is clear therefore that the presence of a market maker does not equate to liquidity. Therefore, additional factors must be taken into account to determine which sub-classes of securitised derivatives are liquid.

- The definition of "liquid market" in Article 2(17)(a) of MiFIR requires there to be "ready and willing buyers and sellers on a continuous basis". This requires there to be more than one buyer or seller in a market for a particular sub-class of instruments for that sub-class to be determined liquid.

In our view, additional liquidity parameters must be used by ESMA to conduct a more thorough liquidity analysis of each of the sub-classes identified by ESMA in paragraph 60 of page 112 of the Consultation Paper (i.e. investment certificates, plain vanilla covered warrants, leverage certificates,

exotic covered warrants, exchange-traded-commodities, exchange-traded-notes, negotiable rights, structured medium-term-notes and other warrants).

Once ESMA has reclassified securitised derivatives, we recommend recalibrating LIS and SSTI thresholds at a more granular level.

- **Supplemental deferral regime**

Q83. Do you agree with ESMA's proposal in relation to the supplementary deferral regime at the discretion of the NCA? Please provide reasons for your answer.

Whilst a four week deferral period is acceptable for the omission of the publication of volume information for a transaction which is illiquid or equal to or above LIS, we do not believe that this period would be sufficient for transactions which are illiquid and equal to or above LIS. In our view, a 12 week deferral period is necessary for transactions which are illiquid and equal to or above LIS.

Additionally, we have significant concerns about the potentially fragmented uptake by NCAs of the supplemental regime. We appreciate that this is within the discretion of each NCA, but we would urge ESMA to work with NCAs to encourage a widespread and harmonised take-up.

We propose the following amendments to paragraphs 1 to 3 of Article 10 of RTS 9:

"1. If competent authorities exercise their rights in conjunction with an authorisation of deferred publication pursuant to Article 11(3) of Regulation (EU) No 600/2014 the following criteria shall apply:

(a) If exercising the right pursuant to Article 11(3)(a) of Regulation (EU) No 600/2014, competent authorities shall request during the 48 hour time period of deferral the publication of:

(i) all the details of a transaction listed in Table 1 of Annex II except for those relating to volume, namely quantity and quantity notation; or

(ii) the publication the next working day before 09.00 CET of transactions in a daily aggregated form for a minimum number of 5 transactions executed on the same calendar day.

(b) If exercising the right pursuant to Article 11(3)(b) of Regulation (EU) No 600/2014 the publication of the volume of an individual transaction shall be omitted during an extended time period of deferral of: ~~four weeks following the transaction.~~

(i) 12 weeks following the transaction if the transaction meets the criteria in sub-paragraphs (a) and (b) of Article 8(1); or

(ii) four weeks following the transaction for all other transactions.

(c) If exercising the right pursuant to Article 11(3)(c) of Regulation (EU) No 600/2014 ~~R~~regarding non-equity instruments that are not sovereign debt, competent authorities shall request the aggregation of several transactions executed over the course of one calendar week to be published on the following Tuesday before 09.00 CET, ahead of the extended period of deferral of the publication of all the details of the transactions on an individual basis of: ~~four weeks if exercising the right pursuant to Article 11(3)(c) of Regulation (EU) No 600/2014.~~

(i) 12 weeks following the transaction if the transaction meets the criteria in sub-paragraphs (a) and (b) of Article 8(1); or

(ii) four weeks following the transaction for all other transactions.

(d) Regarding sovereign debt instruments, competent authorities shall request the aggregation of several transactions executed over the course of one calendar week to be published on the following Tuesday before 09.00 CET if exercising the right pursuant to Article 11(3)(d) of Regulation (EU) No 600/2014.

2. In relation to all instruments that are not sovereign debt, when the extended time period in accordance with paragraph 1(b) lapses, the outstanding details of all the transactions shall

141 be published on the next working day before 09.00 CET. For sovereign debt instruments the same shall apply if competent authorities decide not to use the options in Article 11(3)(b) and (d) of Regulation (EU) No 600/2014 consecutively pursuant to the second subparagraph of Article 11(3) of Regulation (EU) No 600/2014.

In relation to sovereign debt instruments, if competent authorities apply the options in Article 11(3)(b) and (d) of Regulation (EU) No 600/2014 consecutively pursuant to the second subparagraph of Article 11(3) of Regulation (EU) No 600/2014, competent authorities shall request for several transactions to be aggregated over the course of one calendar week and for the total volume traded per sovereign debt instrument in that calendar week to be published on the Tuesday following the expiry of the extended period of deferral ~~of four weeks~~ counting from the last day of the calendar week.

3. In relation to all instruments that are not sovereign debt, when the extended time period in accordance with paragraph 1(c) lapses, all the details of the transactions on an individual basis shall be published an extended period after the publication of the aggregated details in accordance with paragraph 1(c) before 09.00 CET, that extended period being:

(i) 12 weeks following the transaction if the transaction meets the criteria in sub-paragraphs (a) and (b) of Article 8(1); or

(ii) four weeks following the transaction for all other transactions."

3.8 Temporary suspension of transparency requirements

Q84. Do you agree with ESMA's proposal with regard to the temporary suspension of transparency requirements? Please provide feedback on the following points:

(1) the measure used to calculate the volume as specified in Annex II, Table 3

(2) the methodology as to assess a drop in liquidity

(3) the percentages determined for liquid and illiquid instruments to assess the drop in liquidity. Please provide reasons for your answer.

We highlighted in our response to the May 2014 Discussion paper that NCAs need to be in a position to temporarily suspend transparency requirements with a speed that keeps pace with changing market conditions, particularly in stressed market conditions. In our view, this means that NCAs must be able to act within hours of becoming aware of a significant decline in liquidity. The current

proposal, which requires 30 days of trading data, would not permit NCAs to act with sufficient speed to adequately respond to a significant drop in liquidity.

NCAs should have regard to a wider range of factors than just trading volumes when assessing whether there has been a significant drop in liquidity. For example, if prices move by a certain amount, NCAs should be able to temporarily suspend transparency obligation if they have reasonable grounds to believe that the price movements have been caused by a significant drop in liquidity.

The framework proposed for NCA's temporary suspension powers is highly dependent on a sufficiently granular determination of derivative sub-classes. Indeed, Article 9(5)(a) of MiFIR indicates that the temporary suspension powers should be applied on an instrument basis. Despite this reference in Article 9(5)(a) of MiFIR, we understand that ESMA intends for NCAs to assess whether there has been a significant decline in liquid on a sub-class basis (using the same COFIA sub-classes proposed by ESMA for the purposes of the liquid market definition). As we have stated in our responses to earlier questions, we believe that ESMA needs to adopt a more granular classification of sub-classes across all derivative asset classes. The percentages proposed by ESMA to determine whether there has been a significant drop in liquidity should reflect the homogeneity of the class of financial instruments. If ESMA does not propose to adopt a uniformly granular classification across all derivative asset classes, then the thresholds proposed for the temporary suspension regime should be lower for those classes of derivatives which are more heterogeneous.

In the May 2014 Discussion Paper, ESMA proposed a percentage decline of 80% for instruments with a liquid market and a percentage decline of 60% for instruments which do not have a liquid market (this is summarised in paragraph 4 on page 314 of the Consultation Paper). We note that ESMA's current proposal (as outline in the Consultation Paper and reflected in Article 14 of RTS 9) requires a higher percentage decline for illiquid instruments than liquid instruments – it now requires a percentage decline of 60% for instruments with a liquid market and 80% for instruments which do not have a liquid market. ESMA has not explained in the Consultation Paper why it has made this change. We therefore query whether this change was intentional.

3.11 Trading obligation

- **Criteria for determining whether derivatives should be subject to the trading obligation**

Q88. Are there any other criteria that ESMA should take into account when assessing whether there are sufficient third-party buying and selling interest in the class of derivatives or subset so that such a class of derivatives is considered sufficiently liquid to trade only on venues?

It is imperative that the assessment of whether there is "*sufficient third-party buying and selling interest in the class of derivatives or subset so that such a class of derivatives is considered sufficiently liquid to trade only on venues*", takes into account all variables which may impact the liquidity and tradability of an instrument and the assessment must therefore be conducted at a suitably granular level. If this approach is not followed then there is a risk that a derivative product which is insufficiently standardised and which cannot be traded on venue or in which there insufficient third-party buying and selling interest will be declared subject to the trading obligation.

We therefore support ESMA's view that option 2 (as set out on page 126 of the Consultation Paper) is preferred and that ESMA should distinguish between benchmark or integer tenors and broken dates and note that adoption of option 2 would help to align MiFID II/MiFIR to US regulation (since

the CFTC MAT product set only contains integer tenors and a limited number of forward-starting USD swaps). However, we would reiterate that there are likely to be a number of other parameters which will determine whether a derivative can be traded on a trading venue and the liquidity of the relevant derivative. By way of example the liquidity of an IRS instrument will be impacted by the inclusion of a number of bespoke terms including, but not limited to:

- day count fractions,
- reset frequency,
- reference index (e.g. six month LIBOR or 3 month LIBOR),
- coupons: at-market coupon ("par" swaps) or non-par coupons with the exchange of a fee,
- payment conventions (e.g. some swaps have payments made in arrears),
- compounding basis (e.g. some swaps have payments compounded across several reset periods, rather than paid at every reset), and
- variable notionals vs. constant notional.

It is therefore necessary for the sub-classes which are determined for the purpose of the liquidity assessment to be set at a granular level or (at a minimum) that the relevant "certain size" is set at a low level to reflect the fact that the liquidity assessment does not reflect the relevant parameters.

In addition, with regards to the average frequency of trades, we would note that a sub-class of derivatives should not be made subject to the trading obligation unless it trades every day during the assessment period.

Furthermore, we would highlight that in determining whether a sub-class of derivatives should be made subject to the trading obligation, ESMA is also required to "*take into consideration the anticipated impact that trading obligation might have on the liquidity of a class of derivatives or a relevant subset thereof and the commercial activities of end users which are not financial entities*" (Article 32(3) of MiFIR). In this regard, we note that ISDA's research indicates that a failure to align trading mandates on a cross-border basis has a demonstrable impact on market liquidity (see footnote 88 and Market Fragmentation: An ISDA Survey (December 2013); and Made-Available-to-Trade (MAT): Evidence of Further Market Fragmentation (April 2004); available at http://www2.isda.org/functional-areas/research/research-notes/) and underlines the importance of global harmonisation of trading obligations.

Q89. Do you have any other comments on ESMA's proposed overall approach?

1. Transactions below a certain size

With respect to the assessment of whether a class of derivatives is only sufficiently liquid in transactions below a certain size, we agree with ESMA that whilst the methodology for establishing the "certain size" should be consistent with methodology establishing the LIS thresholds, the thresholds themselves may not always be identical. However, in our view it would not be appropriate to set the "certain size" at a level higher than the LIS. We therefore agree with (i) those respondents to ESMA's discussion paper that noted there is unlikely to be sufficient liquidity for trading platforms to support LIS transactions – i.e. once a transaction in an instrument is large in

scale, it is no longer liquid – and (ii) the CFTC approach whereby block trades can be executed off-venue.

Accordingly, when establishing the "certain size" for a class or sub-class of derivatives, we would encourage ESMA to use the LIS as its starting point and to conduct a further liquidity assessment to determine whether the threshold should be reduced in light of the specific liquidity profile of the relevant class or sub-class.

2. Packaged Transactions

Furthermore we urge ESMA to clarify the treatment of package transactions.

a) Overview

ISDA would like to propose that ESMA considers specific and tailored treatment for package transactions as the Consultation Paper does not address how these transactions might be treated under the new framework. In response to the May 2014 Discussion Paper, ISDA included a number of detailed comments on the nature of package transactions which we draw ESMA's attention to. We reiterate the points made in that response and put forward a proposal which we hope ESMA will find workable and flexible enough to apply for venue and SI transparency obligations and the derivatives trading obligation. This will preserve the market for package transactions and ensure that pricing and liquidity is not negatively impacted for end investors.

We believe that Level 1 is flexible enough to empower ESMA to specify how package transactions are treated in order to determine if such transactions are liquid or "traded on a trading venue" (both for determining whether transparency obligations apply as well as determining whether the derivatives trading obligation applies). The Level 1 text clearly sets the foundation for the pre- and post-trade transparency regimes in non-equities by defining the asset classes – "bonds, structured finance products, emission allowances and derivatives" – on which the Level 2 measures must be built. However, ESMA has flexibility to define how, within these broad asset classes, to identify whether specific financial instruments (or combinations thereof) are to be considered "liquid" or "traded on a trading venue". ESMA has chosen to adopt COFIA as the basis for determining whether a liquid market exists – which suggests to us that ESMA is also empowered to tailor this approach to instruments which fall within one of the specified classes, but are part of a package transaction.

b) Advantages of package transactions to clients

Package transactions allow clients to reduce their transaction costs (i.e. a single transaction is less expensive to execute than multiple transactions) and manage their execution risk (i.e. a single execution alleviates timing and other mechanical/process type risks). They are tailored to provide risk-return characteristics in the form of a single transaction in an efficient and cost-effective manner to clients.

c) Challenges to trading package transactions without a tailored proposal

Below are some very realistic fact patterns which hopefully demonstrate that unless there is tailored treatment for package transactions which recognises that package transactions should be considered in their entirety when being assessed as subject to transparency requirements and/or the derivatives trading obligation, there is a significant risk that such transactions may no longer be available to clients in the EU. This will be due to the individual components being treated differently and inconsistently vs. each other when they are assessed against the relevant requirements which

would negate the advantages highlighted above of trading package transactions. These challenges are likely to be particularly acute where one or more of the components of a package transaction includes derivatives subject to the trading obligation:

- If some components of a package transaction are traded on a trading venue but others are not.
- If some components of a package transaction are deemed liquid but others are not.
- If some components of a package transaction are above the relevant "certain size" thresholds but others are not.
- If the components of a package transaction are below the relevant "certain size" thresholds but together they behave similarly to a single transaction above the "certain size".
- If the package transaction contains a listed derivative which trades on a different trading venue to other components.

If ESMA fails to provide for the appropriate trading of packages, end investors will be required to trade the components independently, resulting in increased transaction costs and increased execution risks, which would seem to conflict with ESMA's policy objectives.

d) ISDA proposal

We would be keen to assist ESMA with the development of a workable regime for the application of the trading obligation to package transactions. We consider that the following proposals could both address the challenges we have described above. We have provided both proposals for ESMA's consideration as we recognise that, whilst Option 1 is a simpler proposal, Option 2 is more accurate.

Option 1:

1. Subject to point 3 below, if each component of a package transaction is liquid:

    a. The package transaction should be considered liquid; and

    b. If any one component is above the relevant "certain size" threshold then the package transaction should be deemed to be above the threshold.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

    a. The package transaction should be considered illiquid; and

    b. If any one component is above the relevant "certain size" threshold then the package transaction should be deemed to be above the threshold.

3. For the purposes of MiFIR Articles 32, all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

If ESMA, for the purposes of the trading obligation, would prefer to represent this in a table format, we propose the following table which reflects the above:

Table 31: ISDA Proposal for the application of the Trading Obligation to package transactions					
Type	**Package type comprising…**	**Example**	**1. All components above "certain size"[2]**	**2. At least one component above "certain size"[2]**	**3. All components below "certain size"[2]**
A	Exclusively derivatives sufficiently liquid	2yr vs 10yr EUR swap	Not subject to trading obligation [2]	Not subject to trading obligation [2]	Trading obligation applies
B	Derivative(s) sufficiently liquid and other derivative(s) in the same asset class[1] not sufficiently liquid	EUR swaption vs. delta hedge	Not subject to trading obligation	Not subject to trading obligation	Not subject to trading obligation
C	Derivative(s) sufficiently liquid and other and exclusively liquid securities	Asset swap vs. cash bund	Not subject to trading obligation [2]	Not subject to trading obligation [2]	Trading obligation applies
D	Derivative(s) sufficiently liquid and other non-liquid securities	Asset swap vs. illiquid covered/corporate bond	Not subject to trading obligation	Not subject to trading obligation	Not subject to trading obligation
E	More than 10 components	Package of several swaps bundled for execution (e.g 10yr EUR swap, 15yr EUR swap, 20yr EUR swap, 25yr EUR swap and 30yr EUR swap)	Not subject to trading obligation	Not subject to trading obligation	Not subject to trading obligation

[1] Interest Rate Derivatives, FX Derivatives, Equity Derivatives, Commodity Derivatives, etc considered as distinct derivative asset classes.

[2] Assuming here that the "certain size" is at the size at which ESMA consider the derivative insufficiently liquid to be subject to the Trading Obligation under MiFIR, as discussed on page 342 of the CP.

Option 2:

1. Subject to point 3 below, if each component of a package transaction is liquid:

   a. The package transaction should be considered liquid; and

   b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its relevant "certain size" threshold. If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant "certain size" threshold. See below for a more detailed explanation of the percentage threshold approach.

2. Subject to point 3 below, if the package transaction contains liquid and illiquid components:

   a. The package transaction should be considered illiquid; and

   b. The percentage threshold for each individual component in a package transaction is equal to the notional of the relevant component expressed as a percentage of its

relevant "certain size" threshold. If the sum of the percentage thresholds for all components in the package transaction is above 100%, then the package transaction (and each of its components) is above the relevant "certain size" threshold. See below for a more detailed explanation of the percentage threshold approach.

3. For the purposes of MiFIR Articles 32, all components of a package have to be tradable on a single venue in order for the package be considered "traded on a venue".

4. If the package transaction comprises ten or more component legs, the package transaction should be considered illiquid.

The percentage threshold approach aims to, in a simple manner, replicate the package of instruments into a single instrument to test whether it would indeed be above the "certain size" threshold or not if it were traded as a single instrument.

Example: if an investor wishes to hedge cash flows at 5-year and 15-year points using EUR interest rate swaps, to create an accurate hedge the investor would trade a package of two EUR swaps at 5-year and 15-year maturities. Alternatively, the investor could enter into a single swap with an average 10-year maturity to try to replicate the risk profile but with less accuracy.

However, whilst the individual swaps in the package of swaps could each be below the relevant threshold, the equivalent single swap would have a larger notional and could therefore be above the threshold, as illustrated below. Given the 5-year and 15-year swaps are economically similar in nature, the pricing of one swap is likely to impact the pricing of the other. By not recognising this, ESMA could create an incentive for the market to trade in the equivalent single average instruments, rather than the package of instruments that provide a more accurate hedge: the result would be to provide a less perfect hedge, thereby retaining risk in the system.

The suggested percentage threshold approach provides a way to calibrate this and ensures that package transactions are not disproportionately disadvantaged.

The below table illustrates the example described above.

Table 32: Example of how the percentage threshold approach (Option 2) operates

	More accurate hedge		Less accurate hedge
	EUR 5yr swap	**EUR 15yr swap**	**EUR 10yr swap**
Notional	60m	60m	120m
Threshold (certain size)	100m	100m	100m
Percentage Threshold	60%	60%	120%

Table 31, prepared in respect of Option 1, could easily be adapted for Option 2 if this is ESMA's preferred option and we would be happy to prepare this table if requested.

e) Safeguarding against avoidance

ISDA is aware that ESMA and national competent authorities may be concerned that adoption of our proposal may lead to market participants creating packages of instruments purely for the purposes

of avoiding the transparency regime or the derivatives trading obligation. ISDA recognises these concerns and suggests that this could be achieved by defining a package and including, within the MiFID II/MiFIR framework, a mechanism that would support the monitoring (and therefore supervision) of this instrument type. ISDA would welcome the opportunity to discuss these safeguards with ESMA in more detail.

1. Definition of package transaction

ISDA recommends that a "package transaction" be defined as a transaction comprising two or more components, each of which is a *bond, structured finance product, emission allowance or derivative* where:

(i) The components are priced as a "package" with simultaneous execution of all such components; and

(ii) The execution of each component is contingent on the execution of the other components; and

(iii) Each component must be able to stand alone and must be able to bear economic risk; and

(iv) Either:

i. the components are economically similar in nature such that the pricing of one component can affect the pricing of the other component; or

ii. the components must have a reasonable degree of correlation.

2. Post-trade transparency flag

With a view to assisting the monitoring of package transactions by supervisors, and as stated in our response to Question 74, ISDA recommends that an additional flag to be reported on trades that are components of package transactions be added to the list of flags set out in Table 2 of Annex II of RTS 9.

We would also draw attention to our response to Question 218 where we suggest that ESMA may wish to consider including a "link ID" field in transaction reports (for the purposes of the Article 26 MiFIR transaction reporting regime). In ISDA's response to ESMA's recent consultation paper on the review of reporting technical standards under EMIR, we recommended the inclusion of a "link ID" field to link together trade reports of components of the same package. ESMA may wish to consider whether to incorporate such a field in the transaction reports required under the MiFIR transaction reporting regime as this would give supervisors greater visibility in respect of the usage of package transactions.

3. Risk Reduction Trades

We welcome Recital (9) in RTS 11, which discounts trades that are clearly identified as 'non-price forming post-trade risk reduction trades with reduced non-market risk in derivatives in line with Recital 27 of Regulation 600/2014'.

- **Criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU**

Q90. Do you agree with the proposed draft RTS in relation to the criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU?

No. In our view it is not necessary or appropriate for the trading obligation to apply to third country entity trades where the clearing obligation under EMIR does not apply to the relevant transactions by virtue of an equivalence assessment under Article 13 of EMIR.

ESMA's current proposal could lead to a situation in which the EU imposes an obligation on two counterparties to trade an instrument on an EU trading venue despite the fact that neither counterparty is based in the EU and the relevant transaction is exempted from the EU clearing obligation by virtue of Article 13 of EMIR. In our view such transactions cannot be properly interpreted as having a direct, substantial and foreseeable effect within the EU and nor is the application of the trading obligation to such transactions necessary to prevent the evasion of the MiFIR as those trades do not impose additional risks in the EU.

Furthermore, such counterparties may be subject to conflicting local law trading requirements and are unlikely to have access to EU trading venues which will make it difficult for such entities to comply with the EU trading obligation. Determining the relevant third country's trading platforms pursuant to Article 28(4) of MiFIR alone insufficiently addresses the potential for duplicative and conflicting rules as the legislation of the relevant third country may not (for legitimate reasons) impose a trading obligation on the particular transaction.

Accordingly, we would urge ESMA to specify in the draft MiFIR RTS that the criteria will not have been met if the clearing obligation does not apply to the transaction as a result of the application of Article 13 of EMIR.

In light of the above, we would encourage ESMA to incorporate these clarifications into the RTS. This could be achieved by inserting a new Article 2(3) and an accompanying recital (8a):

> "*(3) Notwithstanding paragraphs (1) and (2), an OTC derivative contract shall not be considered as having a direct, substantial and foreseeable effect within the Union where the Commission has adopted an implementing act under Article 13(2) of Regulation (EU) No. 648/2012 in respect of a third country in which at least one of the counterparties is established.*"
>
> "*Recital (8a) The trading obligation under Article 28 of Regulation (EU) No. 600/2012 should only apply to an OTC derivatives contract where the counterparties are subject to the clearing obligation under Article 4 of Regulation (EU) No. 648/2012 in relation to that contract. To ensure that goal is effectively achieved, an OTC derivative contract should not be regarded as having a direct, substantial and foreseeable effect within the Union where the counterparties are not subject to the clearing obligation because one or both of the counterparties is established in a third country in respect of which the Commission has adopted an implementing act under Article 13(2) of Regulation (EU) No. 648/2012*."

In any event, we would encourage the Commission to conduct the equivalence assessments under Article 13 of EMIR at the same time as the assessment under Article 33 of MiFIR.

Q91. Should the scope of the draft RTS be expanded to contracts involving European branches of non-EU non-financial counterparties?

No. In our view ESMA has no grounds on which to increase the scope of the RTS in this way and fully support ESMA's decision to delete the reference to non-EU non-financial counterparties.

Q92. Please indicate what are the main costs and benefits that you envisage in implementing of the proposal.

4. Microstructural issues

4.1 Organisational requirements for investment firms

Q93. Should the list of disruptive scenarios to be considered for the business continuity arrangements expanded or reduced? Please elaborate.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We believe that the list of disruptive scenarios should be reduced. The question refers to a list of disruptive scenarios, but we are not entirely clear as to what list ESMA refers. Where ESMA may be referring to the list under RTS 13, Article 20(2)(b) then we make the following comment:

- "system failures, communication disruptions and loss of key staff whether due to technical or operational problems" would benefit a drafting amendment such as "system failures and communication disruptions whether due to technical or operational problems, loss of key staff..."

- "human error" is nebulous and difficult to define or plan for as a 'scenario' in business continuity arrangements; this is reasonably covered by general operational risk considerations mentioned in RTS 13, Article 2(a)

AFME previously raised the point of the definition of 'disorderly/disruptive scenarios/markets' in the August response to the ESMA consultation paper. It was noted that it appears there are two views on this:

- From an investment firm perspective: disorderly markets will refer to a particular market event. It is not clear as to the definition of 'disorderly' and how this would be quantified, evaluated and how long a market must be 'disorderly' to be determined to be a 'disorderly trading condition'. There may be fluctuations in market activity such as monthly ECB announcements which could lead to slight fluctuations in the market however this should not be seen as a 'disorderly trading condition'. It is difficult to 'test' a disorderly trading condition and by way of its current definition it is not clear what would constitute a 'disorderly' market condition.

- From a trading venue's perspective: The emphasis seems to be on IT and operational issues rather than 'real market conditions'.

The difference between the above would need to be clarified in order to ascertain how market participants are to understand what their responsibility in terms of business continuity should be reflected upon and how they should decide as whether something will/will not be 'disruptive to the markets/be a disruptive scenario'.

Where ESMA may be referring to the "business continuity arrangements" (BCP's) listed under RTS 13, Article 20(2) in entirety, and in any case, we make the following comments:

Our members propose the deletion of points (d) and (e) for the following reasons:

In relation to point (d) in which ESMA stipulates that arrangements should cover the '*duplication of hardware components to permit continuous operation in case of a failover',* our members wish to

note that such contingency processes and hardware components are already in place to the extent necessary in the context of overall BCP arrangements..

In relation to (e) in which ESMA stipulates robust requirements which investment firms should also have in place including specific back up plans. Our members feel that their current BCPs cover contingencies and that additional back up facilities are (as proposed by ESMA) more suited to the framework of trading venues. Setting such a minimum requirement for business continuity (in addition to requiring that each of these be tailored to every venue the firm may have access to) is felt to put smaller firms in a disadvantageous position.

Under the organisational requirements for investment firms and their respective BCP's, ESMA proposes in point (g) that a firm should have in place '*business continuity arrangement that are bespoke to each of the venues that it accesses'.* We believe that this requirement is unduly burdensome particularly when considering the current business continuity plans (BCPs) already in place and stipulated by NCAs. Our members support the enhancement of plans to ensure the orderly functioning of the markets for all market participants, however we feel that having BCPs which are bespoke to each venue an investment firm may have access to would disadvantage smaller firms who may not have sufficient funds to build out further BCPs in relation to additional trading venues as well as in addition to the BCPs those firms already have in place for their existing trading venues they access.

In relation to Art 20 (2)(i) *'arrangements for the investment firm to trade all existing orders manually'* should be amended (proposed wording below). This is not always practicable, possible or in the best interest of the clients.

Investment firms should be allowed the flexibility to act in their clients' best interests and as far as is possible in a disruptive scenario within the obligation of best execution.

We propose that the following amendment should be made to RTS 13 Article 20 (2) (i):
"Arrangements for the investment firm to **manage** existing orders in line with the clients' best interests"

By way of explanation for the above we would additionally note that an investment firm may manage existing orders by way of, for example, re-routing the client's orders or processing these manually. We wish to point out that there are several ways in which to manage existing orders in line with the clients' best interest should such a scenario occur.

ESMA should take into account its own principal of proportionality between firms when establishing business continuity arrangements. The proposed arrangements are more relevant for large firms where their systemic market impact is significantly superior to that of small firms. There are instances where a firm itself creates a vast disruption due to its participation in one or several markets, where proportionality due to size or participation in a market should be deemed relevant for their application.

Q94. With respect to the section on Testing of algorithms and systems and change management, do you need clarification or have any suggestions on how testing scenarios can be improved?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Restricted Deployment:

We support the controlled rollout of algorithms with the following drafting qualification at RTS 13, Article 12 (2): *"Limits shall be placed as appropriate on the number of financial instruments being traded, the price, value and number of orders, the strategy positions and the number of markets to which orders are sent."*

However we seek clarification on the notion of 'restricted' for example whether this is in reference to using a certain amount of liquidity. We are still concerned in relation to market makers who would not be able to fully restrict the deployment of a change to an algorithm and still satisfy their obligation to quote on a continuous basis. ESMA notes these concerns in its Consultation Paper but does not elaborate on how these issues are reconciled.

We wish to make the following comments in relation to testing:

We continue to support testing being carried out to ensure the efficient and orderly functioning of the markets (and investment firms already have in place rigorous testing of algorithms and trading systems as part of their IT development processes).

We would again like to point out that the testing requirements should be in line with the 'proportionality principle'. As an example this is the case for non-equities, in the case of small changes in algorithms which are expected to trade at very low levels, such as once per week. The intensity therefore of having all three stage testing procedures applied to each change in algorithms would not always be practicable or appropriate to the nature of the trading activity in respect of the relevant financial instrument.

Members expressed their strong disagreement with ESMA's requirement to test minor non-structural changes to algorithms. Firms regularly introduce immaterial changes such as recalibration or adjustments in parameters that should not necessarily be tested for purposes of compliance with the provisions. Testing requirements should be limited to instances where the firm has introduced material changes (e.g. functioning, substantial or structural changes to the algorithm). Excessive testing provisions and monitoring may prevent market makers from providing liquidity as every algorithm adjustment to market circumstances would require the deployment of onerous testing deployment.

Furthermore, we propose that it should be left for investment firms to deem if the algorithm change is material and thus if it is necessary to conduct initial testing as required by Article 10 in RTS13. In addition, we note that firms monitor the performance of their algorithms on a continuous basis after changes have been deployed, which seek to ensure suitability in their performance once changes have occurred.

Conformance testing (RTS 13)

Regarding conformance testing, we note that the current wording of RTS 13 Article 9 paragraph 1 requires that investment firms who are members or participants of a trading venue perform conformance testing with a trading venue, but that DEA clients of a DEA provider (either using a

sponsored access service on a trading venue or DMA)are not required to do so. We believe that they should be covered by the equivalent requirements. We note also that this would bring Article 9 (conformance testing) in line with Article 11 (algorithm testing) which we feel is appropriate.

We also note that the wording of the same article states in paragraph 1 that an investment firm using a DEA service should perform conformance testing with the DEA provider and (in paragraph 2) that 'this should take place when there is a change in the trading venue's DEA functionality'. This implies that all DEA providers' DMA clients would need to recertify with the DEA provider whenever there's a system upgrade at the trading venue which, given the DEA client isn't directly connected to the trading venue, we don't believe to be appropriate.

Hence we suggest alternative wording of Article 9 as follows:

1. An investment firm shall pass conformance testing:

> a) with the trading venue where it is a direct member or participant, or where it is directly connected using a sponsored access arrangement;
>
> b) with its DEA provider where the investment firm accesses the trading venue using the DEA provider's DMA access;

2. Such conformance testing shall take place when:

> a) where the investment firm is a direct member or participant, or where it is directly connected using a sponsored access arrangement, whenever there is a change in the trading venue's infrastructure such that the trading venue considers re-testing to be necessary;
>
> b) where the investment firm is using its DEA provider's DMA access, whenever there is a change in the DEA provider's infrastructure such that the DEA provider considers re-testing to be necessary;
>
> c) in both of the above cases, whenever the investment firm itself determines that they need to re-certify due to a change within their system or substantial hardware changes.

3. A DEA provider providing sponsored access to clients that are not investment firms, shall require that those clients pass conformance testing with the trading venue under the circumstances set out in paragraph 2a.

4. An investment firm providing DMA to clients that are not investment firms, shall require that those clients pass conformance testing with the it under the circumstances set out in paragraph 2b.

Non-live testing of algorithms (RTS 13/14):

The following response applies equally to Q94 (investment firm algorithmic trading) and Q102 (trading venues) and is repeated for each question.

Our members believe that the proposals regarding non-live testing of investment firms' algorithms are counterproductive, inefficient and unrealistic in their current form.

We understand that one of the primary influences for the non-live testing measures is the incident involving Knight Capital Americas LLC in July 2013. Having reviewed the SEC's assessment* of the incident, our members would like to highlight that the non-live testing measures proposed would

have been unlikely to prevent this incident had they been in place. In contrast, we believe that many of the other measures proposed in RTS 13 would indeed have reduced risk in this respect. The *current* non-live testing proposals however will provide marginal benefit at great cost. Moreover they do not appear to have been dealt with adequately within ESMA's cost-benefit analysis.

We would like to present a counter proposal based on its members' understanding of the risks which ESMA seeks to mitigate in particular with respect to the potential for creating disorderly trading conditions. These can be categorised in the following way:

1) **Compatibility Risk:** The risk that a firm's algorithms and infrastructure are insufficiently tested against a trading venue's infrastructure leading to the creation of disorderly trading conditions.

2) **Market Dynamic Risk:** The risk that a firm's algorithms and infrastructure create disorderly trading conditions due to their interaction with other market participants, or that they fail to respond appropriately in an environment where disorderly trading conditions already exist.

Our members believe that an efficient and additive solution requires these risks to be mitigated separately. Specifically, the former requires access to an environment that mimics the trading venue's production system. The latter requires an environment which represents or models market behaviour, in which multiple participants are simultaneously present and includes facilities capable of artificially imposing disorderly trading conditions (e.g. by imposing capacity constraints on the infrastructure, slowing the system down or introducing simulated erroneous orders).

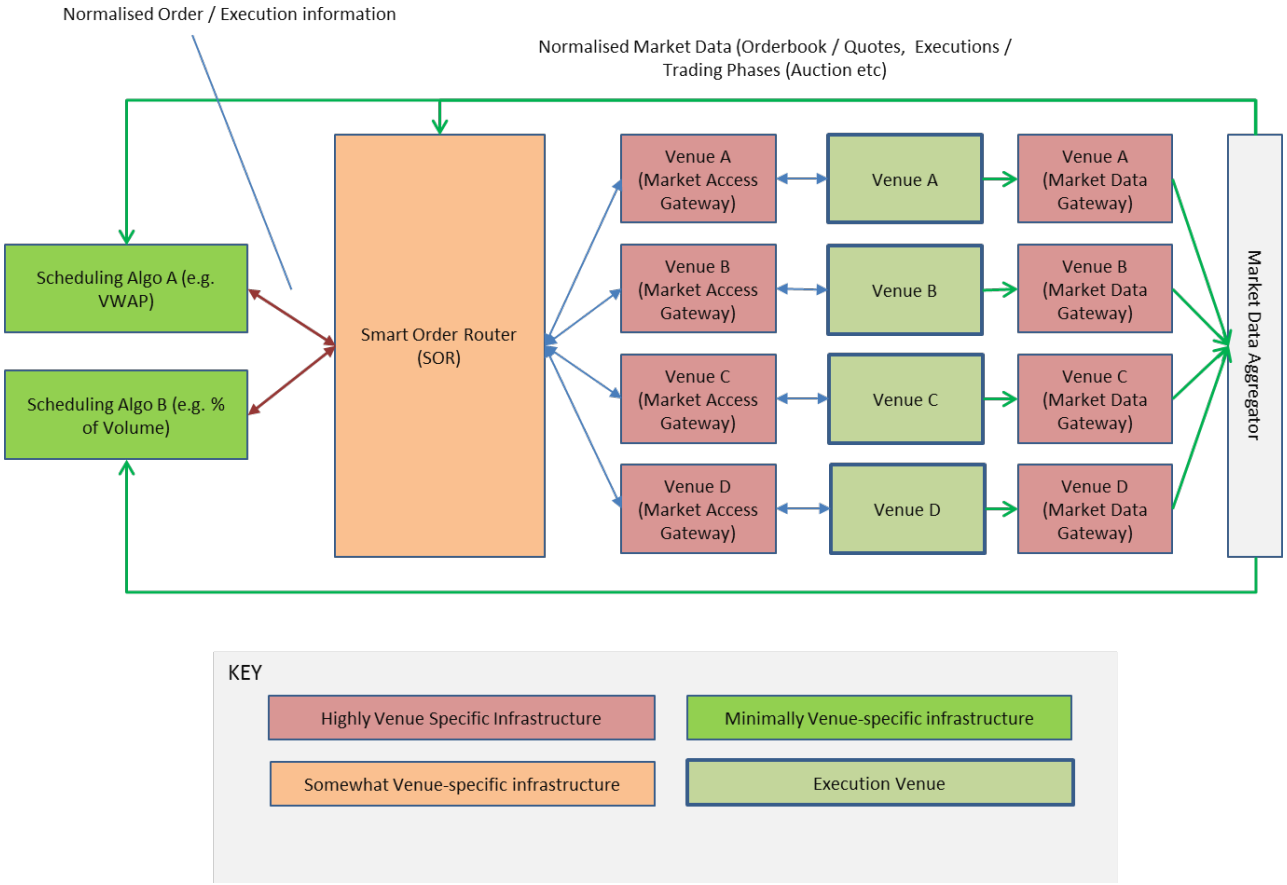
We note that this does not lead to a perfect solution but does lead to a better solution.

Compatibility Risk

In its recent consultation paper, ESMA asserts that *"market microstructure differs greatly from venue to venue".* Though we agree with this statement in totality (i.e. across all asset classes and types of market), if we consider classes of market categorised by market mechanism and asset class, then the microstructure is very similar (differences mainly being confined to variations in trading hours, timing of auctions, minimum/maximum trade size rules, all of which lend themselves to being expressed through venue-specific *parameterisation* of logic rather than venue-specific logic). This is not to argue that these differences are immaterial or should not be addressed, simply that they should be accounted for in an efficient manner.

It is important to note that investment firms will arrange their algorithmic trading infrastructure differently depending on the nature of their business. The attached diagram below illustrates how an investment firm providing order execution algorithms (e.g. for executing client orders) will typically organise itself to execute across multiple EU venues in cash equities. Efficiency is gained for the firm and its clients by modularising the infrastructure so that similar venues can be treated similarly.

(The Table below refers to Cash Equities)



Such an investment firm's infrastructure is typically organised into three categories for order driven markets:

Gateways: This infrastructure is highly tailored to the specific venue that it deals with:

- **Market access gateways** translate orders and executions between the investment firm's internal messaging format to that used by each individual trading venue.

- **Market Data gateways** translate the individual market data protocols into a common protocol which the firm can use to understand market data from individual venues on equal terms (this is allows for data to be aggregated and prices compared where an instrument is listed across multiple venues at once). Market data gateways will normalise the way in which order book information and executions are received and translate "trading phase" information into normalised form (e.g. opening auction, closing auction, volatility auction, regulatory halt).

Smart Order Routers (SORs): SORs are somewhat tailored to the venues that they interact with although they will typically send and receive messages in much the same form to each venue that they interact with. For instance an SOR will need to know which is the "primary (listing market)" for each jurisdiction and will typically defer to that market for multi-listed instruments if the primary market enters a volatility auction.

Scheduling Algorithms: These typically have very little venue-specific logic embedded in them. This is possible because, the majority of the burden of dealing with individual venues is handled by the SOR and Gateways. Scheduling Algorithms are predominantly concerned with generic market dynamics (and therefore also present the majority of the risk in this area).

Investment firms that operate proprietary trading algorithms generally have simpler infrastructures (e.g. for latency reasons) and as such will often either connect the algorithm to market access and market data gateways, or even have the algorithm connect to the trading venue directly.

Proposal

Infrastructure that deals with venue-specifics should be tested most intensively against the venue's own test platform. In the cash equities example given, this means the SOR and the Gateways. Venue-specific logic in an individual algorithm should also be tested where it exists.

In a non-modular example where an algorithm deals more or less directly with the trading venue's infrastructure, we would agree that that algorithm should also be tested intensively on every trading venue on which it is used.

In summary, we believe that an algorithm should **not** be required to be subjected to testing within a non-live environment if it fulfils all of the following criteria:

- The algorithm uses an intermediary algorithm to connect to the trading venue.
- The algorithm contains minimal venue-specific logic and is purposely designed to operate across multiple markets.
- The algorithm has been tested in a non-live environment on at least one market it has been designed to operate on.

Market Dynamic Risk

In our example, the components of an investment firm's infrastructure that pose the most risk when exposed to "live market conditions" are those with the least venue-specific logic. In our example, the scheduling algorithms and SOR pose the greatest risk of causing disruption (in this context) as these are the components which analyse market behaviour and make execution decisions. We also note that algorithms such as SORs are designed to operate across multiple markets at a time and a comprehensive test therefore could not take place within a *single* trading venue's test facility.

Such "real market" conditions are impossible to re-create perfectly however and even imperfect solutions are extremely expensive to implement:

- One solution is to "replay" previous order information into a venue. This is expensive to perform however and does not duplicate the potential for participants to interact negatively with each other.
- A requirement to execute disorderly trading tests across every venue in which they participate (some 15-20 venues for cash equities) is extremely costly and time-consuming to perform. Moreover, it is likely to incentivise to a "box checking" approach by nature of its excessive time consumption

- The incremental benefit of performing these tests across multiple similar venues is also minimal as the components of infrastructure which present the most risk are concerned largely with generic market dynamics and less so with the specifics of the individual trading venue.
- To cater for multi-market algorithms (e.g. SORs) using trading venue facilities, there would need to be a way of connecting those facilities together which we believe to be expensive and most likely unworkable in practice.

Proposal

The risks that algorithms misbehave when they encounter market-like conditions are usually generic because infrastructure is often built to deal with the market generically. Those risks can therefore be reduced much more effectively and efficiently by allowing for them to be tested for centrally.

We believe that higher quality centralised testing is a better way of mitigating of the risks of disorderly trading than performing what are likely to be many individual tests of much lower quality against individual trading venues.

Venues should be able to delegate testing for disorderly trading conditions to a centralised provider where appropriate. The provider's role should be to create an environment which many different participants can come together to exercise their infrastructure in an environment which concentrates their activity so as to re-produce a market-like dynamic. Because the environment would bring real participants and their infrastructure together in a single place, it would provide the most useful advance warning possible of any potential problems.

Requested changes to the RTS

Based on the above we suggest the following changes to RTS 14 Article 11:

Testing the members' algorithms to avoid disorderly trading conditions

1. Trading venues shall require their members, participants and users of sponsored access services to undertake testing of trading algorithms to avoid creating or contributing to disorderly trading conditions. Trading venues shall not grant access to use an algorithm that has not been tested and shall require algorithms to be tested or re-tested whenever:

a) a new algorithm is written;

b) an existing algorithm undergoes a material change (where the user of the algorithm will be required, on the request of the trading venue, to evidence which changes have been deemed 'material')

c) the trading venue itself undergoes a change where it deems it necessary to retest some or all algorithms.

2. Trading venues shall provide access to test facilities which are capable of supporting the following:

a) testing algorithms for compatibility with the trading venue's infrastructure, i.e. facilities that functionally replicate the trading venue's production environment and provide;

i) a representation of a typical normal trading day (for example through the use of replayed historical data or through a simulation);

ii) a simulation of disorderly trading conditions (for example by forcing temporary capacity limits on the test system, slowing the system down or introducing simulated erroneous orders);

b) testing of algorithms for compatibility with multiple trading participants in a realistic production-like environment.

3. Where an algorithm has been tested against one trading venue but does not access the venue directly (i.e. instead using an intermediary system such as a smart order router) and contains no trading logic specific to individual trading venues, then that algorithm can be considered to have been tested across all trading venues that trade the same class of financial instruments and operate a similar market mechanism and hence does not need to be separately tested for each such trading venue.

Real time monitoring:

The ESMA proposed requirement for an independent internal risk control function is deemed cumbersome. Impact of monitoring on a real-time basis of the firms' order book is unnecessary when the firm is acting on a principal capacity to the client.
We request further clarity as to what is considered "independent" by ESMA. Our members understand it is independent from the trading desk but not independent from the firm itself.

Additionally we wish to propose the following amendment for the sake of clarity in RTS 13 Art 16 (3):

Investment firms shall maintain real-time, complete, accurate and consistent trade and account information. This shall include all orders and executions generated by themselves (where running their own algorithms) or their clients (where acting as a DEA provider) regardless of whether the orders go through their own infrastructure. Where orders do not go through the investment firm's infrastructure, this may involve the use of drop-copy feeds of orders and executions from trading venues, CCPs, the DEA provider, their clearing broker or other relevant business partners as appropriate in order to ensure they have a complete picture of trading activity.

We make further comments on Real-time monitoring at the response to Q98 below.

Kill functionality:
We welcome that ESMA has recognised that kill switches are to be considered a last resort and are not the panacea of risk management. We therefore welcome the clarification in RTS 13, Article 17(1) that kill switches are to be used as an emergency measure, i.e. only when absolutely necessary.

For the purpose of clarity RTS 13, Article 17 (2) should be amended as follows:

ESMA notes that *'firms shall have the capability to cancel their outstanding orders at individual trading venues, or originating from their individual traders, trading desks, or, where applicable, their own clients. This implies that firms shall be in the position to know which algorithm corresponds to the relevant firm's traders and, if applicable to the relevant firm's clients'.*

Q95. Do you have any further suggestions or comments on the pre-trade and post-trade controls as proposed above?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Clarity of Proposals / Background

Our members have found the proposals ambiguous in some areas. In particular the context in which RTS 13 is drafted has created some confusion. RTS 13 is drafted in the context of "firms engaged in algorithmic trading" but appears to be a continuation of ESMA's "*guidelines for Systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities*" which had a broader remit.

This, in combination with some of the language used, has left our members unclear as to how to interpret the proposals accurately with a view to future implementation. More specifically, the pre-trade proposals can be interpreted in two ways:

- As controls to be applied specifically to the activity of trading algorithms to ensure that they do not create or contribute to disorderly markets
- As controls to be applied broadly to all orders submitted by an investment firm to the market for the same purpose

For the purposes of this response, we will assume the latter interpretation as it allows us to highlight potential areas of concern if this is indeed the intended outcome. Some of the concerns we will highlight do not apply if the former interpretation is applied.

Article 21: General Interpretation of Language Used

In Article 21, paragraph 1 ESMA uses the term "order entry". Our members typically associate this term with the actions of a human entering an order into a system (which may then generate orders which are submitted to a trading venue). In further drafting of this article, we suggest defining and using two separate terms to provide delineation between different processes:

Order Entry: the actions of a human entering an order into a system which then may result in a submission of an order to a trading venue

Algorithmic Order Submission: the act of a firm submitting an order to a trading venue where the order is initiated without human intervention

Article 21 Specific Concerns

Paragraph 2: states that "*Investment firms' **order management systems** should prevent orders from being sent to trading venues…"*: Order management systems are usually used specifically in the context of *order entry* as defined above. They are, therefore, not appropriate places to put broader pre-trade controls. We recommend revising this drafting as follows:

"*Investment firms' **trading systems** should prevent orders from being sent to trading venues..."*

Paragraph 4

Clause a) The reference to control against price parameters *over a specified period of time* is unworkable based on our understanding of the requirement: We understand this provision to be aimed at controlling situations in which individual orders do not in themselves constitute a major price move but in which multiple orders over a period of time do constitute a major price move. The introduction of such controls by *investment firms* (as opposed to trading venues) will create a number of problems:

- Investment firms cannot calibrate such checks in a way which will reliably distinguish between illegitimate activity and what is simply a "fast market". That is to say, the control will trigger regardless of whether the firm itself is moving the market or the market is simply moving
- These controls should be operated only by trading venues which can then allow legitimate activity to proceed in a controlled manner with the appropriate mechanisms (such as volatility auctions).
- If an investment firm seeks to pre-empt the volatility controls in place on trading venues, it will simply constrain the market artificially during periods of genuine volatility and prevent venues from forming the correct price in a stressed environment.

Clause c) The requirement that "*Limits shall be set in shares or lots*" is unworkable. Appropriate limits for some asset classes but (particularly equities) vary substantially by instrument: Ten shares may be a very large order in one instrument but a very small order in another. It is not practical to maintain individual limits across thousands of instruments. The practical solution to the problem adopted by many firms is to set limits according to a fixed percentage of a metric associated with the specific security which allows the natural identification of an unusually large order. Average daily market volume (ADV) or average trade size (ATS) are alternatives. We propose the following drafting:

"Maximum order volume which prevent orders with an uncommonly large order size from entering the order books. Limits shall be set in shares, lots ***or as a percentage of either:***

- ***average-trade-size or average-daily-volume in that security traded on a given venue(s) or an equivalent measure of liquidity;or***
- ***For order driven markets: prevailing volume available at the time of order submission, within the price constraints referred to in part a) on the relevant trading venues; or***
- ***prevailing volume indicated to uncross during any relevant auction period"***

Clause d) We do not see the workability of this in relation to clients of an investment firm operating their own algorithms

Clause e) We do not understand this as a pre-trade control as drafted. We believe this requirement is in fact covered by the real time monitoring obligations in Article 16

Clause f) We understand this as requiring a throttling of the messages of the way to the trading venues, we would welcome such throttle to be considered as appropriate if only

applicable to new orders and order modifications. We believe cancels should be left outside of such throttle whether on the investment firms or the exchange side. By removing the cancels message from a throttling feature, we do not put at risk the exchange systems as it would only change the level of calibration of such metrics. It would allow and guarantee the investment firms can be confident it can exit the market in an orderly fashion in case of issues, ensure kill switch operates correctly. Although trading venue can provide with cancel on disconnect functionality, it can only be used when the connection between the trading server and the matching engine of the venue is severed and not when one of the desks or firms using the trading server has to call on a kill switch.
If however the trading venue had any concerns in the number of cancels coming through the connection, a proper throttling feature should be able to slow down the cancels on the way to the matching engine and not reject, as the investment firm may not be able to actually processed those rejects and re send the cancel. Hence we would suggest amending the RTS wording by replacing the word "messages" by "new orders and order modifications".

Paragraphs 6, 7 and 8

These procedures must distinguish for nuances that arise when considering both the source of the order and the type of pre-trade control. As paragraph 8 is currently drafted, the necessity for risk management staff to approve the override of any breach is likely to threaten the orderly conduct of legitimate business. We cite the following scenario as an example:

- A client that wishes us to place a large order manually into a closing auction for them on a day in which there is an unusually large amount of activity in the auction itself.
- A pre-trade control blocks the order because it is unusual (although legitimate at this time)
- Approval must be sought from "risk management" even though the relevant trader is adequately qualified (and has access to the most up to date information) to judge that the order is legitimate in the prevailing market conditions.
- By the time approval is received, the auction (which typically lasts 5 minutes) has ended and the client has not been able to execute their trade exposing them to considerable risk

To allow for orderly conduct of business we would propose drafting along the following principles:

- **The following controls can only be overridden with the active approval of risk management**
    - Any breach in respect of article 3 [Credit and Risk Checks]
    - Any breach as a result of an order submitted by an algorithm
- **The following controls may be overridden by authorized trading personnel.** Compliance and risk functions shall have sight of any overrides operated in this regard for subsequent review and challenge
    - Any breach as a result of an order entered by authorized trading personnel in respect of paragraph 4 parts a, b or c [these are market disruption controls and best assessed for validity in real time by trading personnel]

Q96. In particular, do you agree with including "market impact assessment" as a pre-trade control that investment firms should have in place?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We do not support the introduction of a separate control but do support the introduction of the flexibility to operate such real-time controls within the proposed framework for "volume" as per our drafting suggestion in response to Q95 above in respect of Article 21 (4)(c) repeated here:

> *"Maximum order volume which prevent orders with an uncommonly large order size from entering the order books. Limits shall be set in shares, lots* ***or as a percentage of either:***
>
> - ***average-trade-size or average-daily-volume in that security traded on a given venue(s) or an equivalent measure of liquidity;or***
> - ***For order driven markets: prevailing volume available at the time of order submission, within the price constraints referred to in part a) on the relevant trading venues; or***
> - ***prevailing volume indicated to uncross during any relevant auction period***

Q97. Do you agree with the proposal regarding monitoring for the prevention and identification of potential market abuse?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

The Market Abuse Regulation (MAR) already submits our members to appropriate and sufficient controls, which already account for algorithmic trading. Therefore we do not see any need for a specific RTS on monitoring for market abuse to be included in MIFID/R as this is already covered under MAR. In any case, this requirement should not be too prescriptive in this regard and should be aligned with the level 2 text of MAR.

We recognise ESMA's intent when looking to apply market abuse monitoring on a cross-market, cross-asset, cross-product basis, however, we note that this is not practicable in the case of most clients. It is extremely challenging for firms to create monitoring systems that can cover all OTC activities and cross these with all on-exchange activities etc. In addition, firms cannot have a complete picture of the client's activity across all markets. Only where firms undertake cross market strategies specified by clients will firms be in a position to assess the risk of market abuse. Where a firm executes a transaction which is one leg of a strategy where other agents are involved without being apprised of the strategy, a firm is not in a position to identify any specific risk of cross market manipulation.

Furthermore, requiring investment firms to conduct such cross market tests which are not easily applied in all circumstances, will create significant extra cost at little additional benefit. Such monitoring is the appropriate responsibility of NCAs and is covered effectively through the MiFID transaction reporting regime.

We recognise the elements of Annex I A EU regulation No. 596204 as potential indicators of market abuse.

Q98. Do you have any comments on Organisational Requirements for Investment Firms as set out above?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

General comments

Our members would welcome some clarification from ESMA as to the scope of RTS 13. Article 1 defines investment firm as "an investment firm engaged in algorithmic trading" (which definition seemingly applies for the entire RTS). This would mean that the same definition would apply to Chapter IV (on Direct Electronic Access) and Chapter V (Firms acting as general clearing members) notwithstanding the fact that DEA or GCM services may be offered by firms that do not engage in algorithmic trading.

Additionally, with respect to Chapter II (organisational requirements for investment firms)and Chapter III (resilience of trading systems of investment firms) that generally more relevant to firms engaged algorithmic trading, we would welcome clarification as to whether the intention is for these chapters to apply ***when*** an investment firm engages in algorithmic trading or ***if*** an investment firm engages in algorithmic trading.

To the extent that ESMA's intention is for the broader definition (whereby an investment firm is required to comply with the Chapter II and Chapter III even when the trading it is engaging in is not algorithmic trading), then our members would call on ESMA to clarify at what point the pre-trade controls set out in Article 21 are to apply. Article 21(1) suggests that they should apply "on order entry" whereas Article 21(2) states that they should "prevent orders from being sent to trading venues". Our members would not be able to implement certain of these pre-trade controls if the intention is for them to apply "on order entry" as, for example, in the context of a high touch order, it would not be possible to implement "automated execution throttles".

With regards Article 16 of RTS 13 "Real time monitoring", paragraph 3, we proposed a redrafting of the RTS as per below and would like to provide additional information as to why we think it is important.

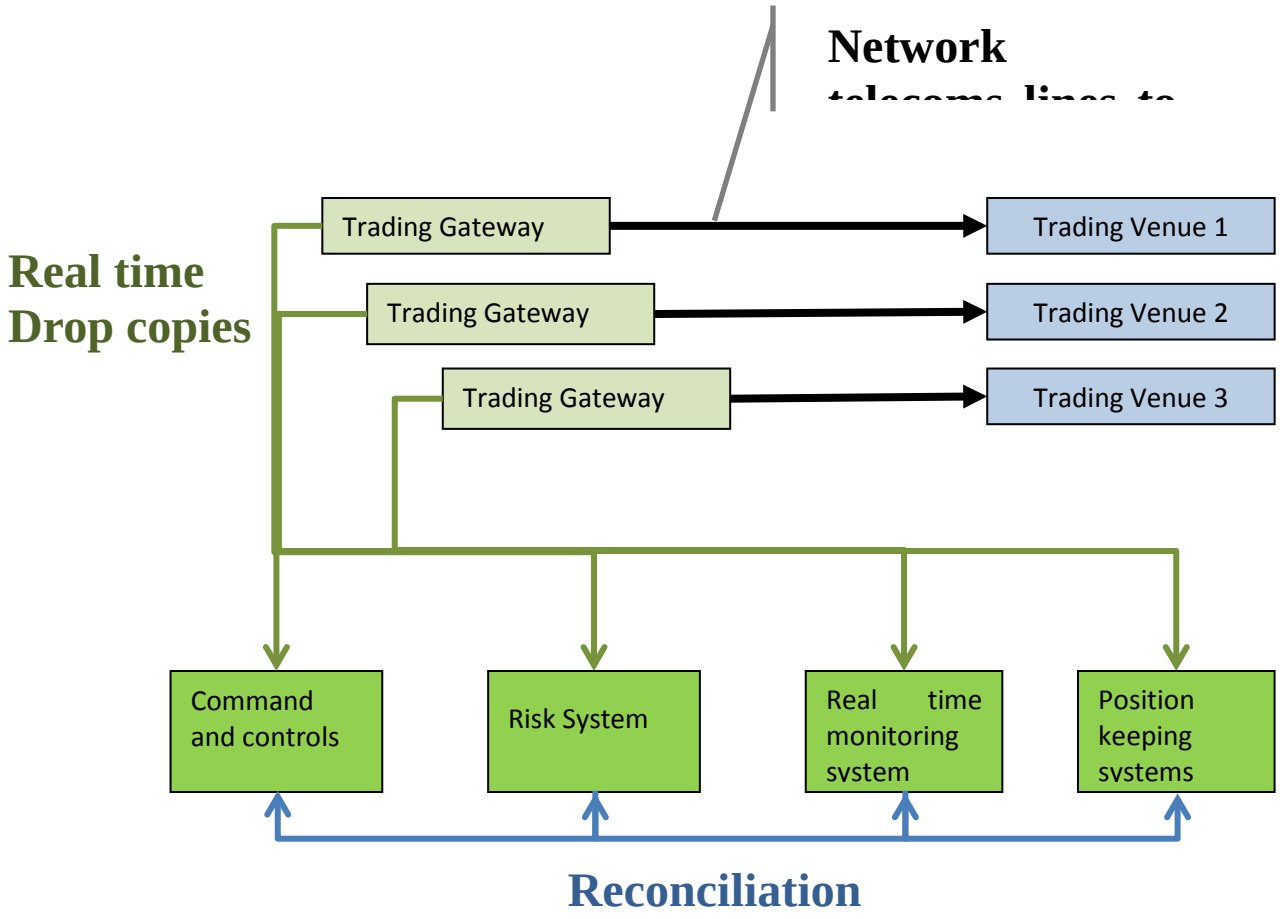
> *Investment firms shall maintain real-time, complete, accurate and consistent trade and account information. This shall include all orders and executions generated by themselves (where running their own algorithms) or their clients (where acting as a DEA provider) regardless of whether the orders go through their own infrastructure. Where orders do not go through the investment firm's infrastructure, this may involve the use of drop-copy feeds of orders and executions from trading venues, CCPs, the DEA provider, their clearing broker or other relevant business partners as appropriate in order to ensure they have a complete picture of trading activity.*

We strongly support the need for investment firm to ensure their trading and account information is accurate and consistent, however we do not believe drop copies from third party would be the only technical mean to achieve this outcome.

As suggested in the draft RTS, we strongly agree firms should be able to compute in real time a number of risk metrics relevant to the business they conduct. Such computation is usually achieved by acquiring multiple data source from different trading systems and aggregating it into another or several systems in charge of monitoring and alerting of issues, as summarised in the figure below. Please note although the below is a simplified to show a classic Direct Electronic Access to the market, it is an accurate description of how a trading system feeds risk and position keeping systems. A similar architecture is and can be built for more complex order flow (including manual trading, algorithmic trading, etc...)

Although simplified, the same principles can and are applied to more complex order flow.

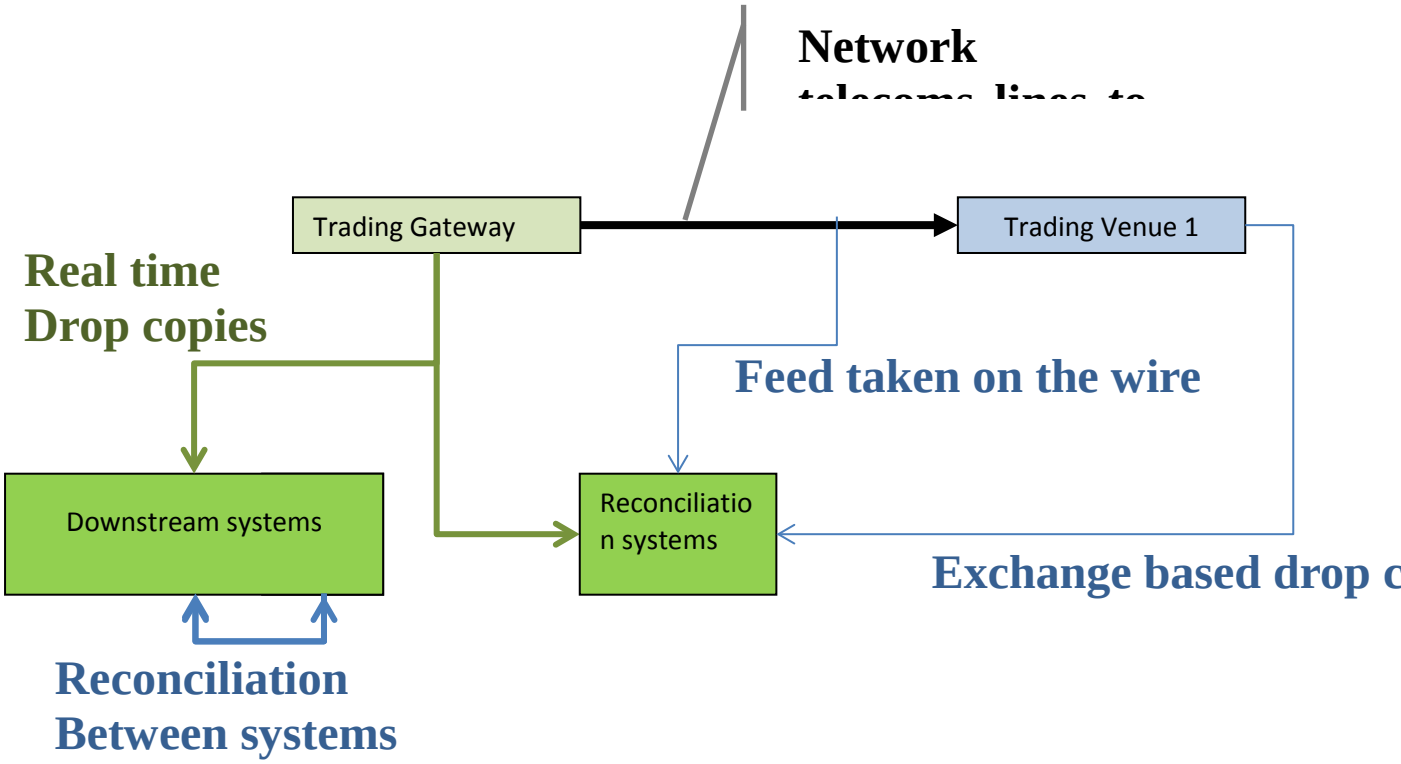
The trading gateway servers are the piece of technology interpreting the messages back from the exchange and sending orders, cancellations, amendments, etc... messages to the exchange. Connectivity to an exchange can either be FIX protocol based or more often use the native protocol of the exchange (OUCH, MIT, ETS, UTP etc...). Trading gateway are usually the data source of many others systems within the investments firm. Systems such as risk management, position keeping or monitoring tools are fed real time by the trading gateways and will run a number of reconciliation process, real time most of the time, ensuring a discrepancy between the trading system (= the trading gateway) and any other systems does not exist.



Although we agree such reconciliation processes in addition to the real time monitoring of key risk metrics are essential to the sound management of an investment firms investment access to the

market, we are not sure there is much added benefit to add an additional drop copy from the exchange to help the reconcialiation process. Several facts actually argue against the efficiency of it when it comes to achieve a "*real-time, complete, accurate and consistent trade and account information*". Assuming there is a real risk of the trading gateway not populating the correct data to the downstream systems, adding a real time drop copy from the exchange would not bring much additional benefit: the exchange will need to manipulate the data of the matching engine as to manage to populate the data on another stream, which could lead to incorrect or partial information being sent. In addition, drop copies should not be used as the primary source for any real time monitoring systems, they often includes only part of the information needed for such systems, and would require the investement firm to enrich the data. Very much likely FIX would be used for exchange based drop copies as to facilitate integration in many downstream systems. If not, the investment firm will also have to manipulate the data, which is likely to be done in the same fashion than for actually trading on the market.

Shall ESMA believe it is still necessary to process a drop copy from the exchange, we believe that their use should complement the existing implementation as to run reconcialiation checks between the exchange data and the data processed by the gateway, but should not be the source of information for critical risk and monitoring systems. In addition, we believe discretion should be left to the investment firm as to how this should be implemented. We understand the objective of ESMA is to make sure the information on which the investment firms rely is accurate, we believe such requirement would be covered by getting an independent source of information than the one known and processed by the trading gateway. As such, getting a drop copy from the exchange is not the only way of getting an independent source of information. Many network equipments are now able to duplicate exactly the feed received from the exchange without altering it, as per the schematic below.



Instead of a drop copy, a feed can be "tapped" or "spanned" directly from the telecom lines, which then can be processed and compared to the information help into the trading gateway. This would achieve the same result than a drop copy provided by the exchange.

Hence we would welcome the amendment of the RTS as to consider drop copies as a possibility to ensure trade and account information are accurate.

With regard to clearing we make the following comments:

- We agree with the proposed list of minimum criteria that clearing firms should assess their clients against on an initial and ongoing basis. Should not require the clearing firm to disclose the levels required of these criteria in a binding written agreement.
- Any additional internal criteria should not be disclosed, made public or detailed in a binding written agreement.
- We support a formal annual review of a client's performance, supplementary to ongoing client risk and performance management. Must be flexible to market conditions, current internal risk appetite and subject to commercial consideration.
- With regards to Annex B, Chapter V, Article 29 Position Limits and Margining; we believe that trading limits should be uncommitted but need to be advised to enable the trading firm to ensure that they adhere to them. In practice many GCM's have contractual limits in place with trading firms today that are bilaterally agreed although the GCM may have the unilateral right to amend.
- Real-time view of client positions is desirable but should not be mandatory. More appropriate for a minimum requirement for intra-day risk management which may increase in accordance with market, volume and risk demands where required. If real time risk management is included in level 2 it needs to be acknowledged that clearing members are only able to comply if they are supplied with real time data by the CCP. A General Clearing Member may not have a relationship with the trading venue and therefore its golden source for information relating to cleared transactions is the CCP. If a real time risk management obligation for clearing members is included it needs to be supported by an obligation for CCP's to provide real time risk management data to its members. Beneficial if CCPs applied limits to clients of clearing firms in order to automatically limit the exposure of clearing firms to their clients. Procedures and oversight should be in accordance with Article 37 of EMIR.
- Annex B, Chapter V, Article 30 should be wholly in accordance with EMIR Articles 38 & 39.

In addition, we do not believe CCPs should be bifurcating clearing member limits by client as it is the clearing member's role to determine how they would like to split their credit exposure across their clients. Having said this, we believe that CCPs should be providing clearing certainty via a pre-execution credit check. At a minimum, CCPs should be providing real-time visibility to clearing members of their credit line and utilization against that line. However, we would note that we agree with Article 29.3 of RTS 13 that "Investment firms acting as a clearing firm shall monitor their clients' positions against these limits on real-time basis and have appropriate pre- and post- trade procedures for managing the risk of breaches".

Q99. Do you have any additional comments or questions that need to be raised with regards to the Consultation Paper?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

- Request to consider the following requirements: i) for CCPs to apply limits to clients and clearing firms in order to automatically limit exposures of the clients to the clearing firms, ii) the practicality of CCPs applying limits to parties that they do not have relationships with E.G

Trading Member Firms. Need to consider and protect against the unintended consequences of limit application in order to prevent any competitive advantage of one CCP over another. We believe it is feasible to have limits at the clearing level that can be applied to control trading level activity.

- The requirement to notify the CA of a breach to electronic security – seems sensible, but should this apply more broadly to any major incident affecting trading critical systems
- The requirement with regard to penetration testing does not allow enough flexibility with regards to frequency. They should be able to be conducting with a frequency of less than one year

4.2 Organisational requirements for venues

Q100. Do you have any comments on Organisational Requirements for trading venues as set out above? Is there any element that should be clarified? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We, in the main, defer to the Trading Venues to comment in this section. However, referring to RTS 14, Article 12 (2) we note that trading venues should know the latency that their own systems can tolerate. They should, therefore, maintain discretion to state what latency they will tolerate, potentially set at a minimum standard of latency relating to usual performance, deviating only up to a factor of 'X'.

Q102. Is there any additional element to be addressed with respect to the testing obligations?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Non-live testing of algorithms (RTS 13/14):

The following response applies equally to Q94 (investment firm algorithmic trading) and Q102 (trading venues) and is repeated for each question.

Our members believe that the proposals regarding non-live testing of investment firms' algorithms are counterproductive, inefficient and unrealistic in their current form.

We understand that one of the primary influences for the non-live testing measures is the incident involving Knight Capital Americas LLC in July 2013. Having reviewed the SEC's assessment* of the incident, our members would like to highlight that the non-live testing measures proposed would have been unlikely to prevent this incident had they been in place. In contrast, we believe that many of the other measures proposed in RTS 13 would indeed have reduced risk in this respect. The *current* non-live testing proposals however will provide marginal benefit at great cost. Moreover they do not appear to have been dealt with adequately within ESMA's cost-benefit analysis.

We would like to present a counter proposal based on its members' understanding of the risks which ESMA seeks to mitigate in particular with respect to the potential for creating disorderly trading conditions. These can be categorised in the following way:

1) **Compatibility Risk:** The risk that a firm's algorithms and infrastructure are insufficiently tested against a trading venue's infrastructure leading to the creation of disorderly trading conditions.

2) **Market Dynamic Risk:** The risk that a firm's algorithms and infrastructure create disorderly trading conditions due to their interaction with other market participants, or that they fail to respond appropriately in an environment where disorderly trading conditions already exist.

Our members believe that an efficient and additive solution requires these risks to be mitigated separately. Specifically, the former requires access to an environment that mimics the trading venue's production system. The latter requires an environment which represents or models market behaviour, in which multiple participants are simultaneously present and includes facilities capable of artificially imposing disorderly trading conditions (e.g. by imposing capacity constraints on the infrastructure, slowing the system down or introducing simulated erroneous orders).

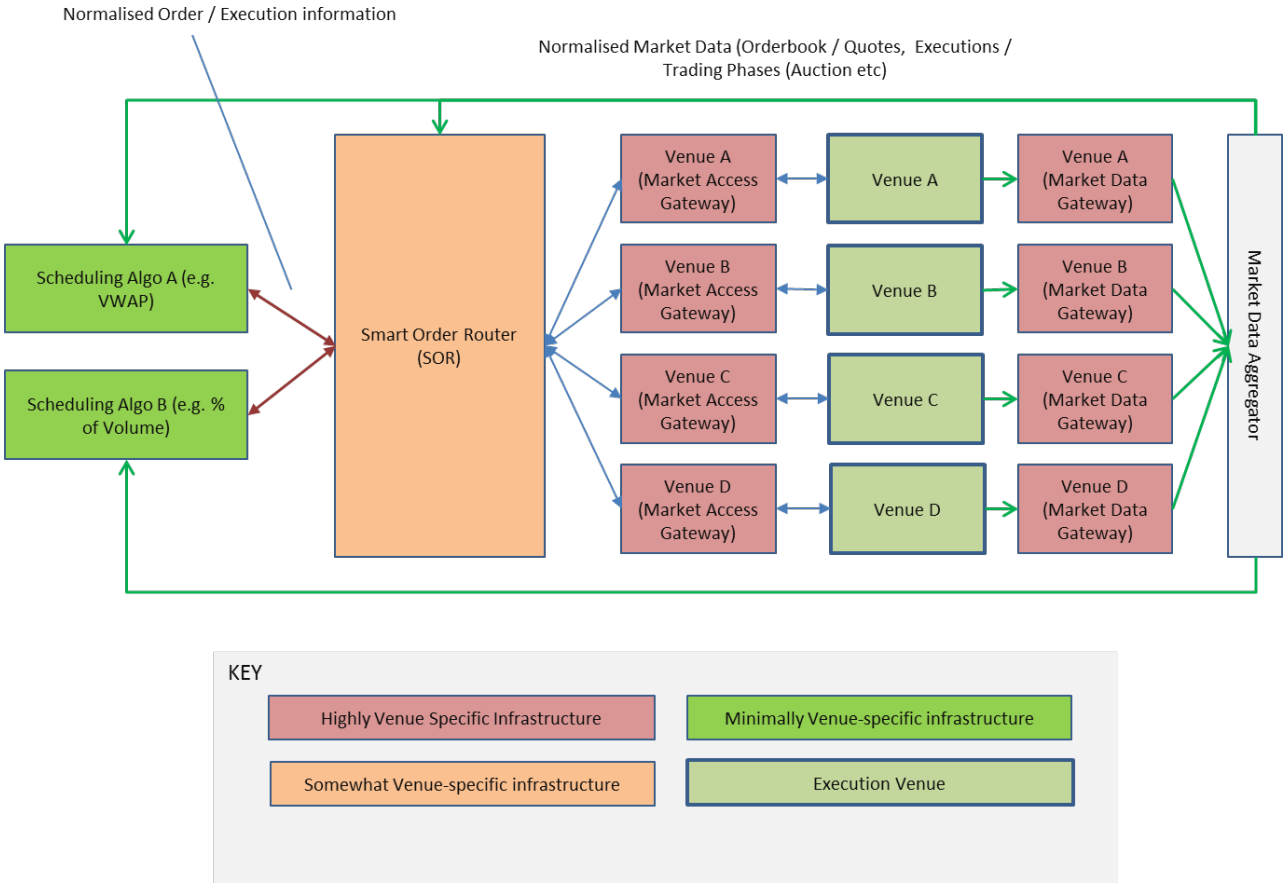
We note that this does not lead to a perfect solution but does lead to a better solution.

Compatibility Risk

In its recent consultation paper, ESMA asserts that *"market microstructure differs greatly from venue to venue".* Though we agree with this statement in totality (i.e. across all asset classes and types of market), if we consider classes of market categorised by market mechanism and asset class, then the microstructure is very similar (differences mainly being confined to variations in trading hours, timing of auctions, minimum/maximum trade size rules, all of which lend themselves to being expressed through venue-specific *parameterisation* of logic rather than venue-specific logic). This is not to argue that these differences are immaterial or should not be addressed, simply that they should be accounted for in an efficient manner.

It is important to note that investment firms will arrange their algorithmic trading infrastructure differently depending on the nature of their business. The attached diagram below illustrates how an investment firm providing order execution algorithms (e.g. for executing client orders) will typically organise itself to execute across multiple EU venues in cash equities. Efficiency is gained for the firm and its clients by modularising the infrastructure so that similar venues can be treated similarly.

(The Table below refers to Cash Equities)



Such an investment firm's infrastructure is typically organised into three categories for order driven markets:

Gateways: This infrastructure is highly tailored to the specific venue that it deals with:

- **Market access gateways** translate orders and executions between the investment firm's internal messaging format to that used by each individual trading venue.

- **Market Data gateways** translate the individual market data protocols into a common protocol which the firm can use to understand market data from individual venues on equal terms (this is allows for data to be aggregated and prices compared where an instrument is listed across multiple venues at once). Market data gateways will normalise the way in which order book information and executions are received and translate "trading phase" information into normalised form (e.g. opening auction, closing auction, volatility auction, regulatory halt).

Smart Order Routers (SORs): SORs are somewhat tailored to the venues that they interact with although they will typically send and receive messages in much the same form to each venue that they interact with. For instance an SOR will need to know which is the "primary

(listing market)" for each jurisdiction and will typically defer to that market for multi-listed instruments if the primary market enters a volatility auction.

Scheduling Algorithms: These typically have very little venue-specific logic embedded in them. This is possible because, the majority of the burden of dealing with individual venues is handled by the SOR and Gateways. Scheduling Algorithms are predominantly concerned with generic market dynamics (and therefore also present the majority of the risk in this area).

Investment firms that operate proprietary trading algorithms generally have simpler infrastructures (e.g. for latency reasons) and as such will often either connect the algorithm to market access and market data gateways, or even have the algorithm connect to the trading venue directly.

Proposal

Infrastructure that deals with venue-specifics should be tested most intensively against the venue's own test platform. In the cash equities example given, this means the SOR and the Gateways. Venue-specific logic in an individual algorithm should also be tested where it exists.

In a non-modular example where an algorithm deals more or less directly with the trading venue's infrastructure, we would agree that that algorithm should also be tested intensively on every trading venue on which it is used.

In summary, we believe that an algorithm should **not** be required to be subjected to testing within a non-live environment if it fulfils all of the following criteria:

- The algorithm uses an intermediary algorithm to connect to the trading venue.
- The algorithm contains minimal venue-specific logic and is purposely designed to operate across multiple markets.
- The algorithm has been tested in a non-live environment on at least one market it has been designed to operate on.

Market Dynamic Risk

In our example, the components of an investment firm's infrastructure that pose the most risk when exposed to "live market conditions" are those with the least venue-specific logic. In our example, the scheduling algorithms and SOR pose the greatest risk of causing disruption (in this context) as these are the components which analyse market behaviour and make execution decisions. We also note that algorithms such as SORs are designed to operate across multiple markets at a time and a comprehensive test therefore could not take place within a *single* trading venue's test facility.

Such "real market" conditions are impossible to re-create perfectly however and even imperfect solutions are extremely expensive to implement:

- One solution is to "replay" previous order information into a venue. This is expensive to perform however and does not duplicate the potential for participants to interact negatively with each other.
- A requirement to execute disorderly trading tests across every venue in which they participate (some 15-20 venues for cash equities) is extremely costly and time-

consuming to perform. Moreover, it is likely to incentivise to a "box checking" approach by nature of its excessive time consumption

- The incremental benefit of performing these tests across multiple similar venues is also minimal as the components of infrastructure which present the most risk are concerned largely with generic market dynamics and less so with the specifics of the individual trading venue.
- To cater for multi-market algorithms (e.g. SORs) using trading venue facilities, there would need to be a way of connecting those facilities together which we believe to be expensive and most likely unworkable in practice.

Proposal

The risks that algorithms misbehave when they encounter market-like conditions are usually generic because infrastructure is often built to deal with the market generically. Those risks can therefore be reduced much more effectively and efficiently by allowing for them to be tested for centrally.

We believe that higher quality centralised testing is a better way of mitigating of the risks of disorderly trading than performing what are likely to be many individual tests of much lower quality against individual trading venues.

Venues should be able to delegate testing for disorderly trading conditions to a centralised provider where appropriate. The provider's role should be to create an environment which many different participants can come together to exercise their infrastructure in an environment which concentrates their activity so as to re-produce a market-like dynamic. Because the environment would bring real participants and their infrastructure together in a single place, it would provide the most useful advance warning possible of any potential problems.

Requested changes to the RTS

Based on the above we suggest the following changes to RTS 14 Article 11:

Testing the members' algorithms to avoid disorderly trading conditions

1. Trading venues shall require their members, participants and users of sponsored access services to undertake testing of trading algorithms to avoid creating or contributing to disorderly trading conditions. Trading venues shall not grant access to use an algorithm that has not been tested and shall require algorithms to be tested or re-tested whenever:

a) a new algorithm is written;

b) an existing algorithm undergoes a material change (where the user of the algorithm will be required, on the request of the trading venue, to evidence which changes have been deemed 'material')

c) the trading venue itself undergoes a change where it deems it necessary to retest some or all algorithms.

2. Trading venues shall provide access to test facilities which are capable of supporting the following:

a) testing algorithms for compatibility with the trading venue's infrastructure, i.e. facilities that functionally replicate the trading venue's production environment and provide;

i) a representation of a typical normal trading day (for example through the use of replayed historical data or through a simulation);

ii) a simulation of disorderly trading conditions (for example by forcing temporary capacity limits on the test system, slowing the system down or introducing simulated erroneous orders);

b) testing of algorithms for compatibility with multiple trading participants in a realistic production-like environment.

3. Where an algorithm has been tested against one trading venue but does not access the venue directly (i.e. instead using an intermediary system such as a smart order router) and contains no trading logic specific to individual trading venues, then that algorithm can be considered to have been tested across all trading venues that trade the same class of financial instruments and operate a similar market mechanism and hence does not need to be separately tested for each such trading venue.

Test Instruments

We completely agree that systems should be tested adequately in dedicated test environments and that a live production environment is not to be used for such a purpose, whilst also recognising that there are certain types of tests that really can only be performed on the production system.

We therefore recommend that trading venues be required to provide 'test' instruments in their production systems. Such test instruments should be made available on all venues across all asset classes and, where a trading venue operates sub-markets or trades multiple asset classes, that multiple test instruments exist for that venue in order to ensure adequate coverage of the technical and functional scope of that venue.
Test instruments should have complete reference data (including public instrument identifiers) and should be handled in trading venues' and investment firms' trading systems as 'normal' instruments. They must, however, be blocked from feeding any post trade settlements infrastructure.

4.3 Market making, market making agreements and market making schemes

Q104. Do you agree with the proposed draft RTS? Please provide reasons for your answer.

No, we do not agree with the proposal.

Market making is a commercial activity, and across all asset classes it is important that an appropriate commercial framework is put in place. Failure to do so will lead to a deliberate withdrawal of market making activities, or particularly in the case of FICC markets a broad move away from providing firm continuous quotes, with a fallback to indicative quotes only. In FICC markets, firm quotes are present today in some of the more liquid instruments but under threat from ill designed models.

The design of the structure needs to be based on a simple principle which is the deliberate intention by a firm to want to be a market maker. These requirements should encourage such activity and not try to undermine it by creating unclear open ended obligations for these firms. We do not therefore believe that it is appropriate for a firm to be deemed to be pursuing a market making strategy based on the actions of a single trading day.

In order to be identified as a market maker, we also believe that only proprietary order flow should be considered in the calculations. We therefore strongly believe that the ESMA Technical Advice on Section 5.1 (Algorithmic Trading and HFT) relating to page 339 point 5 (as per below) should be taken into account when looking at the market making obligations and therefore propose that this be included in the RTS for Section 4.3 (Market Making):

> For the identification of high frequency trading, ESMA is of the view that only proprietary order flow should be considered. Regardless of the approach followed by the Commission to identify high frequency trading, it is proposed that if an investment firm is classified as HFT, the firm may challenge this classification if they believe this is a direct result of their non-proprietary messaging flow. To that end, investment firms should analyse the records under Article 25 of MiFIR to determine the level of messaging activity which is attributable to the proprietary activities of the investment firm, and the level which is attributable to the clients of the investment firm and provide this summary to the relevant competent authority who would determine whether the firm has been incorrectly identified as exhibiting a "high intra-day message rate".

The above relates to an important point relating to only proprietary order flow being in scope for consideration and we believe that the same consideration should be stated when stipulating a firm entering a market making agreement. The participant who is running the algo should be responsible for that algo regardless of whether they are a 'member of the exchange'.

Our members seek further linguistic clarification in relation to whether a market making agreement would be necessary per comparable instrument or whether such an agreement would be based on asset class. Requiring to have in place a market making agreement per individual instrument would make the application of the parameters as stipulated by ESMA (for example trading for 30% of market hours per day) impractical, particularly for non-equity instruments where there can be instances of high liquidity and subsequently low liquidity within short timeframes.

The text does not specify any detail around the process / timeline to be followed for signing a market making agreement, nor how an agreement can be exited should a firm decide it wishes to cease pursuing this type of strategy. Under the process for becoming a Systematic Internaliser, investment firms have one month to do so after they have identified that they exceed the quantitative thresholds. We would suggest that a similar approach could be followed here.

It is felt that in relation to quoting requirements, an investment firm should be able, at its own discretion, to determine whether it wishes to pursue a market making strategy during certain instances of 'exceptional market conditions'. In such an instance it should be the investment firm who is able to exit a market making agreement without the final decision being at the discretion of the trading venue. In its proposal (RTS 15 Article 4 (3)) ESMA notes:

'The agreement shall specify that an investment firm engaged in a market making agreement may suspend its market making activity without incurring any penalties from the trading venue, if the trading venue determines the state of its market to be under exceptional circumstances as defined by this Regulation'.

Our members feel that the specific notion that it should be up to a trading venue to determine whether 'exceptional circumstances' are occurring and whether therefore a market maker is able to pursue a market making strategy seems unduly justified and our members feel that this should not be within the remit of a trading venue. Our members believe that an investment firm is best placed to determine whether they are able to continue pursuing a market making strategy in 'exceptional circumstances' and would in such instances inform the trading venue and be able to immediately suspend its market making agreement.

Furthermore, our members believe that the definition/parameters of 'exceptional circumstances' as per RTS 15 Article 5 (2) should be listed under the definitions.

Our members seek clarification that by using the terms 'market hours, trading hours, normal trading hours, daily trading hours' ESMA is referring to European market hours. Furthermore we suggest that this should be made clear throughout ESMA's proposals in aid of consistency.

Should ESMA's intention not have been to specify the trading hours it references then our members would like to note that such clarification is necessary. Some trading venues operate a 24 continuous venue and therefore there would be a considerable difference between imposing a quoting obligation of 30% compared to a quoting obligation of 50% during the hours of 8.30 and 16.30. Our members strongly suggest that consideration be given to the differing trading venues' trading hours and that a standard timeframe should be noted to avoid confusion.

Q105. Should an investment firm pursuing a market making strategy for 30% of the daily trading hours during one trading day be subject to the obligation to sign a market making agreement? Please give reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

No, this is not appropriate.

It is not appropriate to determine whether a firm is pursuing a market maker activity based on a single day trading. Averages for a broader period need to be considered. It is entirely feasible that a firm holding a position they are trying to liquidate provides quotes for more than 30% of a single trading day in at least that instrument; this alone should not then trigger a deeper, longer commercial obligation. We believe that in this respect market making obligations should be assessed over a 4 week period consistent with the SI regime.

Our members would like to seek further clarity on what ESMA considers 'market hours, trading hours, normal trading hours, daily trading hours'. We suggests that ESMA should refer to European hours in the RTS to avoid any confusion. As an example in a 24 hrs continuous trading venue, a trading presence of 30% is above an investment firms' market practice. Consideration should be given to the differences between such venues and those which operate based on standard European hours.

Q106. Should a market maker be obliged to remain present in the market for higher or lower than the proposed 50% of trading hours? Please specify in your response the type of instrument/s to which you refer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Our members believe that the 50% obligation is workable from a non-equity perspective. It should be noted that this investment firm should not be tied to a narrow obligation due to this agreement between venue and firm. Venues should take into account that market makers will perform their duties on multiple platforms.

As an example of the complexities for certain instrument classes, in the case of primary dealer agreements we question whether these would be deemed as market making agreements per se and primary dealers must therefore apply to a venue and commit to provide liquidity all day every day which is not practicable. The continuous liquidity provision to numerous venues places much more responsibility on investment firms.

Our members note that it is unclear what the legal consequences of falling below the 50% quoting obligation may be as this is not referenced in the ESMA proposal currently.

Particularly for non-equities, our members wish to propose that a rule of 50% of on-going quoting over a period of 4 weeks should be considered when determining the amount of quoting an investment firm is required to provide during 'market hours' (once more we would like to clarify that ESMA wishes to refer to European trading hours for all references to 'market hours').

Q107. Do you agree with the proposed circumstances included as "exceptional circumstances"? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

It is recommended that the indication of what ESMA has deemed to be an 'exceptional circumstance' be included in the definitions under RTS 15 Art 1.

We understand that it will be the responsibility of the trading venues to determine an event of 'exceptional circumstances'. However we would like to note that it should not be solely down to one trading venue to determine whether an investment firm is in a situation of an 'exceptional circumstance'. Investment firms do currently have in place several clear measures and procedures in order to determine whether their organisation is under any form of unusual or exceptional circumstances and it appears unreasonable and impracticable to expect a trading venue to have access to an investment firm's operational status. Accordingly, as noted in our response to question 104, our members feel that a market making firm (rather than a trading venue) is best placed to make the determination as to whether exceptional circumstances exist which will prevent the firm from providing quotes and relieve the firm of its obligations under the market making agreement.

We strongly disagree with making public the occurrence of exceptional circumstances, as by doing so this may produce undesirable consequences in the orderly functioning of markets and performance of other market participants.

It would be operationally onerous to monitor the occurrence of exceptional circumstances (e.g. conditions of "extreme volatility" or a significantly stressed market conditions).

There may be instances when IT disruptions may prevent an investment firm from being able to provide a quote and thus comply with the stringent quoting obligations set within the market making agreement. We would like to propose that in order to capture such instances, ESMA include a mention to such exceptional circumstances (caused by internal IT disruptions) which may prevent a market maker from continuously providing liquidity under its market making agreement. In the event of an IT disruption on the side of the venue, members would like to note that it is important any orders submitted before such a disruption will still be good following the resolve of any issues.

Additionally it is important that any data releases are also considered in the context of 'exceptional circumstances'. Such 'pre-planned information events' (ESMA RTS 15 Art 5 (3)) may have an effect on the fair value of a financial instrument and should be considered when determining whether a firm is able to comply with its market making obligations under the market making agreement.

We seek further clarification as to the parameters of the ESMA proposed fine setting mechanism ("negative incentives as per Art 10 of RTS 15). We do not feel that the trading venue should be able to set a fine without the correct ESMA guidelines.

Q108. Have you any additional proposal to ensure that market making schemes are fair and non-discriminatory? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

Although we welcome the new addition that 'the agreement shall specify that an investment firm engaged in a market making agreement may suspend its market making activity without incurring any penalties from the trading venue, if the trading venue determines the state of its market to be under exceptional circumstances as defined in this Regulation', we would like to note that we feel this is sufficient and in line with ESMA's intentions.

However, we would like to note that an investment firm party to a market making agreement should also be able to suspend its participation within such an agreement based on its own analysis and ability to continue with its market making strategy, subject to an appropriate notice period (e.g. one month).

We welcome the recognition of requirements for trading venues with respect to market making agreements during 'stressed market conditions' however we believe that the definition of 'stressed market conditions' should be broadened to include market events (in line with 'disorderly markets suggestions as above) as well as expanded to furthermore detail and clarify the parameters upon which a TV should determine whether the market is in a 'stressed condition'.

Q109. Do you agree with the proposed regulatory technical standards? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We agree with the general approach of the RTS and are supportive of the fact that introducing OTR will help limiting the in flow of messages to a trading venue's system and help preventing disorderly markets as it will encourage firms to better control their order to trade ratio. We support the introduction of 2 ratios to limit the gaming opportunities. We welcome the annex provided with the order types to take into consideration as they make interpretation easier and more certain. However we do see potential issues with the RTS.

The RTS should define the ratio for the purpose of article 48.6, which refers to controls as to "*ensure that algorithmic trading systems cannot create or contribute to disorderly trading conditions*". It seems that the way the ratios are defined and their associated limits is more to be read along article 48.9 where possible fines could be associated to a breach of the OTR as per *"Member States may allow a regulated market [.../...] to impose a higher fee on participants placing a high ratio of cancelled orders to executed orders [.../...] in order to reflect the additional burden on system capacity*". We would welcome clarification as to how the OTR should be used as a mechanism to prevent the creation of orderly market conditions.

If the OTR ratio were to be prevent creating disorderly markets, we believe it should be tailored to each market participant and should not be a one size fits all. This would be in line with the throttling mechanisms are currently calibrated: A small firm may only need 5 or 10 messages/second capacity whilst a larger firms concentrating large client order flow for instance, would need maybe 10 or more times the capacity. The same can be said about order to trade ratio. For firms executing client orders, OTR is not something which can be fully controlled, even so it can be monitored. In addition, we question the validity of considering a high order to trade ratio as a threat to a market stability in itself. A firm sending only aggressive flow (low OTR) but millions of messages to a trading venue would be much more of a threat to an exchange system stability than a participant with a small volumes of messages but with a very high order to trade ratio.

Finally although we welcome the set up of a yearly limit, we disagree with the methodology to compute the actual limit of the ratio (threshold that would constitute a breach) as we believe it will lead to a situation where it would be extremely difficult for a market participant not to breach and for new Trading Venues to grow.

Consequently we believe a few modifications and clarification should be made with regards the current proposals:

- The ratio should be used to assess a breach and associated fine, as per level 1 text, article 48.9.
- The ratio should not include cancels and IOC/Amends should be considered as one message, please refer to question 111 for more information.
- The limits for the ratio should include a floor and be calibrated at a reasonable level to allow the diversity of market participants to operate normally and for new trading venues to grow. Please refer to question 113.

Q110. Do you agree with the counting methodology proposed in the Annex in relation to the various order types? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We agree with the counting methodology in general and welcome the approach ESMA has taken. We understand the list of order type is to be seen as guidelines as to accommodate for future markets innovation. Therefore we think that the logic leading to the number of messages to consider should be clear enough to allow for easy interpretation for order types to come.

Q111. Is the definition of "orders" sufficiently precise or does it need to be further supplemented? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We believe the definition of orders is sufficiently precise and will accommodate for future order types. We understand "all input messages" as relating to messages sent in reference of a financial instruments but to exclude any technical messages sent to the trading venue. Similarly we would consider cancellation following the uncrossing of auction as not falling into the scope of "submission, modification, cancellation sent to a trading venue" for the purpose of the OTR computation. Finally we would welcome clarification as to the treatment of cancellations due to the use of kill switches or following IT issues (also known as cancel on disconnect), which is a feature many markets provide and many firms have implemented when their clients disconnect. We believe trading venues should have the ability to allow for such exclusions.

However, excluding part of the cancellation messages may prove difficult for trading venues and investment firms to monitor. We would therefore suggest an alternative method to define order, leading to a slightly different computation for both ratio.

We feel that the counting methodology should only be considering messages that have the potential to create executions not messages that are removing this potential. The purpose of the OTR is to ensure that algorithmic trading systems cannot create or contribute to a disorderly trading condition on the market. This would happen when you have excessive number of messages that are creating or changing orders. This method would remove any question around partial fills, cancellation at the end of the auctions, cancellation following kill switch, etc...

Hence we would suggest amending the RTS 16 definition of orders as per below:

> *"'order' means all input messages, including submission of a new order or a modification of an existing order, ~~cancellation~~, sent to a trading venue's trading system; this shall include market orders and limit orders such as Immediate-or-Cancel orders or pegged orders as well as any type of quotes including any indications of interest irrespectively of whether or not they are actionable"*

Such change would not alter the purpose of the OTR as it can achieve the same result by way of calibration. An OTR including cancels will be higher than an OTR not including cancels, but so would be the limit. Hence we believe it still achieves the RTS objective whilst removing source of misinterpretation. It would also put new orders and modification on the same level, by considering both as 1 message and will allow an easy interpretation of the volumes and number of orders to take into consideration.

Q112. Is more clarification needed with respect to the calculation method in terms of volume?

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

The calculation seems clear enough as it is, provided the necessary clarification are being made with regards the exact messages and number of shares to take into account. Especially in the case of IOC where the order got partial fills, we would interpret the current RTS as requiring to only consider the qty cancelled when computing the ratio on volumes of shares, but as non executed for the ratio on number of orders.

However, should ESMA consider our proposal at question 111, such clarification would not be necessary as the ratio in volume would be de facto taking into account all shares sent vs all shares executed, reducing the divergent interpretation.

Q113. Do you agree that the determination of the maximum OTR should be made at least once a year? Please specify the arguments for your view.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

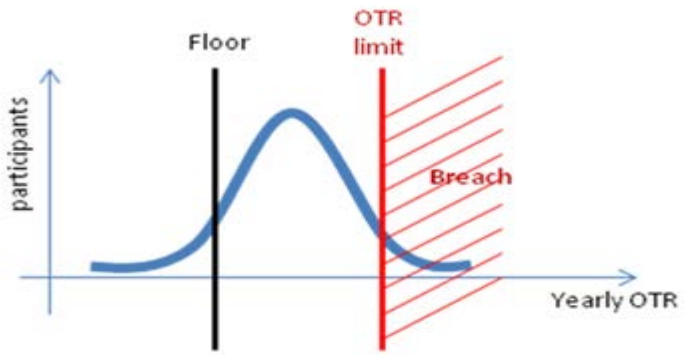
We agree computing the ratio to be made once a year. We however see some issues with the method to actually set the threshold for determining a breach.
By setting the limit at the maximum observed OTR across all participants, by design, it will put every year a number of participants above the threshold. This would incentivise market participants to reduce their OTR in order to not breach the limit and mechanically bring the limit to levels where it would be difficult to operate without breaching. In addition, firms executing client orders would not be able to control their overall order to trade ratio and may face breaches as a consequence of their activity. The normalisation of the OTR around an average value would lead to such a situation.

The graph below illustrates this risk. Assuming 20 participants with OTR ranging from 0.5 to 200 and assume the maximum OTR across participants is 50 on Year 1. Most participant lower their OTR to avoid breaching the threshold, the next year, participants' OTR range from 0.5 to 60, and the maximum OTR across participants is now 30 for year 2. New OTR limit for year 3 is now 30, which will push market participants to lower even more their ratio, if possible or face consequences for breaching the OTR if they cannot fulfil their service without doing so. This could lead some market participants and mainly those trading passively to not be able to pursue their activities as they would be in a situation where managing risk, price would lead to breach the OTR ratio.

In addition, the make up of the threshold makes it impossible for it to increase from one year to another. This could prevent venues to grow market share, and could even hamper the development of trading venues in non equities markets. Competitive markets tends to have more active order books than less liquid ones, as there is a direct relationship between the "order messages" activity and the efficiency of the order book, its spread and its depth. The more participants, the more likely orders will have to be cancelled or modified.

We would suggest amending the RTS in order to recognise a diverse market is made of liquidity takers (ratio close to 1), passive traders and market makers. Passive traders, without being market makers, would tend to have a much higher ratio, and should not be penalised by a design taking an average value as the actual limit. We would therefore suggest considering setting the limit by

looking at the distribution of market participant yearly OTR and set the limit at 80%, computed over a defined a period, for instance yearly. As illustrated below:



We would also recommend introducing for each relevant group of instrument a floor under which the OTR would not change. Those recommendation combined would prevent an artificial normalisation of the order to trade ratio and allow for venues to grow market and gain participants. Such floor could be set by the venues with approval of the home state regulator.
Therefore we suggest amending the RTS as per below (article 3.5 and article 3.6):

> 5. A trading venue shall calculate the maximum ratio of unexecuted orders to transactions in both volume and number terms at least once a year for each participant. For that purpose, trading venues shall take into account all the orders submitted by all each members and participants across all phases of the trading sessions, including the auctions, during the preceding twelve months' trading. The venue will then determine for both ratio the value for which 80% of members or participants are below the said value. The venue will also determine a floor for both ratio, taking into account the capacity of their systems and will notify their competent authority for review.
>
> 6. The ratio of unexecuted orders to transactions calculated by the trading venue in accordance with this Article shall be considered as exceeded by a member or participant of the trading venue on a trading session where the trading activity of this member or participant in one specific instrument, taking into account all phases of the trading session including the auctions, exceeds any of the two ratios specified under paragraph 4, unless the computed ratios are below the set floors.

Q114. Should the monitoring of the ratio of unexecuted orders to transactions by the trading venue cover all trading phases of the trading session including auctions, or just the continuous phase? Should the monitoring take place on at least a monthly basis? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We think clarification is needed with regards order cancelled end of auctions and any cancels following kill switches being invoked. We believe such orders should not be considered in the order

to trade ratio to compute. Please refer to question 111 for the treatment of cancels in the ratio computation.

Q115. Do you agree with the proposal included in the Technical Annex regarding the different order types? Is there any other type of order that should be reflected? Please provide reasons for your answer.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

We think the technical annex is helpful and could be complemented by concrete examples as to make interpretation even clearer. We don't think order type are missing currently and we think the RTS provide with a framework which can accommodate future order type.

4.7 Material markets in terms of liquidity

Q132. Do you agree with the proposed regulatory technical standards?

Yes. However, we would note that ESMA's proposals appear to be particularly focussed on preventing disorderly trading conditions in securities. As derivatives are bespoke instruments, please could ESMA confirm that the only regulated market which is material in terms of liquidity, for derivative purposes, would be the venue where the derivative is first admitted to trading?

7. Commodity derivatives
7.2 Methodology for calculating position limits

Q183. Do you have any comments on the proposed framework of the methodology for calculating position limits?

Risk of real economy impact

In designing the framework for the calculation of position limits, consideration must be given to the impact on those organizations which utilise commodity derivatives to hedge the various business/commodity risks associated with their day to day business (e.g. manufacturers, end users and corporate treasurers).

ISDA members are concerned that the proposed regime may lead to market disruption to the extent that liquidity is reduced either due to liquidity providers having less scope to provide key intermediation hedging to their clients, notably end users of commodities.

In particular, we call for caution about the metric used to set the baseline limit and a large majority of ISDA members are concerned by the narrow definition of OTC economically equivalent contracts to contracts subject to limits and consequently of netting.

In our view, the position regime should be calibrated to ensure that they avoid disruption to the market/real economy. In this regard, we highlight that commodity derivatives markets are global by nature. Market participants need to hedge their risk across multiple contracts (both OTC and on-venue). The EU position limits regime should therefore allow netting on a broad basis in order to accurately reflect:

a. The global position given it is common for EU risk to be hedged with contracts traded on third country venues, i.e. the real risk exposure; we would nevertheless caution against extra-territorial application of EU position limits third-country venue contract because it could lead to conflicting rules and requirements applying to the same position.

b. The reality that end users (e.g. manufacturers, airlines, refiners) require financial institutions to provide hedging instruments to manage price risk for their physical commodity consumption and/or production.

   Refiners and airlines, for example, depend on financial institutions to assume basis risk in order to hedge their specific grade of fuel oil (e.g. 0.1 Gasoil Rotterdam) used for their commercial activities because these institutions commonly offset this exposure with more liquid exchange traded contracts (e.g. gas oil futures). In addition this dynamic allows financial institutions to aggregate bespoke interests in a diverse client base resulting in an aggregated central pool of liquidity which is highly correlated. The liquidity pool is created by aggregating a highly correlated set of bespoke interest in a commodity type for example, an airline buys an OTC swap from a financial institution referencing Jet Rotterdam which the financial institution immediately hedges with gasoil futures. The next day a refiner sells a swap to a financial institution referencing Gasoil 0.1 FOB Med which isn't exactly the same as Jet Rotterdam but it is highly correlated and therefore that second trade provides a hedge for the first at which point the financial institution can terminate the gas oil futures which provide a temporary hedge until the various OTC flows can be matched.

c. these end user entities rely upon the flexibility of financial entities acting as liquidity providers for hedging intermediation to allow them to manage their exact price risk. In order to ensure the availability of hedging instruments and to prevent liquidity pools from shrinking or dissipating, it is critical (in the absence of a pass through hedge exemption) that any positions which the financial institution executes to reduce the risk of that end user hedge can be netted. As demonstrated above, it is vital that hedges that may be non-MiFID instruments or which are highly correlated to an on-venue contract can be taken into account in determining a person's net exposure or, at the very least, the limits are established at appropriate levels in recognition of the fact that financial institutions will not benefit from a pass through exemption in respect of end user risk reducing transactions; and

d. the fact that fabricators / manufacturers look to financial institutions / trading houses for supply of physical commodities (e.g. metal fabricators) and that these financial institutions / trading houses will hedge these physically settled forwards (e.g. non-MiFID financial instruments) with on venue commodity derivatives. To the extent that physical positions remain ineligible for netting, the risk position will not be accurately reflected and the limit will be reached quicker than if netting of OTC physical positions was permitted. In addition if physical positions cannot be netted this may lead to hedges for such physical OTC transactions may migrating off-exchange.

Deliverable Supply

As the EU framework is to establish baseline limits for both spot and other month by reference to deliverable supply as defined in RTS 29 (i.e. deliverable supply means that which is used either as settlement for, or a pricing reference to, that commodity derivative), before market participants are able to opine on the appropriateness of the baseline figure of 25% we require clarity regarding how the concept of deliverable supply will be applied by ESMA. At a minimum, we require ESMA to:

i. publish the methodology for calculating deliverable supply. We believe the proposed deliverable supply definition in Recital (5) and Article 1(2) of the RTS could be interpreted to mean overall trading interest in the commodity derivative whether for pricing purposes (i.e. cash settled commodity derivatives or physical settlement).

Alternatively, the definition of deliverable supply (if based on the Article 3 deliverable supply adjustment factor) may be interpreted as the total physical supply of a commodity that meets the delivery specifications of a futures contract. Taking the ICE Brent contract for the spot month and other months as an example, on the first interpretation, deliverable supply could be very low whereas if based on the standard market definition it would be much higher.

Furthermore, in our view, limits should be established for the (i) spot month based on deliverable supply and (ii) other months (i.e. aggregate limit) based on an estimate of open interest, subject to a de minimis threshold. Please see our response to question 184 for further details.

In the event that deliverable supply means the quantity of the underlying physical commodity then we propose that deliverable supply should only be used to establish the spot month limit and that other months limits should be established based on open interest, which we believe to be a more suitable metric. Also given the broad scope of commodity derivatives for which position limits will need to established, it is critical that open interest is defined as overall outstanding trading interest in the commodity derivative instead of the

traditional exchange based definition of open interest. Article 4 appears to capture the concept that open interest should reflect overall outstanding trading interest in other financial instruments (e.g. OTC contracts) however we need to ensure that "other financial instruments with the same underlying commodity markets" includes underlyers which are correlated to the exchange traded contracts e.g. crude oil and refined petroleum products; and

ii. publish estimates of deliverable supply for (at minimum) the key commodity benchmarks. Without estimates of deliverable supply, the industry will be unable to determine with any certainty if the baseline figure is overly restrictive / appropriate. It is clear for some commodities it will be very challenging to source data to determine deliverable supply. For example, physically settled gold (some of which may be in scope of the regime e.g. physically settled forwards and options traded on-venue) is predominantly traded OTC (i.e. there is no exchange traded contract and only a small portion of OTC is cleared on exchange). Therefore deliverable supply estimates on which limits are to be based will need to be sourced from OTC data which is not publicly available. Another example is refined petroleum products which can be sourced anywhere in the world which may make it very difficult to obtain access to the relevant data in order to achieve a credible estimate of deliverable. Also if a broader definition of deliverable supply applies, the overall outstanding market interest derived from OTC swaps etc. may be difficult to source; and

iii. provide clarity as to how the adjustment mechanism will work in relation to the factors proposed, in particular, deliverable supply and open interest. For example paragraph 28 of the Consultation Paper provides that the greater the volume of open interest the greater the position limit. However, if the baseline figure is low due to no available deliverable supply data, the regulator is only able to increase the limit by a maximum of 15%. Accordingly it is critical that ESMA identify the markets for which it would be difficult to obtain deliverable supply and to provide for further flexibility in the event open interest is the only reliable / available metric.

Contracts where there is no "deliverable supply" for the relevant underlying

The definition of "commodity derivatives" includes contracts which relate to underlyings referred to in Section C(10) Annex 1 MiFID2. ESMA's technical advice to the Commission (page 422) indicates that those underlyings will include factors which are not deliverable e.g. environmental variables such as weather factors and indices and other measures of prices or values. ESMA's proposals for setting position limits do not address how position limits should be set where there is no deliverable underlying. In our view, this should be addressed in a supplemental consultation. In addition, this highlights the need for ESMA to provide the methodology for the calculation of deliverable supply to determine the baseline where there is no deliverable supply for the relevant underlying.

Commodity derivatives in the form of listed warrants or similar instruments

The definition of "commodity derivatives" includes transferable securities covered by Article 4(1)(44)(c) MiFID2, such as cash-settled warrants relating to commodities or underlyings covered by section C(10). It is not clear how ESMA envisages that the methodology for setting position limits will be adapted in cases where the commodity derivative takes the form of a warrant listed or traded on a securities trading venue. For example, it is unlikely that trading venues for such warrants will calculate the deliverable supply as contemplated by the recitals to draft RTS 29. It may also be more difficult to determine the "spot month" when a range of similar warrants trade on a particular venue.

ESMA should also make clear that the definition of "commodity derivative" does not include:

- warrants that are physically settled by delivery of the underlying commodity or other deliverable since Article 4(1)(44)(c) MiFID2 only covers instruments "giving rise to a cash settlement" (or instruments exercisable into transferable securities); or

- shares or bonds or other forms of securitised debt, even if they embed derivatives relating to commodities or other underlyings specified in Section C(10) Annex I MiFID2, because Article 4(1)(44)(c) MiFID2 is a residual category covering "other securities" i.e. securities not already covered in Article 4(1)(44)(a) or (b).

Territorial and personal scope of the position limits regime

It is not clear from the consultation paper what ESMA's views are on the territorial and personal scope of the position limits under Article 57. It will be important that Member States take a common approach to the scope of application of these requirements. Accordingly, ESMA should indicate how Member States should apply the requirements.

ESMA states in paragraph 41 of its consultation paper that it regards the geographical scope of Article 57 as bounded within the EU and Article 5(3) of draft RTS 30 only envisages aggregation of positions with other positions held by other persons within the same group "in the European Union" to determine the final net position.

Whilst Article 57(1) MiFID2 refers to position limits applying to "a person", it should be read in the context of Article 1 MiFID2 which sets the scope of the Directive. Article 1(1) provides that the Directive applies to, amongst others, investment firms and third country firms performing relevant activities through a branch in the EU and Article 1(6) provides that Articles 57 and 58 shall also apply to a person exempt under Article 2. In addition, Article 1(3) also indicates that the position limits applies to EU authorised credit institutions performing MiFID2 regulated services and activities. Even though Article 1(3) does not refer to Article 57 or 58, position limits are imposed under Article 69(2)(p) by virtue of Article 57(11) and Article 1(3)(d) does refer to Article 69.

This suggests that the position limits under Article 57 are not intended to apply to persons outside the EU or to persons in the EU that are not "investment firms" within the definition in Article 4(1)(1) or exempt from the requirements that apply to investment firms under article 2 (e.g. individuals that are not "undertakings").

Equivalence and Flexibility

In our view, given the global nature of the commodity markets, it is imperative that the regime is consistent as possible with other existing regimes, (i.e. the US). In this regard, ISDA members note, that the US use open-interest as the metric for other months.

In addition given the issues highlighted above, we believe it is necessary for the regime to be sufficiently flexible in terms of both the expression of limits and measure of the market size to adapt to market changes. We believe the mechanism proposed in which the NCA or central CA can adjust the baseline figure according to the factors proposed in Articles 2-8 of RTS 29 (e.g. the maturity of the commodity derivatives contracts, deliverable supply in the underlying commodity, the overall open interest, number and size of market participants and characteristics of the underlying commodity) is an expression of the type of flexibility the market will require given dynamic nature of the commodity markets. That said, it is critical that participants understand the methodology for

calculating deliverable supply in order to determine if the adjustment mechanism proposed builds in an appropriate level of flexibility including a possible de-minimis threshold below which the established position is not applied.

Q184. Would a baseline of 25% of deliverable supply be suitable for all commodity derivatives to meet position limit objectives? For which commodity derivatives would 25% not be suitable and why? What baseline would be suitable and why?

Deliverable supply

ISDA members take the view that ESMA's proposed 25% of deliverable supply baseline limit for spot-month contracts may be appropriate and also support the flexibility granted to national regulators to adjust it by +/- 15%.

However in order to come to a conclusive view, market participants (corporates, financial firms) need ESMA to (i) confirm its interpretation of the "deliverable supply" definition, including methodology for calculating deliverable supply and (ii) provide estimates of deliverable supply (based on the relevant interpretation of the deliverable supply definition) for key contracts to assess whether the 25% is appropriate for all commodities and whether the adjustment mechanism will provide sufficient flexibility for national regulators.

In addition, limits should be established for the (i) spot month based on deliverable supply; (ii) other months (i.e. aggregate limit) based on an estimate of open interest, subject to a de minimis threshold.

For other month's limits, a large majority of ISDA members underline that it will be challenging to obtain estimates of deliverable supply for other month limits and that open interest is the most relevant metric. We note ESMA's concerns that the use of open interest for other months limits may constrain legitimate business for contract months further along the curve, however this could be addressed by introducing a de minimis threshold below which limits could not be set, thereby avoiding any constraints on contract growth.

In addition, as highlighted in response to Q.183, end user participants rely upon centralised pool of liquidity for correlated underlyers (e.g. refined petroleum products) as a key component of efficient end user hedging intermediation which allows such entities to manage their exact price risk related to the specific grade of fuel oil which they use in their commercial activities. Financial institutions aggregate bespoke interests in a diverse client base resulting in an aggregated central pool of liquidity which is highly correlated. This liquidity pool is created by aggregating a highly correlated set of bespoke interest in a commodity type, for example, an airline buys an OTC swap from a financial institution referencing Jet Rotterdam which the financial institution immediately hedges with gasoil futures which for the financial institution hedge the majority of the OTC risk.

The next day a refiner sells a swap to financial institution referencing Gasoil 0.1 FOB Med which isn't exactly the same as Jet Rotterdam but it is highly correlated and therefore that second trade provides a hedge for the first at which point the financial institution can terminate the gas oil futures which provide a temporary hedge until the various OTC flows can be matched.

The availability of this centralised pool of liquidity among correlated underlyers is a key component of efficient end user hedging intermediation. If ESMA's vision of the population of underlyers which are eligible for offsets is too narrow then there is a risk that these correlations will be broken, impacting the provision of liquidity for end users (i.e. if financial institutions are restricted from

netting the futures with this pool of instruments which reference these correlated underlyers then financial institutions will be restricted in making that pool of liquidity available to end users).

It is critical that these correlated underlyers are eligible for netting because the degree of correlation is even tighter in the outer months.

Furthermore reference to deliverable supply raises the following points:

- How ESMA/ National regulators will measure the deliverable supply, including production and storage is very unclear, and notably how they can access data from physical facilities not subject to financial supervision (e.g. oil refineries). Whereas it seems workable for some commodities (e.g. metals), it is raising significant challenge for other commodities in particular when markets are global (e.g. oil, agriculture)

- What period will be considered as relevant for the measure of deliverable supply compared to the maturity of other months contracts is also unclear as well as how ESMA/ national regulators will distinguish between storable/ no storable commodities, seasonal/ non seasonal commodities.

- What geographical spectrum is to be considered for the measure of the deliverable supply, i.e. European – Global, is also unclear. Whereas some market remain mostly national (e.g. natural gas and power), some others are global by nature (oil, agriculture).

In the light of all the operational challenges that the size of deliverable supply present market participants and regulators, a majority of ISDA members generally consider open interest a better metric for other months contracts as the open interest reflects all relevant market factors relating to the trading of the relevant contract (e.g. maturity, volatility, number and size of market participants) thereby ensuring limit flexibility to prevailing market conditions for the relevant underlying commodity.

Open Interest

We also point out that when market liquidity (i.e. trading activity) is too low, open interest is constrained and the limit is no longer relevant, ESMA should consider a de minimis threshold. This threshold would be different depending on the contract and we encourage ESMA/ NCAs to engage with trading venues and market participants to establish what is appropriate for each contract. The threshold should be in end commodity units, which can be used by MTFs/ OTFs and which exchanges can translate into lots.

We would accordingly suggest the following amendments to RTS 30

Amendment to **recital 10**:

"(10) The national competent authority of the trading venue for the commodity derivative will calculate a baseline position limit for the commodity derivative based on (25%) of the deliverable supply for the spot-month contract or spot-month contracts to which the position limit shall apply. The baseline shall be specified in the number of lots of the relevant commodity derivative. The national competent authority of the trading venue for commodity derivative will calculate a baseline limit on open interest for all other month contracts subject to a de minimis threshold below which limits could not be set"

Article 1 - The methodology for the calculation to be applied in establishing position limits

"(2) The competent authority shall, for each commodity derivative traded on a trading venue for which it is the competent authority, or central competent authority as specified in Article x, determine a baseline figure on the basis of the deliverable supply *for spot month contracts and on the basis of open interest for non-spot month contracts* for that commodity derivative. The deliverable supply shall be that which is used either as settlement for, or a pricing reference to, that commodity derivative."

"(3) The baseline figure *for spot month contracts* shall be (25%) of the deliverable supply for the commodity derivative to which the position limit shall apply. The baseline figure shall be specified in the number of lots of the relevant commodity derivative with the definition of lot being the unit of quantity used by the trading venue on which the commodity derivative contract trades."

"*(4 – new)) The baseline figure for other months contracts shall be X% of open interest*"

"*(5 – new) The competent authority will set a de minimis threshold for all contracts subject to position limits below which limits could not be set.*"

Article 3 - ***The deliverable supply in the underlying commodity***

"*1. The competent authority, or central competent authority as specified in Article x, shall assess whether the deliverable supply in the underlying commodity is such that the baseline figure for the position limit for spot month contracts requires adjustment. The deliverable supply shall be that which is used either as settlement for, or a pricing reference to, a commodity derivative contract.*"

Article 4 - ***The overall open interest***

"*1. The competent authority, or central competent authority as specified in Article x, shall assess whether the overall open interest in the commodity derivative and the overall open interest in other financial instruments with the same underlying commodity markets is such that the baseline figure for the position limit for spot month contracts requires adjustment. Any adjustment made to the baseline figure for the position limit shall be based on the principle that there is a commonality between the volume of overall open interest in the commodity derivative and the overall open interest in other financial instruments with the same underlying commodity markets and the level of the position limit so that the greater the volume of overall open interest, the higher the overall position limit.*"

Article 5 - ***The volatility of the relevant markets***

"*The competent authority, or central competent authority as specified in Article x, shall assess whether the volatility of the relevant markets in the commodity derivative is such that the baseline figure for the position limit requires adjustment. Any adjustment made to the baseline figure for the position limit shall be based on the principle that there is a commonality between the level of volatility in the markets relevant to the*

commodity derivative and the level of the position limit so that the greater the level of volatility, the higher ~~lower~~ the overall position limit."

Article 6 - ***The number and size of market participants***

"*The competent authority, or central competent authority as specified in Article x, shall assess whether the number and size of market participants that hold a position in the commodity derivative is such that the baseline figure for the position limit requires adjustment. ~~Any adjustment made to the baseline figure for the position limits shall be based on the principle that there is a commonality between the number and size of market participants that hold a position in the commodity derivative and the level of the position limit so that the greater the number of position holders, the lower the overall position limit~~*"

Q185. Would a maximum of 40% position limit be suitable for all commodity derivatives to meet position limit objectives. For which commodity derivatives would 40% not be suitable and why? What maximum position limit would be suitable and why?

In the absence of clarity regarding the definition of 'deliverable supply' and estimates for deliverable supply we are unable to comment on whether a maximum position limit of 40% is appropriate.

As stated in response to question 184 above, we would advocate the introduction of a de minimis threshold, below which limits could not be set, thereby avoiding any constraints on contract growth. In this regard, we believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. In this way the position limits regime would only capture position above a size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortions.

In our view consideration needs to be given for non-linear position changes which may occur as a result of option expirations for any contract i.e. options on futures expiring ahead of the corresponding future contract expiration.

It can be difficult to manage limits during the option expiration window and participants could find themselves over the limit and may not know what the delta will be until the future has expired. Under CFTC regime, there is a 1 day grace period after option expiration to come into compliance with the limit.

Q186. Are +/- 15% parameters for altering the baseline position limit suitable for all commodity derivatives? For which commodity derivatives would such parameters not be suitable and why? What parameters would be suitable and why?

Without the methodology for calculating deliverable supply, market participants cannot accurately assess whether the +/- 15% adjustment is suitable. It may be more appropriate to allow regulators some flexibility due to factors specific to the commodity asset class (such as open interest, number of market participants) in the event that a higher or lower adjustment is required.

Giving recognition to the fact that unique circumstances may exist across the wide range of underlyers which come within the scope of the position limit framework could be a useful concept although it is likely that this could be picked up through open interest if used as the metric for other months.

Q187. Are +/- 15% parameters suitable for all the factors being considered? For which factors should such parameters be changed, what to, and why?

ESMA is required to consider volatility and recognise that volatility may have a residual value in terms of reflecting illiquidity issues.

We highlight that if open interest is used to determine other month limits, the other factors become incidental. This is because open interest numbers would already factor in such matters as maturity of contracts, volatility, number and size of participants and characteristics of underlying commodity markets.

Q188. Do you consider the methodology for setting the spot month position limit should differ in any way from the methodology for setting the other months position limit? If so, in what way?

Yes. Deliverable supply is the correct metric for physically settled spot month contracts.

For cash settled spot-month contracts, deliverable supply may be the correct metric for setting the cash spot month limit. Consideration should however be given to a higher limit for the cash settled spot month contract than the physically settled spot limit (e.g. the limit could be a multiple of the limit set for the physically settled spot month) as cash settled contracts are not structured for delivery and therefore are not constrained by available supply of physical inventory. However, further consultation with the industry would be needed on this issue.

In addition, we acknowledge the logic for ESMA's conclusion at para. 21 of the Consultation Paper that the limit for the spot month should generally be lower than the other months limits given that other months limits will apply to multiple expiries. However, we note that the bulk of trading activity occurs in the spot month or at least the first couple of contract expirations (this is especially the case in oil contracts, where 50% of open interest sits in the first three contract months and the remaining 50% of open interest accounts for the other expirations). We believe further analysis should be undertaken to test this assumption and no conclusion should be reached with the calculation methodology for deliverable supply and open interest is made available.

For other months' limit, as mentioned under question 184, we propose introducing a de minimis threshold below which limits could not be set, thereby avoiding any constraints on contract growth. In this regard, we believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. In this way the position limits regime would only capture position above a size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortions.

In relation to the use of open interest for other month limits on physical and cash settled other months contracts, as the MiFID II regime applies to a broader range of commodity derivatives than just futures derivatives and will include economically equivalent OTC contracts, it will be necessary for open interest to reflect the end commodity unit of OTC contracts relating to the relevant on-venue contracts. It is also the case that certain commodities may not have a related futures contract and competent authorities will need to estimate the deliverable supply, open interest based on notional amounts of swaps and other relevant OTC contracts (e.g. options and forwards). Open interest/deliverable supply data should be available via trade repositories as a result of EMIR reporting.

We also note the difference between commodities means that some are durable and can be stored indefinitely and some cannot; this means that for some commodities, as well as production, deliverable supply should also include stock levels (i.e. surplus production stored from a prior period). As a general matter, estimated deliverable supply should include the quantity of commodity, including volume in storage, that is available for sale on a spot basis at the contract's delivery points.

We also think that ESMA and/or national regulators should include an obligation on RMs/MTFs and OTFs to provide data to ESMA/ regulators in order to ensure sufficient data is available to set position limits. This would address ESMA's concern that they may not received relevant data from exchenges (RMs, MTFs and OTFs) on open interest.

Q189. How do you suggest establishing a methodology that balances providing greater flexibility for new and illiquid contracts whilst still providing a level of constraint in a clear and quantifiable way? What limit would you consider as appropriate per product class? Could the assessment of whether a contract is illiquid, triggering a potential wider limit, be based on the technical standard ESMA is proposing for non-equity transparency?

ISDA members think that ESMA should consider mechanisms to ensure that the limits do not hamper developing liquidity in the new contracts.

Low liquidity is not only a characteristic of new contracts, but also of many more regional or specialised commodity products. Where very few market participants exist with respect to a contract, liquidity will naturally be limited. Any consideration and/or methodology adopted for new contracts should therefore be extended to existing illiquid contracts.

We believe that the best approach would be to take each new or illiquid contract separately and consider a reasonable multiple of the current transaction size after a defined period of trading.

New contracts often are illiquid/ immature initially and may be used by a small number of market participants. In order to accommodate the demand of hedges and develop a robust, established market, it may be necessary to permit a small number of market participants to represent a relatively large share of the (small) market. Concerns regarding market abuse can be adequately addressed through enhanced reporting and surveillance, as necessary.

We propose introducing a de minimis threshold is established, below which limits could not be set, thereby avoiding constraints on contract growth.

If liquidity in a contract is not present, then it is a clear indicator that trading activity in the contract is either irrelevant or not sufficiently significant to need to limit it. In such case, the threat of distortion should therefore be considered as irrelevant. As stated in response to question 184 above, we would advocate the introduction of a de minimis threshold, below which limits could not be set, thereby avoiding any constraints on contract growth. In this regard, we believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. In this way the position limits regime would only capture position above a certain size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortions.

Q190. What wider factors should competent authorities consider for specific commodity markets for adjusting the level of deliverable supply calculated by trading venues?

We believe that the seasonal supply outages in the physical market, the perishability of deliverable materials and the capacity constraints (with regard to transportation and delivery) should be taken into account under the "characteristics of the underlying" factor.

We reiterate that the absence of accurate data on production and storage of some commodities should be reflected in the consideration related to the characteristics of the underlying commodity market.

Whilst estimated deliverable supply is the appropriate baseline for setting spot month limits, we believe that open interest is the appropriate metric for all other months, and that this metric would take into account all relevant factors particular to the relevant commodity contract: it would then not be necessary to provide for an adjustment mechanism driven by an exhaustive list of factors.

It is also critical that deliverable supply or open interest calculations for other months limits allow for the inclusion of correlated underlyers (e.g. refined petroleum products such as jet ara, jet rott, gasoil fob 0.1). As these correlated underlyers use the commodity derivative as a hedge, it would be inaccurate not to recognise these underlyers for the purposes of calculating deliverable supply and / or open interest.

Q191. What are the specific features of certain commodity derivatives which might impact on deliverable supply?

Please see response to question 190 above.

Q192. How should 'less-liquid' be considered and defined in the context of position limits and meeting the position limit objectives?

Please see responses to questions 189 and 184 above.

We also point out that the test for liquidity should be 'high hurdle' because commodity derivative markets are globally dispersed, seasonal and often fragmented between venues.

Q193. What participation features in specific commodity markets around the organisation, structure, or behaviour should competent authorities take into account?

ISDA members believe that where a product is traded by a small number of participants, ESMA should seek to understand the composition of market participants before determining the position limit. For example, a market with ten active participants may have two sellers and eight buyers, or just one risk management provider amongst nine participants seeking risk management services. In such markets, a single position limit may have a disproportionate impact on some of the participants.

Appropriate recognition to legitimate offsets (via definition of EEOTC contracts) is a key component of efficient end user hedging intermediation for liquidity providers. In addition risk monitoring entities within financial institutions have aligned their monitoring and reporting architecture to this dynamic (i.e. offsetting correlated underlyers with exchange based benchmarks as the instruments are seen as broadly fungible) and this same architecture should serve as a model / broad framework for regulators when trying to accomplish / identify these correlations for the purpose of establishing netting rules for the position limits regime.

As stated in response to question 184 above, we would advocate the introduction of a de minimis threshold, below which limits could not be set, thereby avoiding any constraints on contract growth. In this regard, we believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. In this way the position limits regime would only capture position above a certain size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortions.

We particularly question ESMA's assertion that overall position limits should move inversely against the number of market participants: We would suggest that the greater the number of participants in a given market segment, the lower the chances of a single actor having a dominant or otherwise inappropriate position. Thus, the logic proposed by ESMA for new or illiquid markets should apply equally to established markets.

Q194. How could the calculation methodology enable competent authorities to more accurately take into account specific factors or characteristics of commodity derivatives, their underlying markets and commodities?

We broadly agree with the principles proposed by ESMA to enable the competent authority to adjust the limits. However we believe that ESMA's assumption that position limits should move up in direct proportion to the flexibility of the relevant commodity market is wrong. Actually, the reverse is likely to be true, in the sense that the more restricted a market (in terms of few points of delivery, geographic specificity, and seasonality etc.) the greater the tolerance for inadvertent large positions needs to be built into the calibration.

We also believe that ESMA's assumption that position limits should be adjusted downwards in volatile market conditions is incorrect. In volatile markets there is an increase in demand for price risk management services from financial institutions and other liquidity providers. Restricting the ability of price risk management providers to offer these services in volatile markets will have an adverse impact on end users.

As we say we also believe that open interest would factor in the relevant characteristics / specific factors relating to a particular commodity market.

Q195. For what time period can a contract be considered as "new" and therefore benefit from higher position limits?

Please see our response to questions 184 above and 198 below.

We think that NCAs should have discretion on a case-by-case basis to take a view on the relative maturity of a contract after its commencement.

Q196. Should the application of less-liquid parameters be based on the age of the commodity derivative or the ongoing liquidity of that contract.

No. ISDA members underline that the age is irrelevant as a contract may never reach trading levels which are sufficiently high to result in the need for a position limit to be applied. In this regard, we feel that the case by case approach is more appropriate. Please see our responses to questions 184 and 189 above.

Q197. Do you have any further comments regarding the above proposals on how the factors will be taken into account for the position limit calculation methodology?

We ask that ESMA clarify how it interprets its definition of deliverable supply (i.e. clarifies that it is meant to be broader than just the amount of physical commodity for example the amount stored in a warehouse) and promotes live data to test the proposed baseline / adjustment percentages against.

Furthermore, we would highlight that the frequency and timing of limit revisions is critical for monitoring a well-functioning market. From a practical perspective, position limits should not be changed more frequently than annually with a minimum 6 month compliance window.

Q198. Do you agree with ESMA's proposal to not include asset-class specific elements in the methodology?

Yes. We agree with ESMA that the methodology should provide competent authorities with sufficient scope to take into account the specificities of the different markets without incorporating asset-class specific elements in the methodology.

Also, it is critical that open interest is used as the metric for other month limits as open interest will factor in asset specific elements relevant to the particular commodity in question.

Q199. How are the seven factors (listed under Article 57(3)(a) to (g) and discussed above) currently taken into account in the setting and management of existing position limits?

ISDA members highlight that these seven factors listed under Article 57(3)(a) to (g) are all relevant but suggest that open interest for other months limits is the universal metric which is collectively reflective of all of them. In addition, differentiation between asset classes would be reflected through open interest and they are in our view is the more appropriate metric for other months.

7.3 Application of position limits

Q200. Do you agree with the proposed draft RTS regarding risk reducing positions?

The EMIR definition recognises that positions that offset the risks arising from the potential change in value of assets, services, inputs, products, commodities or liabilities that a firm owns, produces, manufactures, processes, provides, purchases, leases, sells or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of business are risk reducing. We support this definition.

However, the clarification to the definition provided today in the EMIR Q&A is rather unhelpful and creates practical problems in being able to achieve hedging status.

Risk management systems are based around an analysis of positions and not transactions. Positions are created through transactional activity but the character of an individual position and the transactions that led to it can change over time. The key measure for commercial firms is whether the portfolio of positions is risk reducing.

As an alternative to demonstrate hedging status, we would propose ESMA develop a process to allow a firm to prove its hedging of risks as already exists for the US Ag contracts.

The US contracts are the most liquid and widely traded contracts in the Ag markets globally and have been subject to a position limit framework that has been in place for many years. Most firms active in the Ag markets will utilise these US markets as part of their global risk management activities. It is strongly preferable for the approach to hedging is as consistent globally as possible.

Hedge exemption applications to exchanges in the US are supported by analysis of historical cash market exposures over the previous 12 months together with details of monthly processing capacity. It is recognised that a position that offsets the cash market exposure or covers uncontracted raw material requirements or processing outputs for the following 12 months qualifies as a hedging transaction. The cash market information is provided for each commodity showing the inventory held in that commodity together with fixed price forward purchase and sale contract values at the aggregate group level. A description of the processing capacity together with projected monthly processing volumes for the next 12 months is provided to support the risk arising from processing activity. This allows the exchange and the CFTC to review and validate that positions held as hedges do in fact offset risk.

We believe that ESMA should follow this principle under the MiFID2 position limits regime and assess total exposure arising from fixed price cash positions together with uncontracted processing capacity (inputs and outputs) in the same way as in the US.

We disagree with the comment in section 7.3.9 of the consultation paper that suggests that this approach is not consistent with Recital 21 or EMIR.

We believe that the approach is only incompatible with the EMIR regime due to the guidance in the ESMA EMIR Q&A.

We therefore believe ESMA could establish the process proposed above, rather the one proposed in the EMIR Q&A.

We also request that ESMA consider exempting arbitrage positions (simultaneous purchase and sale of identical or equivalent commodity futures contracts or other instruments across two or more regulated markets) from the position limits.

Q201. Do you have any comments regarding ESMA's proposal regarding what is a non-financial entity?

We agree that the term "non-financial entity" should be understood to cover persons that are not either:

- persons who are regulated under the various EU directives or regulations regulating financial entities; or

- persons who would be regulated under those directives or regulations if they were established in the EU.

We consider that the definition should be read in this way even if the territorial and personal scope of Article 57 is limited to EU persons. Even if this is the case, there is a risk that the positions of non-EU non-financial entities could need to be aggregated with the positions of a parent undertaking in the EU. The non-EU entity or its EU parent on its behalf should be able to obtain the benefit of the exemption for risk reducing positions.

Q202. Do you agree with the proposed draft RTS regarding the aggregation of a person's positions?

Exception to aggregation

MiFID II (article 57.1) states that the limits apply to "the net position which a person can hold at all times" and clarifies that the limits "shall be set on the basis of all positions held by a person and those held on its behalf at an aggregate group level".

Whilst, we understand that the level 1 text does not allow disaggregation of positions within the same legal entity, we are of the view that the definition of what qualifies as a position held on behalf of this legal entity does allow disaggregation based on independence of decision. Accordingly, we strongly believe that the basis for disaggregation proposed by ESMA in RTS 30 (Art. 2(2)) in respect of positions held by an intermediary on behalf of a client, is unduly restrictive. ESMA should allow disaggregation of independently managed business to which legal mandatory information barriers already apply (e.g. asset management businesses). These businesses are separated from principal trading businesses by firewalls (which may make it impossible to aggregate due to lack of access to the relevant data)/information barriers designed to ensure no exchange of information can occur between these businesses or no control can be asserted by one business over the other. It is critical that Article 2(2) is expanded to provide for disaggregation on this basis. In our view, any other interpretation would conflict with the independence requirements set out in European legislation (for example UCITS, AIFMD) and ignore the reality of such businesses. Furthermore, we do not believe that positions should be aggregated with other entities the group where such entities are not included in the same fully consolidated accounting group. This is consistent with Article 3(1) of EMIR. Accordingly, we would propose that Article 5(3) is amended as follows:

> "*The positions of a person in a commodity derivative… shall be aggregated with the net positions in that commodity derivative held by other persons within the same group <u>which are included in the same consolidation on a full basis as such person</u> …*"

Furthermore, whilst we welcome Article 2(2) of the draft RTS 30 which provides that positions that are held by an intermediary on behalf of a client shall not count towards that intermediary's own position limits regardless of whether, for reasons of market practice, operational structure or legal framework, the positions are held by the intermediary as principal. However, we note that in Europe the principal-to-principal model is used for exchange traded derivatives which means that, as a matter of market practice, positions that are held by an intermediary on behalf of a client will be held as principal. We therefore request that the reference to "regardless of whether" in Article 2(2) is amended to provide further clarity that for exchange traded derivatives such arrangements should not be construed narrowly as an exception, but are in fact market practice in Europe

In addition, we would welcome specific clarity regarding the rules on aggregation for fund structures. In this regard we note that ESMA and the Commission have accepted, in the context of the draft RTS on the clearing obligation interest rate derivatives (published on 29 January 2015) and the RTS on minimum margining requirements, that independent investment funds should not be aggregated at group level for the purpose of the relevant thresholds. We would encourage ESMA to provide similar clarity in the context of aggregation of position limits for investment fund structures (ie. that the thresholds shall be determined at an individual fund level and not on a group basis)

Prorata consolidation

We note that a 100% consolidation, rather than a pro rata consolidation, is likely to lead to double counting positions. We don't think it is appropriate to attribute control twice for the same position. We also urge ESMA to consider that a 100% consolidation provides an opportunity for participants in a 50-50 joint venture to each receive 100% netting benefit from a contra position held in the Joint venture.

Parent company holds no positions in commodity derivatives traded on a trading venue

We believe the effect of ESMA's proposals is that where a parent or ultimate holding company itself holds no positions in commodity derivatives traded on a trading venue or economically equivalent OTC contracts, that entity will not be subject to aggregation rules notwithstanding positions may be held by one or more subsidiary undertakings of that entity.

At paragraph 19 of Section 7.3 of the Consultation Paper ESMA states that the aggregation will comprise of the positions of a person together with those of any wholly or partly owned subsidiaries of that entity but 'aggregation with the positions of fellow subsidiaries of a mutual parent or ultimate holding company' is not required. It follows therefore that the parent or ultimate holding company should not have to aggregate its positions with those of its subsidiaries where it holds no positions in commodity derivatives traded on a trading venue or economically equivalent OTC contracts itself as otherwise this could result in the position limits applying on an aggregated basis between the positions of fellow subsidiaries of that mutual parent or ultimate holding company which would be inconsistent with the position as set out in Section 7.3, paragraph 19.

Accordingly, we would welcome further clarification in the RTS that the position limit regime is only applicable where the relevant person holds positions in commodity derivatives and accordingly a parent or ultimate holding company that holds no positions in commodity derivatives is not required to aggregate the positions of its subsidiaries.

We would accordingly suggest the following amendments to RTS 30:

Recital (8)

"*Article 57(1) of Directive 2014/65/EU requires that position limits shall be set on the basis of all positions held by a person and those held on its behalf at an aggregate group level. Article 4(34) of Directive 2014/65/EU establishes the definition of group in Article 2(11) of Directive 2013/34/EU which refers to a group as a parent undertaking and all its subsidiary undertakings. The positions of a person which is a member of a group shall therefore be aggregated with the positions in commodity derivatives that it holds in its own name together with those of any wholly or partly owned subsidiary undertakings of that entity with the exception of positions to which legal mandatory information barriers apply under the EU legislation. Subject to this exception, ~~T~~the ~~whole~~ positions of the other entities within the group will be added to the person's positions~~, to simplify reporting and to reflect that a person which has effective control of an entity may use the full amount of that entity's position to support its activities~~…*"

Article 2 - ***Determining when positions of a person are to be aggregated within a group***

"*1. The positions of a person shall be aggregated within a group by aggregating the positions in commodity derivatives that the person holds in its own name (whether held directly by itself or on its behalf by third parties such as investment firms, under a client relationship) together with those of any subsidiary undertakings of that*

group, but not to aggregate the positions of other subsidiary undertakings of a mutual parent or of any intermediate or ultimate holding company. ~~Such aggregation shall be made on a whole position basis and not on a pro rata basis.~~ A subsidiary undertaking means an undertaking that is controlled by a parent undertaking."

"2. By exception to aggregation within the group between the position of a person and those of any subsidiary undertakings of that group as defined in article 2.1 of RTS 30, positions taken by subsidiaries to which legal mandatory information barriers apply shall not be aggregated with the positions of their parent undertaking.I"

"3. The aggregation within the group between the position of a person and those of any subsidiary undertakings of that group as defined in article 2.1 of RTS 30 shall be in proportion to the capital held by the parent company."

Q203. Do you agree with ESMA's proposal that a person's position in a commodity derivative should be aggregated on a 'whole' position basis with those that are under the beneficial ownership of the position holder? If not, please provide reasons.

Please see our response to question 202 for further information.

No. It does not make sense to aggregate the positions taken by funds managed by an asset management company with the position taken by its mother company on the basis that the mother company owns more than 50% of the capital of the asset management company. It would in any event conflict with the regulation put in place by the EU to ensure independence of decision making and information in the asset management space.

Q204. Do you agree with the proposed draft RTS regarding the criteria for determining whether a contract is an economically equivalent OTC contract?

No. The functioning of commodity derivatives markets makes it critical that the definition of Economically Equivalent OTC contracts (EEOTC) recognises the global nature of markets.

As we make clear in our response to question 207 below, narrow netting rules will restrict capacity for financial institutions (and other liquidity providers) to provide liquidity to real economy customers (e.g. commodity producers, suppliers and manufacturers) to execute their price risk management strategies and do not accurately reflect the net risk exposure of a counterparty.

In addition, we point out that although recital 10 of Draft RTS 30 suggests that there would be a conclusive list of EEOTC contracts maintained by the competent authorities/ ESMA, we believe producing such a list may be operationally unworkable given the large number of commodity derivative contracts and the dynamic nature of the market. We therefore believe that market participants should assess for themselves what constitutes a EEOTC contract and note that this approach has worked effectively in the context of EMIR trade reporting.

Q205. Do you agree with the proposed draft RTS regarding the definition of same derivative contract?

We agree that it is a subset of economically equivalent and that a contract is "the same" if it is at least economically equivalent and in addition has other equivalent properties. However we think

that the definition of 'same contract' should allow netting between long and short positions transacted on different broker patforms/ exchanges in effectively the same product.

Q206. Do you agree with the proposed draft RTS regarding the definition of significant volume for the purpose of article 57(6)?

ISDA members do not think that the '3 lot' rule is appropriate as it is not material enough to be disturbed on a daily basis by relatively minor market activity.

Q207. Do you agree with the proposed draft RTS regarding the aggregation and netting of OTC and on-venue commodity derivatives?

No. In our view, the inability to net non-MiFID instruments with MiFID instruments will make the calculation of positions inaccurate as the position will not reflect the real risk exposure of markets participants. In this regard, we note that the term "economically equivalent OTC contracts" is not defined by the Level 1 text and so in our view there is scope for ESMA to interpret this term broadly.

We also question that the level 1 text does not allow netting between contracts traded on EU venues and contract traded on third country venues. The recognition of third-country venues is critical feature of the European financial legislation (EMIR as well as MiFID) and it seems arbitrary to state that for the purpose of netting the article 57 is bounded at European level.

As noted in response to question 183, consideration must be given to the netting treatment of OTC contracts to ensure that in calculating the net position of an entity that entity is able to net OTC instruments which are closely correlated to on-venue contracts. We view this as critical to financial institutions to continue to provide efficient end user hedging intermediation.

Specifically, non-financial entities require financial institutions to provide hedging instruments to manage price risk in respect of their physical commodity consumption and/or production. Refiners and airlines, for example, depend on financial institutions to offer OTC derivative contracts to hedge their specific grade of fuel oil (e.g. Jet Rotterdam) as the alternative would be to hedge with on-venue contracts (e.g. gas oil futures) which would involve assuming unwanted basis risk. These financial institutions commonly offset the OTC derivative exposure with exchange traded contracts (e.g. gas oil futures) as the OTC derivatives are closely correlated to the futures. In addition, this dynamic allows financial institutions to aggregate bespoke interests in a diverse client base resulting in a highly correlated centralised pool of liquidity which provides an efficient source of hedging intermediation for non-financial entities. However to ensure financial entities can continue to offer this, it is critical (in the absence of a pass through hedge exemption) that that these correlated OTC instruments continue to operate as legitimate offsets to the futures exposure assumed by financial institutions to deliver this source of liquidity to non-financial entities. Accordingly, we would ask ESMA to clarify that exposures to such OTC swaps can be taken into account in determining the net position.

Furthermore, it is critical that market participants can consider REMIT products and physical positions (which do not constitute MiFID instruments) and commodity index swaps as reducing the net position held in an on-venue commodity derivative.

As discussed above, these products are often used to hedge the risk of commodity derivatives. An inability to include them in calculating the net position will restrict the capacity for financial institutions to execute their price management strategies. By way of example, commodity index swaps are hedged through future positions.

An inability to offset cash settled commodity index swaps with the futures positions will limit ability of financial institutions to write swaps for pension funds / asset managers etc. seeking to use such instruments to achieve diversification objectives. Accordingly, it is imperative that commodity index swaps and non-MiFID instruments will receive appropriate recognition as legitimate offsets under the position limits regime and we therefore believe it is necessary for ESMA to clarify that exposures to these non-MiFID instruments and commodity index swaps can be taken into account in determining a person's net position.

Q208. Do you agree with the proposed draft RTS regarding the procedure for the application for exemption from the Article 57 position limits regime?

No. ISDA members, particularly commodity producers/ suppliers, raised serious concerns with the proposed approach in the draft RTS. There are some situations where a firm would expect to be in position where it needs to exceed the position limit on an ongoing basis for the purposes of commercial hedging. It is not always possible to precisely predict the amount by which the firm will need to exceed the limit at a future date as the commercial risk being hedged can fluctuate significantly day to day. The proposed approach appears to require a regular renewal of the exemption application in order to continue to do this.

We believe this approach will be extremely inefficient and impractical both for the firms and the competent authority. We propose an approach that closely follows the well established approach in the US Grain markets. Exemptions should be applied for at the group aggregate level and based on historical and anticipated needs. It is critical that the process is relatively straightforward and efficient.

On the basis we would support an ex-post approval procedure. This is of fundamental importance if entities give to be able to effectively hedge positions – market participants cannot wait 30 days to do so.

Accordingly we suggest the following amendment to RTS 30:

Article 6 - ***Procedure for application of use of exemption from position limits***

"3. The non-financial entity shall ~~apply~~ declare ~~to~~ the use the exemption before it exceeds the limits set for the size of a position in that particular commodity derivative. A position under Article x(10) shall ~~not~~ be considered as exempt from the relevant position limit ~~if~~ unless the competent authority ~~has~~ does not approve the exemption."

"4. A competent authority shall have up to 30 calendar days to approve an application under Article x(10) after the declaration made by the non-financial entity. The competent authority shall send a confirmation to the non-financial entity to approve or reject the application. Where the non-financial entity has not received a refusal, confirmation or request for more information from the competent authority within a period of 30 calendar days, ~~the person may use the exemption~~the exemption is considered granted."

Q209. Do you agree with the proposed draft RTS regarding the aggregation and netting of OTC and on-venue commodity derivatives?

It appears that the question is a repeat of question 207. We assume this question is instead meant to refer to pages 550 and 551 of the Consultation Paper. If that's the case, we think the approach that ESMA proposes is sensible. However, this is only likely to be relevant within a more workable and wider definition of what constitutes the 'same' commodity derivative, which we would favour.

7.4 Position reporting

Q212. What other reporting arrangements should ESMA consider specifying to facilitate position reporting arrangements?

International consistency

ISDA members would strongly encourage ESMA to consider a process for end client reporting close to the form 40 approach used in the US under the CFTC rules pursuant to which the end-client can directly send the relevant information to the CFTC without passing through the chain of intermediaries, which protects client confidentiality vis à vis the intermediaries.

We also point out that the end client reporting provisions, if implemented in a manner that forces clients' information to pass through the whole chain of intermediaries, would conflict with national privacy laws in a number of jurisdictions and we typically experienced this issue when implementing the CFTC reporting rules of derivatives derived from the Dodd Frank Act.

Territorial and personal scope of position reporting

It will be important that Member States take a common approach to the scope of application of these requirements. Accordingly, ESMA should clarify the personal and territorial scope of the obligations that are laid down in Article 58(2) and (3) and should indicate how Member States should apply the requirements.

In this regard, Article 58(2) MiFID2 refers to reporting obligations applying to "investment firms" and Article 58(3) refers to reporting obligations applying to "members", "participants" and "clients" of EU trading venues.

However, Article 1 MiFID2 defines the scope of application of the provisions of the directive.

- Article 1(1) provides that the Directive applies to, amongst others, investment firms and third country firms performing relevant activities through a branch in the EU and Article 1(6) provides that Articles 57 and 58 shall apply to a person exempt under Article 2.

- Article 1(3) does not explicitly provide that position reporting requirements apply to EU authorised credit institutions performing MiFID2 regulated services and activities because it does not expressly refer to Article 57 or 58. However, competent authorities may apply position reporting to credit institutions by virtue of Article 69(1)(j) and Article 1(3)(d) does refer to Article 69 (compare Article 57(11) in relation to position limits).

Thus, Article 1 indicates that the position reporting requirements of Article 58(2) and (3) would only apply to:

- EU incorporated and authorised investment firms;

- EU incorporated and authorised credit institutions performing MiFID2 regulated services and activities; and

- EU persons that are "investment firms" as defined in Article 4(1)(1) MiFID2 but which are exempt from the requirements that apply to EU incorporated investment firms by virtue of Article 2,

but, in the case of Article 58(3), only if the undertaking is also a member, participant or client of an EU trading venue. Accordingly, the reporting requirements under Article 58(2) and (3) are not intended to apply to persons outside the EU or to persons in the EU that are not "investment firms" (e.g. individuals that are not "undertakings"), even if they are a member, participant or client of an EU trading venue and we would therefore encourage to include an acknowledgment to this effect.

Scope of obligations of investment firms

An investment firm subject to position reporting under Articles 58(2) or (3) may have relationships with clients that do not involve contracts or interests within the scope of Articles 58(2) or (3). The investment firm should only be required to obtain daily information for inclusion in a report required under articles 58(2) or (3) from a client with whom the investment firm has executed contracts within the scope of Articles 58(2) or (3) or for whom the investment firm currently holds positions in products within the scope of Articles 58(2) or (3) for the client (e.g. where the investment firm holds derivative warrants in custody for the client).

Reporting delay

ISDA members, for operational reasons, would support that the reporting of positions is done for trade T no later than close of business T+1.

Accordingly, we suggest the following amendment to article 2 of ITS 31:

> After article 2.1, introduction of point 2 and 3 as follows:
>
> > "*2. Investment firms shall produce the daily reporting of their position for trade day T no later than close of business T+1.*
> >
> > *3. When the reporting by investment firms of their clients and the clients of those clients until the end client is reached breaches any existing privacy or confidentiality law in the country where the client or the investment is established, the end-client shall directly reports its position to the financial regulator of the country where he is established*."

General comments

To ensure consistent application and implementation of the regime we also believe it is necessary for ESMA to provide clarity on the following issues:

Annex I and Annex II: It is possible that an OTC contract may be economically equivalent to contracts traded on two or more venues (perhaps with different competent authorities). It is not clear whether it is expected that a position in those contracts should be reported separately to each relevant competent authority.

Annex II – field 4: The unique product identifier for warrants may be an ISIN rather than an Alternative Instrument Identifier. Accordingly, field 4 should reference an ISIN or, where the ISIN is not the industry method of identification, the Alternative Instrument Identifier.

Annex II – field 6: It should be made clear that the spot month is determined in the same way as for position limits. However, the methodology for determining spot months will need to be adapted to take account of the structure of OTC derivatives, warrants and emission allowances.

Annex II - field 7: For OTC derivatives, derivative warrants and emission allowances, the "number of contracts" may not be a meaningful measure (or possible to calculate). The notional amount, number of warrants, units of allowances, etc. may be more meaningful.

Annex II – field 9: It is not clear how to report if some but not all of the contracts being reported are risk reducing. The flag to indicate if a position is 'risk reducing' is linked to the flag on the client, as per EMIR. This assumes that a single client cannot have one position which is risk reducing and one which is not.

8. Market data reporting

8.1 Data standards and formats

Q213. Which of the formats specified in paragraph 2 would pose you the most substantial implementation challenge from technical and compliance point of view for transaction and/or reference data reporting? Please explain.

ISDA members believe that proprietary or customised reporting formats would pose the most substantial implementation challenge. For example, firms envisage that implementing non-XML based formats would take the most effort to implement.

Similarly, any format that contains technical limitations that might affect a firm's ability to comply with its transaction reporting obligations in some way should be avoided. In this regard, we note that TREM does not allow for amendment action to be taken, whilst certain formats may not currently provide sufficient coverage to represent all MiFID instruments.

ISDA's members are supportive of the proposal to have FpML as the standard format for transaction reporting and financial instruments reference data. This is because FpML is the standard format by which ISDA members represent OTC derivatives for confirmation and reporting purposes under EMIR. Furthermore, FpML allows for the full representation of other non-derivative instruments.

In determining the suitability of a technical format for transaction reporting purposes, ISDA members believe that ESMA should have particular regard for the technical formats used for other reporting regimes, both in Europe and in other jurisdictions globally. FpML is also suitable for this reason, as it is used for reporting under EMIR and in other jurisdictions.

ESMA should provide flexibility in the technical formats that firms are permitted to use when undertaking transaction reporting, so as to respect the reality that different market participants have different technical structures and capabilities (particularly non-financial counterparties). The implementation should be uniform across national competent authorities and each should provide the same options for transaction reporting. This would enable an investment firm, that has multiple legal entities operating in different member states, to replicate its reporting technology at each entity if they so wish.

8.2 Obligation to report transactions

- **Transaction and execution of a transaction**

Q214. Do you anticipate any difficulties with the proposed definition for a transaction and execution?

Yes. ISDA's members commend ESMA's efforts to clarify the definitions of "transaction" and "execution" and welcome ESMA's decision to exclude securities financing transactions ("**SFTs**") that are reportable under the SFT Regulation from the scope of the transaction reporting. However, there is likely to be a difference in timing of the implementation of MiFIR and the SFT Regulation, as well as potential exemptions from reporting under the SFT Regulation that will not be carried through to the MiFIR framework if the current draft of RTS 32 remains unchanged.

ISDA's members presume that it is not ESMA's intention for firms to report SFTs under MiFIR for the period between MiFIR implementation and SFT Regulation implementation, nor that it is ESMA's

intention that reporting exemptions in the SFT Regulation should not apply to MiFIR. ISDA's members would therefore welcome definitive confirmation from ESMA that SFTs are not reportable under MiFIR during any interim period in which firms may have an obligation under MiFID, but the SFT Regulation has not entered into force. In addition, ESMA should confirm that SFTs that are exempt from reporting under the SFT Regulation are not reportable under MiFIR.

ISDA's members wish to state that they are not supportive of any approach that attempts to break the connection between sequential events that change an investment firms' position in an instrument. The approach that is proposed in paragraph 15, on page 561 of the Consultation Paper, which sees increases or decreases to a position as individual transactions to be reported independently of the original (or previous) transaction which formed this position, is such an approach. It does not respect the legal basis of OTC markets, where a transaction is executed with specific terms and transactions to increase or decrease are carried out under the terms of the original transaction. As well as not respecting the original terms of the trade, this approach is not consistent with EMIR. Nevertheless, ISDA's members believe that an alignment with EMIR is possible for OTC derivatives and would like to see a solution which provides for this.

We are also concerned with ESMA's clarification as to what constitute a transaction with regards to non-EEA branches of EEA firms. ESMA states in the consultation paper (paragraph 8) that "direct action by the investment firm clearly constitutes execution and this includes where it acts through its branches regardless of whether these are located inside or outside the EEA". ESMA also states that "unlike subsidiaries, branches have the same legal identity as the investment firm itself and therefore activity by them is reportable". We believe the above statement could be misleading and might suggest that non-EEA branches of EEA firms might be required to separately report to EU regulators. We believe it is not ESMA's intention to require non-EEA branches of EEA firms to separately transaction report to EU regulators, but rather to require MiFID investment firms to report the transactions and flag whether part of the activity was carried out by one of their branches (whether based inside or outside the EEA).

In order to avoid any misunderstanding, firms would like ESMA to confirm in RTS 32 that non-EEA branches of EEA firms will NOT be required to report to EU regulators. We would therefore suggest amending RTS 32, Article 13(5) as follows:

"All transaction reports for transactions executed in whole or in part by the investment firm, including through its branches, shall be sent to the home competent authority of the investment firm. Where the transaction is executed by an a EEA branch of a non-EEA investment firm, reports must be sent to the host competent authority of the investment firm based in the Union."

Q215. In your view, is there any other outcome or activity that should be excluded from the definition of transaction or execution? Please justify.

No. However, as over reporting is expressly not allowed under MiFIR, ISDA's members would support ESMA's efforts to provide a specific list of activities which should be excluded from the definition of "transaction" for the purposes of transaction reporting. The importance of this cannot be underestimated considering the lack of flexibility regarding the over reporting of transactions. ISDA's members support the proposed list and particularly welcome the detail of Article 3(3)(f) of RTS 32, if its purpose is to remove from the transaction-reporting scope internal trades between branches (within the same legal entity under the same Legal Entity Identifier (LEI)) done for purely operational reasons. ISDA's members' understanding is that the requirement is aligned with EMIR in this case, where transactions between legal entities that have the same LEI (e.g. between branches) are not reportable, whilst transactions between different legal entities with different LEIs (e.g.

between subsidiaries of the same group or holding company) are reportable.

ISDA's members propose amending the RTS language in line with the understanding outlined above in terms of legal entity/LEI so as to avoid the use of ambiguous phrases like "purely internal movements", which is used in the Consultation Paper (p.563), as it is impossible to distinguish the "purely internal movements" from the "movements where there is a change in position".

In addition to this, ISDA's members believe that if "a change in the composition of an index after a transaction occurred" is not reportable then this should extend to changes in the composition of baskets and sectors as well.

ISDA member's propose that RTS 32, Article 3(3)(h) should therefore be amended as follows:

"A change in the composition of an index, basket or sector after a transaction occurred".

- **Transmission of an order**

Q216. Do you foresee any difficulties with the suggested approach? Please justify.

Yes, ISDA's members would note that the logistical barriers to transmitting all the required data to fulfil the "transmission of an order" conditions, along with the large operational barrier of having written agreements in place, will lead to all parties in a chain reporting independently rather than by transmitting orders.

Notwithstanding the comment above, it is the understanding of ISDA's members that the transmission of an order mechanism for satisfying an obligation to transaction report is available for all reportable MiFID instruments without exception.

It is also the understanding of ISDA's members that the transmission of an order mechanism applies irrespective of whether the non-transmitting investment firm is acting in a principal capacity or an agency / quasi-agency capacity, and irrespective of the way in which the relevant transaction between the two investment firms arose. For example, a firm which is acting on a discretionary basis and which transacts with a dealer (which is an investment firm) on the basis of a Request for Quote should consider itself to have "transmitted an order" (and therefore should not itself transaction report the relevant transaction) provided that the conditions in Article 4(1) of RTS 32 have been satisfied. We should be grateful for confirmation of this understanding.

Our understanding is that ESMA allows flexibility in the order transmission chain & details around CLIENT ID fields.

The next person in the chain can fill in the requirement if it has all the data details around the order, investment firms don't necessarily need to trace back to the client and disaggregate orders if they agree up front who would report the details.

ISDA's members interpret Section 8.2, paragraph 41 of the Consultation Paper to mean that a firm ordering a quantity of an instrument at a yet-to-be-fixed price will not be able to report the price (and will use a default blank value if they must report) but if they transmit the order to their counterparty to report, and that counterparty knows the price, then the counterparty should use the price which has been fixed. In RTS 32, table field 45, the "Details To Be Reported" segment says "Where no price is available, a default value shall be used". Guidance from ISDA on how these default values should work will be required – ISDA's members will assume that the price may be left

blank in most instances.

ISDA's members welcome the clarity provided in Section 8.2, paragraph 42 of the Consultation Paper, that receiving firms will rely on transmitting firm's information regarding:

i. Client information (designation and additional details);
ii. Designation to identify short sale by the client; and
iii. Where the order is aggregated for several clients, details of the allocations.

In practice there may be timing issues related to provision of this information from transmitting firms and the receiving firm may receive updates to the order information with respect to these specific details as the transmitting firm understands the designation of the client, short sale status and allocations. ISDA's members will expect that amendments to order information will be a feature of written agreements for transmission of an order.

ISDA's members would note that when transaction reporting a received order, investment firms will be acting in good faith and will be able to check the received information for completeness against the details required, as set out in the written agreement for transmission of an order, but the accuracy of the data cannot be verified. In this context, it is unclear what is meant by "obvious errors" in RTS 32, Article 4(4). Receiving firms should be able to rely on the information provided to them by the transmitting firm, and so we suggest this reference be deleted (or at least clarified as to its meaning).

Furthermore it should be noted that the written agreements detailing sufficient requirements for transmission of an order do not have any legal context in place at present and a very considerable effort will be needed to draft and negotiate these written agreements if full transmission of orders is to take place with an investment firm's counterparties.

- **General approach to reporting**

Q217. Do you agree with ESMA's proposed approach to simplify transaction reporting? Please provide details of your reasons.

ISDA's members support the principle of developing as simple an approach to transaction reporting as possible. However, the approach taken by ESMA for the buy/sell indicator does not simplify or address the problem of how to define the buyer or seller on an OTC derivative. This is particularly an issue for OTC swap derivatives, where firms exchange cash flows that are each based on floating rates or prices. As MiFID expands to encompass such products, it is important that the transaction reporting technical standards consider such products. Efforts to assign a de facto "Buyer" or "Seller" to transactions which do not readily fit such a classification may be a very challenging task and not populating the "Buyer" and "Seller" fields may be the most sensible approach for such trades with, for example, an alternative representation of the transaction available to show who is paying or receiving each leg. Examples of such trades in interest rate markets would be basis swaps where one party pays a floating rate according to a specific index (e.g. 1-month USD LIBOR) to their counterparty whilst receiving another floating rate (e.g. 6-month USD LIBOR) from their counterparty. In commodity markets such trades, where floating rates or flows based on the prices of different commodities are exchanged by counterparties, are also common and termed "spreads" or "spread swap trades".

Notwithstanding the point made above, ISDA's members are indifferent as to the approach set out in Section 8.2, paragraph 52 of the Consultation Paper and are supportive if it aids national competent authorities and ESMA's work. However, the ambiguity which remains about designating

the buyer and seller for derivative transactions (where such a designation does not readily exist) is the major concern for ISDA's members. ISDA's members would also note that all of the examples provided are related to on-trading venue transactions. Guidance and scenarios including OTC derivative transactions will be required for firms to better understand the approach to take for such products. As has been mentioned above, it is not always clear from the guidance which counterparty should be assigned buyer or seller of the risk. If ESMA is intent on designating a buyer and seller on every transaction report, ISDA's members would urge ESMA to work with the industry to develop and endorse best practices and to make sure global standards are followed across jurisdictions, in order to ensure the determination of buyer and seller is done as consistently and accurately as possible.

- **Table of fields**

Q218. We invite your comments on the proposed fields and population of the fields. Please provide specific references to the fields which you are discussing in your response.

Firstly, ISDA's members would like, where possible, the field names, definitions, details to be reported and formats to match EMIR and other reporting regimes within the EEA primarily (as well as beyond the EEA if at all possible). The re-use of the EMIR datasets for MiFID transaction reporting where possible will be an important implementation consideration for ISDA's members. It is clear that ESMA has endeavoured to do this in some cases and ISDA's members commend ESMA for this. ISDA would welcome the opportunity to work with ESMA on solutions for a number of fields detailed below, for example, developing a clear framework for Quantity/Quantity Notation and Price/Price Notation which incorporates ISDA's response to the consultation paper on proposed amendments to the EMIR technical standards. Also in that response, ISDA has proposed an additional field, termed a "link ID" to link together trade reports of components of packages. This may be something for consideration in the future in respect of MiFIR transaction reporting and ISDA's members would welcome the opportunity to further investigate this with ESMA.

ISDA's members would like to understand which reporting fields are mandatory, which are conditional (or not applicable in certain circumstances) and which can be left blank. This may be best illustrated by the provision of sample reports for different scenarios and transaction types. ISDA and its members would welcome the opportunity to work with ESMA to provide scenarios and transactions for OTC derivatives.

Also some fields will need to be repeatable to allow multiple values to be included. It is unclear in the draft RTS table which fields will allow for multiple values that might be required.

With reference to draft RTS 32 Annex 1 Table 1

Field 1 – 4 Reporting and Submitting Entity fields:

ISDA's members interpret the Reporting entity fields (1 & 2) to be used for identifying the entity which executed the transaction and the Submitting entity fields (3 & 4) to be used to identify the entity submitting the transaction report to the competent authority (for example an Approved Reporting Mechanism). The Submitting Entity will almost certainly be a legal entity so other options seem redundant for fields 3 & 4.

If legal entities can only provide an LEI as identification, ISDA's members would be concerned that smaller entities and entities which are outside the EEA might not obtain the relevant LEI.

Fields 5, 6, 20, & 21 Buyer and Seller fields:

As outlined in response to Q217, certain OTC derivative instruments do not have a buyer and seller, particularly where firms exchange cash flows that are each based on floating rates or prices. As MiFID expands to encompass such products, it is important that the transaction reporting technical standards consider such products. Efforts to assign a de facto "Buyer" or "Seller" to transactions which do not readily fit such a classification may be a very challenging task and not populating the "Buyer" and "Seller" fields may be the most sensible approach for such trades with, for example, an alternative representation of the transaction available to show who is paying or receiving each leg. Examples of such trades in interest rate markets would be basis swaps, where one party pays a floating rate according to a specific index (e.g. 1-month USD LIBOR) to their counterparty, whilst receiving another floating rate (e.g. 6-month USD LIBOR) from their counterparty. In commodity markets such trades, where floating rates or flows based on the prices of different commodities are exchanged by counterparties, are also common and termed spreads or spread swap trades. If ESMA is intent on designating a buyer and seller on every transaction report, ISDA's members would urge ESMA to work with the industry to develop and endorse best practices and make sure global standards are followed across jurisdictions, in order to ensure the determination of buyer and seller is done as consistently and accurately as possible.

Fields 13-19 Decision Maker fields:

If the decision to acquire the financial instrument is made by a committee ISDA members would welcome ESMA's clarification on the information that should be provided here. Decision maker information is an example of transaction information which is not stored today, so it will be challenging to incorporate into systems. ISDA's members would like ESMA to confirm that clients are required to provide this information on orders for execution, so that investment firms have all the required information to report the transaction. If it is not available, investment firms should report only the information that they have about the decision maker (or buyer or seller) from the information received. This may be particularly important for transactions with non-EEA entities where there may be privacy laws masking information from the investment firm.

With reference to the allowable format of the fields above and those for identification of Traders (Fields 1, 2, 3, 4, 5, 6, 13, 14, 20, 21, 68, 69, 71 & 72):

Where an LEI is used in these field (and in others where an LEI is used to identify an entity) ISDA's members would like clarity from ESMA that the validation of LEI will be expected only prior to provision of investment services and LEIs in a lapsed state may still be used for identifying an entity, should the entity not have renewed its LEI with their Local Operating Unit.

For these fields and others where natural persons are identified, ISDA's members believe that identification is also a challenge. Using the proposed Table 1 in Annex II of RTS 32 firms may encounter inconsistencies. Individuals may have multiple passports or national identification numbers and these may expire, with a new number being reissued after certain periods. Whilst ISDA's members appreciate this is partially addressed in proposed RTS 32, Article 6, challenges and inconsistencies will remain and may be subject to manipulation by individuals. ISDA's members also believe it is challenging to validate any of this information and it will be received from clients and collected from individuals on a best efforts basis.

Firms would like to reiterate their concern with the amount of personal data that ESMA is suggesting to include in each transaction report. We believe that ESMA's proposals to have natural persons identified by a national ID number robustly and uniquely identifies each natural person and should

therefore be enough for transaction reporting purposes. We do not agree that additional information such as the name, the surname, the date of birth, the country of residence and the post code is required in order for competent authorities to monitor for market abuse. We would urge ESMA to review the amount of personal data that it is proposing to include in transaction reports and to reduce it to a minimum.

In the Consultation Paper (paragraph 98), ESMA acknowledges concerns related to data protection and states that it "will ensure full compliance with the data protection law". Providing personal data in transaction reports greatly increases the risk of personal data fraud, risks of identity theft and raises important privacy concerns under the EC Data Protection Directive. The industry would like to understand how ESMA will mitigate these risks.

Fields 35-39 Transmission of order fields:

ISDA's members would like to note that information such as that regarding the end beneficiary will only be provided on transaction reports by an investment firm if transmission of the order took place, otherwise such information will not be available and beneficiary fields will be blank. For this reason it is important to clarify these fields to understand which are required to be completed if transmission of the order took place. This point directly relates to the opening point made in this answer regarding illustrative examples.

Fields 40-41 Trading Day and Time fields:

ISDA's members would like to see common time formats used for both MiFID and EMIR reporting. For EMIR, Execution Timestamp is one field showing the date and time of execution. MiFID should use the same designation and not separate into two fields as is proposed. This may be solved by separating or concatenating the date and time at a Trade Repository or Approved Reporting Mechanism, but standardisation of formats for at least the most basic and homogenous data points is an important principle to try to adhere to.

Field 42 Trading Capacity field:

ISDA agrees with and supports the question 219 response from the BBA on this point.

Field 43, 44, 45, 46 & 60 Quantity, Price and Strike Price fields:

ISDA has recently responded to ESMA's consultation on proposed changes to the technical standards for Article 9 of EMIR, to ask for this field to be extended to 20 characters in order to match the proposal here for Transaction Reporting. Likewise, ISDA's response to that consultation suggested that Quantity Notation be provided in the EMIR technical standards also and that the allowable notation values be expanded to allow quantities for non-Nominal or Monetary notations, such as for commodities (e.g. barrels, m^3).

The price and strike price fields should not be linked by the Price Notation field. Often a Strike Price may be displayed in percentage terms whilst the option price is given in monetary value. A Strike Price notation will be required. The price notations should also be expanded for price notations other than monetary value or percentage, or be better defined as being a total cost. ISDA members note that prices can be per lot of contracts or, in commodity markets, may have prices indicated per barrel or per m^3.

ISDA's members would welcome the opportunity to work with ESMA to solve the field requirements

for representation of the Quantity, Nominal/Notional, Price, Strike Price in a way that is consistent and standard across reporting regimes.

Field 50 Consideration field

ISDA's members do not understand the purpose of this field and feel it is redundant in the context of other information provided on a transaction report. It is not applicable for all derivative types so, if it is to remain in the table, further guidance will be needed.

Fields 53 to 56 Instrument Identification and Classification fields:

Where an instrument is identified using an ISIN value in field 54, subsequent instrument identifier fields should not be populated. This approach will minimise the risk of inaccuracies and improve the quality of the data that regulators receive.

ISDA's members have major concerns for derivative products which do not have an ISIN or Aii code. ESMA should allow a Unique Product Identifier (UPI) code as a valid value for such products. As mentioned elsewhere in our response, ISDA is engaged in work with CPMI-IOSCO on a solution for a global UPI and would very much like to see ESMA amend these fields to allow a UPI value to be submitted here. Furthermore, the CFI code is not sufficient for identification of OTC derivatives and the frequency of change of the CFI taxonomy is of concern for ISDA's members. As well as not being granular enough to classify OTC derivatives sufficiently, changes are not reactive to market realities or new products in the way that the ISDA taxonomy is. The ISDA taxonomy should be considered for classification of OTC derivative financial instruments and for endorsement as a solution for UPI.

Fields 57 & 58 Underlying Instrument fields:

The format proposed does not cater for OTC derivatives and is related to the problems outlined above. Furthermore, commodity underliers cannot be reported in this field at all as they do not have ISINs or Aii codes. ISDA's members would point to the Commodity Reference Price as being a market standard description of the underlying and grade of commodity trades which is used for legal confirmation of commodity trades. The Commodity Reference Price is the final level/node of the latest version of the ISDA taxonomy.

Field 63 Result of the exercise field:

ISDA's members note the approach taken by ESMA to not require information on lifecycle events and communication from NCAs that MiFIR transaction reporting is focussed on market surveillance to identify suspicious trading. ISDA's members understand that competent authorities will need to see the resulting transaction report from an exercise i.e. a transaction report for the purchase or sale of an asset or the entering into of a new derivative trade, but the fact that it was the result of an exercise seems redundant information. Furthermore, this information may be stored on different systems at an investment firm and so will be a challenge to obtain. The execution of the transaction may happen in a system which received its order from a settlement or custody system for the option, but may be agnostic to that fact.

Field 65 & 66 Up Front Payment fields:

These fields are the same as the EMIR fields and this fact should be stated explicitly, as it should for any other fields where this is the case.

Fields 68 & 69 Trader Identification fields:

Firms would like to reiterate their concern with ESMA's proposal to have traders identified by National ID numbers. ISDA's members would suggest that there are other more suitable items of identification that could be used (and are already used) within firms to identify individuals, for example, the national competent authority's registration number. Whilst we understand the need for a unique national ID number to be used for natural persons when they are clients, we do not think this is justified in the case of a trader working within a firm, who is already identified to the national competent authorities via the registration number. A trader ID need not be identified more broadly. Moreover, a registration number is better than a personal ID, as a particular trader may have dual nationalities.

Fields 74 & 75 Algorithm fields:

No comments

Field 77 Short Selling field:

ISDA's members would find it very challenging/near impossible to flag short sales at the time of execution and at a legal-entity level. In order to make this requirement feasible for firms, we urge ESMA to either consider having this flag aligned with the Short Selling Regulation or consider having short sales flagged at a desk/book level.

Field 79 Commodity Derivative field:

This field appears to be analogous to EMIR RTS field 15, directly linked to commercial activity or treasury financing. ESMA should consider aligning these fields across the regimes if possible.

Field 81 Report Status field:

ISDA's members are concerned that modification has been removed as an applicable value here and action for MiFID reporting. ISDA's members believe that this is an important functionality for correction of errors and to reduce the number of cancellations and resubmissions of transaction reports.

- **Trading capacity**

Q219. Do you agree with the proposed approach to flag trading capacities?

ISDA's members would like to note that the proposal in the RTS suggests that trading capacity information is maintained by the trading venues but such field is not available on the template for order reporting. It should also be noted that different venues may use different terminology for trading capacity, and therefore standardisation is important. Another consideration ISDA's members would like ESMA to recognise is the scenario in which a trading venue and investment firm report different Trading Capacities.

Whilst ISDA's members are supportive of the proposal for Trading Capacity, ESMA should note that for OTC derivative transactions the trading capacity will almost always be *Principal*.

However, in relation to the wider market of financial instruments, ISDA's members are supportive of the proposal contained in the response from the British Bankers' Association (BBA) regarding the provision of an alternative Trading Capacity (in addition to the ones proposed). The BBA state the

following: "To provide a more complete view of where firms are acting as facilitator between buyer and seller having already identified the other side to a position, firms would suggest that ESMA considers broadening (i.e. create an additional trading capacity category in addition to the three above) the scope of the permissible scenarios for Trading Capacity to include "Facilitation". Firms would for example use this trading capacity where they are facilitating a client order across multiple venues or executions but where the facilitator makes no profit or loss other than a previously disclosed fee or commission. This is a recognised behaviour within firms where their internal systems and controls mean that they have credit risk against market side and client side counterparties but no position risk and would enable NCAs to clearly identify this activity as part of their surveillance. The reason why trades that firms facilitate in this way cannot fall under the existing definition of Matched Principal is because the trading is not always done simultaneously."

- **A designation to identify the applicable waiver**

Q220. Do you foresee any problem with identifying the specific waiver(s) under which the trade took place in a transaction report? If so, please provide details

Yes, consequently ISDA's members would like categorical guidance that the waiver information will be provided by the trading venue to the investment firm and the investment firm will receive it in good faith only. For example, non-EEA venues may not transmit information in full or in the same format as required for the investment firm to transaction report, therefore, firms are reliant on such information being correct when received.

- **Reportable instruments**

Q221. Do you agree with ESMA's approach for deciding whether financial instruments based on baskets or indices are reportable?

No. If there were a golden source of MiFIR instruments to reference, then ISDA's members would be comfortable in deciding whether a financial instrument based on baskets or indices is reportable. It should be noted that in the absence of a golden source of MiFIR instruments, there will be a propensity for over reporting of instruments which are based on baskets or indices, as firms err on the side of caution in designating whether a component is a MiFIR instrument and as such, whether it is reportable. For instruments based on baskets (as is developed in answer to Q222), ISDA's members would prefer to identify all component instruments of the basket on the transaction report rather than having to extract only individual components admitted to trading or traded on a trading venue for identification. ISDA's members would also like to note that the decision as to whether a financial instrument based on a basket or index is reportable will be made at the time of transaction reporting only and any changes to the composition of the basket or index which takes place subsequently will not have an impact on the transaction report. ISDA's members therefore feel that draft RTS 32, Article 3(3)(h) should also refer to a basket and not just "an index".

ISDA would like to note a discrepancy between the RTS and the Consultation Paper at this point. In Section 8.2, paragraph 159 of the Consultation Paper it is stated that "Financial instruments based on a basket should be reportable as soon as at least one component of the basket is a financial instrument which is admitted to trading or traded on a trading venue" whereas the draft RTS 32 recital (17) says "In particular, financial instruments based on a basket should be reportable as soon as more than one component of the basket is a reportable financial instrument." ISDA's members expect that the draft RTS will be amended to match the text from the Consultation Paper.

Q222. Do you agree with the proposed standards for identifying these instruments in the transaction reports?

Regarding the identification of these instruments, ISDA's members responded to an ESMA consultation on Review of the technical standards on reporting under Article 9 (*Reporting obligation*) for EMIR, on the topic of representation/identification of basket and index underliers and would like to reiterate the points made in that response here:

- Instruments with index components: flexibility will be the key feature required for the identification of indices, so ISDA's members would ask ESMA to allow either the index name (as provided by the index sponsor) **or** an ISIN be provided as the value for identification of an index. It is difficult to confirm whether an ISIN has been issued for every index exhaustively so an approach in which an investment firm should endeavour to use ISIN but may alternatively use the index name, would be preferred by ISDA's members.
- Instruments with basket components: Firstly, ISDA's members do not want to have to identify only components admitted to trading or traded upon a trading venue, but want to report the full basket representation of the basket with all its components. This will be a simpler technical representation to effect. However, it is noted that ESMA expects ISIN to be the sole identifier to be used to identify the components of the basket. Consideration of baskets of non-securitised components which do not have an ISIN is needed in the specification of this field. E.g. baskets of components which are, for example, OTC derivatives or currencies. ISINs or Aii codes do not suffice for such underliers (a point made in the response to Q218). Further to this point, guidance would be required regarding what to do when a basket contains components which are individually identified via different identifiers (not uniformly ISINs for each component). ISDA and its members would welcome the opportunity to work with ESMA to find a solution to the reporting of instruments based on baskets that works for both EMIR and MiFIR.

➢ **The application of transaction reporting obligations to branches of investment firms**

Q223. Do you foresee any difficulties applying the criteria to determine whether a branch is responsible for the specified activity? If so, do you have any alternative proposals?

ISDA's members would like ESMA to confirm whether branches may report independently or whether the head office of the branch will always have to report on the branch's behalf (with information about the branch indicated).

In addition, ISDA members request clarity from ESMA regarding the reporting process to be followed in respect of EEA branches of non-EEA firms. Where reporting obligations arise for transactions executed by an EEA branch of a non-EEA firm, ISDA's members propose that such transactions be reported by that EEA branch to the competent authority of its host member state. ISDA members would therefore suggest that the draft RTS 32, Article 13(5), be amended as follows:

"All transaction reports for transactions executed in whole or in part by the investment firm, including through its branches, shall be sent to the home competent authority of the investment firm. Where the transaction is executed by an a EEA branch of a non-EEA investment firm, reports must be sent to the host competent authority of the investment firm based in the Union."

➢ **Conditions to develop, attribute, maintain and use legal entity identifiers**

Q224. Do you anticipate any significant difficulties related to the implementation of LEI validation?

No, ISDA's members do not see any significant difficulties related to this implementation for entities which have LEI. However, the LEI system is still developing and take up of LEIs has been varied across regions and certain client sectors. ISDA's members assume that the status of the LEI is not important and identifying entities using LEIs with a "lapsed" status will not be an issue for ESMA, for the following reasons:

1. ISDA's members do not believe that it is their responsibility to force their clients to maintain their LEI; and
2. ISDA's members obtain/confirm the LEI (and indeed may register the first LEI with a Local Operating Unit) from their client before provision of the investment service as ESMA references but this will take place during an on-boarding or KYC process, so moving to a live/dynamic validation would be a major problem.

Furthermore, it is ISDA's members' understanding that ESMA would like to mandate use of LEI to identify all legal entities (and additionally make a counterparty's lack of an LEI a barrier to trading with such a legal entity), regardless of the location of the legal entity and without prejudice even for legal entities from locations where LEI take up may not be mandated or comprehensive. ISDA's members would like to note this may have a detrimental commercial impact on firms operating in the EEA and trading in EEA instruments and derivatives of these instruments. Another example of a detrimental commercial impact would be a case in which a client is restricted from trading or delayed in executing a transaction whilst they obtain an LEI. A non-financial counterparty may have a hedging position which they would like to unwind or increase and the implementation of their hedging position could be delayed in this instance.

ISDA's members would like to suggest that ESMA allow alternative identifiers such as a BIC for use as identification of legal entities for an interim period from January 2017 (MiFIR transaction reporting commencement). ISDA's members feel this is a practical consideration for the reality of the status of the global LEI system at present. Another suggestion which ISDA's members would like to note is that LEI take-up could be encouraged amongst problem sectors of the market, such as amongst NFC-s (where take up has been low), by asking the ROC to endorse reduced costs for registration and to waive renewal fees at LOUs for such legal entities. ESMA could discuss such incentives with the ROC and LOUs to help LEI take-up in the long term.

- **Methods and arrangements to report financial transactions**

Q225. Do you foresee any difficulties with the proposed requirements? Please elaborate.

ISDA's members note the response in the Consultation Paper that a golden source of instruments is not something that ESMA feels should be provided centrally. In ISDA's members' opinion, the absence of a golden source of instruments for reference will make it nearly impossible for firms to make precise and reliable decisions regarding the scope of what is reportable and what is not reportable under MiFIR transaction reporting. Over reporting will be inevitable in such circumstances and we do not think investment firms should be penalised or prescribed (through the RTS) to over-report.

The removal of a functionality or action type that allows amendment or modification to transaction reports is of concern for ISDA's members. Cancelling and Resubmitting transaction reports is not an efficient way to implement a modification of information or correction of an error and will have an impact on the traffic and volume of transaction report messages, as well as make record keeping and audit trailing more difficult.

ISDA's members would like to commend ESMA for efforts to align the MiFIR transaction reporting regime with the EMIR reporting regime and would encourage similar approaches to data formats and specifications, as well as tying actions and events together where possible. Further clarity on the extent to which the data for a trade which has been reported to an EMIR-registered trade repository may be used to fulfil MiFID transaction reporting if the trade repository is also a MiFIR Approved Reporting Mechanism will be important for a large portion of the reportable transaction population of ISDA's members.

8.3 Obligation to maintain records of orders

- **Relevant parties, trading capacity and liquidity provision flag**

Q226. Are there any cases other than the AGGREGATED scenario where the client ID information could not be submitted to the trading venue operator at the time of order submission? If yes, please elaborate.

Yes. ISDA's members wish to point out that the Client ID proposal constitutes a considerable technology change for firms. Currently, client ID information would not be held in order execution systems today and, as such, a major technology change would be required to allow storage and transmission of this data in the execution systems.

Additionally, there are certain scenarios where the client ID information will not be available in the execution system as the trader executing the trade may not have knowledge of specific client details (such as passport number) or it is not disclosed to the trader in the system.

Also, it should be noted that ISDA's members believe the operative interpretation, as to what to report for the Client ID when the client may be a fund or a fund manager, will be to identify the client as the fund manager in all cases for orders if that is the only information regarding the client which is available for the order.

- **Date and time, validity period/trade restrictions, priority timestamp/size and sequence number of the events**

Q228. Do you foresee any difficulties with the proposed differentiation between electronic trading venues and voice trading venues for the purposes of time stamping? Do you believe that other criteria should be considered as a basis for differentiating between trading venues?

ISDA's members do not foresee any difficulties with the proposed differentiation and welcome ESMA's work on this issue and the provision of different time stamp requirements for different types of venue. As a further measure, ISDA's members would propose that a sequence number be included for tracking the sequence of execution of transactions in instruments on a trading venue – this may have value for transactions executed with the same time stamp, but may not be relevant for all venues and products.

- **Identification of the order, details of new order, order modification/cancellation and partial/full execution of the order**

Q229. Is the approach taken, particularly in relation to maintaining prices of implied orders, in line with industry practice? Please describe any differences?

ISDA's members' understanding is that this obligation does not apply to investment firms or

systematic internalisers. However, whilst that is the case, ISDA's members do feel that the specification of this requirement will have impact on investment firms as they need to provide trading venues with the information. It should be recognised that investment firms will need to build connectivity to the trading venues and may need to provide information in different formats for each trading venue and investment firms would be concerned as to whether such data is fully secure.

A side point for ESMA to note would be that in the market today, the information available at trading venues is typically a function of the setup of the venue rather than the products provided on the venue.

8.4 Requirement to maintain records of orders for firms engaging in high frequency algorithmic trading techniques

Q230. Do you agree on the proposed content and format for records of orders to be maintained proposed in this Consultation Paper? Please elaborate.

No, ESMA should allow an investment firm engaging in a high-frequency algorithmic trading technique to maintain data under its own protocols and only require such firm to provide data in a specified format following a request from a competent authority. This would follow the applicable requirements for the maintenance of records of order data under draft RTS 34, recital 3: "Therefore the trading venues are permitted to keep the relevant data according to their own classifications and protocols under the condition that upon request of the competent authority such data will be provided in the format prescribed in this Regulation."

With specific reference to the proposed content and format for records of orders for firms engaging in high frequency algorithmic trading techniques, ISDA's members have some concerns that a lot of the fields are redundant in many cases. By definition, *Trader Identification* and other fields related to the identification of clients and persons seem not to fit a list of fields for the recording of orders of high-frequency algorithmic trading techniques. The *Initial order designation*, *Additional information from the client* and *Additional information relating to the outgoing order* (which are free text fields) are unclear in their specification and ISDA's members are unclear how these fields would be populated by a trading venue.

ISDA's members are concerned that the proposed definition of high-frequency algorithmic trading techniques is too broad and brings in market making activity which is crucial to well functioning markets. Market making firms may be reluctant to provide liquidity to markets if they are to be captured by the high-frequency algorithmic trading classification which may have a detrimental reputational and operational impact on their vital market making activity.

Q232. Do you agree with the proposed record-keeping period of five years?

Yes, however ISDA's members' understanding is that the 5-year period commences on the date of submission of the order. ESMA may also want to consider reviewing the applicability of this proposal for record keeping after 1 year of its adoption, as there could be a strong case for reducing the amount of order information kept in records. ISDA's members expect the size of this dataset to be considerable even after a shorter period of 5 years.

8.5 Synchronisation of business clocks

- **Members or participants of venues**

Q233. Do you agree with the proposed criteria for calibrating the level of accuracy required for the purpose of clock synchronisation? Please elaborate.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

In the absence of other relevant time precision benchmarks enabling comparability across trading venues, we agree that calibration based on gateway-to-gateway latency makes sense as a starting point to create a framework against which appropriate levels of clock precision and accuracy as required under MiFID 2 can be specified by ESMA, as applicable to trading venues. However, we do not agree with the details of the framework as proposed in the draft RTS, in particular to the extent to which they would extend to investment firms. We note that ESMA has acknowledged industry concerns with the proposals outlined in the original DP, and in particular that the level of accuracy should be calibrated to take account of different types of market participant and trading venues, as well as different trading models. We do not believe that the proposals in the RTS currently achieve the intended outcome of an appropriately calibrated model.

The current CP and draft RTS define parameters for time recording and synchronisation which, whilst ostensibly giving dispensation to slower electronic and voice traded markets, nonetheless would likely mean that in all practical terms any market participant who trades on a major equity venue will be required to provide time stamps to a precision (granularity) of one microsecond. The proposals would mean that timestamps must be accurate to a tolerance of +/- 1 microsecond from the UTC reference feed and, depending on the specific system setup of the participant, may need to be provided across all of the participant's trading platforms regardless of the asset class or trading model. We do not agree with ESMA's proposals to link clock synchronisation requirements for investment firms broadly and directly to the trading venues on which they trade

We also do not believe that the proposals adequately distinguish between a level of accuracy that would be relevant and meaningful for high frequency trading activity executed on venues on the one hand (for which more granular and accurate timekeeping is appropriate) and non-HFT and even non-electronic activity or reportable events that were not transacted through a venue on the other. As a result, the proposals would introduce significant and disproportionate costs for firms to upgrade their systems.

MiFID II Art 50 requires ESMA to develop RTS to specify the level of accuracy to which clocks are to be synchronised, but does not require that the same levels of accuracy must apply to trading venues and their members or participants. We would hence recommend that ESMA distinguish between requirements applicable to trading venues, and requirements applicable to investment firms.

We have set out in more detail in the response to question 234 below a number of concerns with the proposed level of accuracy required in the draft RTS, with some recommended changes that we believe would retain the broad shape of ESMA's proposed calibration model for trading venues, whilst also introducing obligations for investment firms that are more practical to apply, avoiding a disproportionately expensive implementation cost to the industry, and enabling the differentiated outcome intended.

Q234. Do you foresee any difficulties related to the requirement for members or participants of trading venues to ensure that they synchronise their clocks in a timely manner according to the same time accuracy applied by their trading venue? Please elaborate and suggest alternative criteria to ensure the timely synchronisation of members or participants clocks to the accuracy

applied by their trading venue as well as a possible calibration of the requirement for investment firms operating at a high latency.

ISDA's members have had the benefit of reviewing AFME's response to this question. We support and endorse the points made therein. For ease of reference, we have set out the response in full below:

There are significant technical impediments to achieving the requirements currently set out in the draft RTS. For the purpose of this document the following definitions are used:

Accuracy – How close to a specific time an entity is expected to be. This can be considered the tolerance for error. E.g. When considering a trade event, entities must store the time to a precision of (for instance) microseconds and in doing so must be certain that that timestamp is synchronised to within a one microsecond tolerance of the reference clock (UTC)

Precision – The granularity of a time stamp. This can be equated to the number of decimal places to which an event's time must be stored. E.g. For microseconds (µs) this is 1 x 10-6 seconds.

Accuracy

Given current technological capability it is considered extremely difficult to comply with the expected level of accuracy and the expected consistency of that accuracy. The current RTS expects that the required accuracy will be met 100% of the time. Such high technical demands will be a significant technological and financial barrier to entry into European trading markets.

The levels of accuracy proposed in the current RTS do not adequately take account of the different layers of software and networks involved in financial market infrastructure. Many common platforms simply do not support microsecond levels of accuracy, meaning firms would need to customise off-the-shelf software, or that core industry platforms will need to be extensively upgraded.

Operating systems:

Red Hat (Linux): Red Hat can retrieve timestamps to microsecond precision but the accuracy is not clearly defined as it would be dependent on the hardware it is running on. This time function does have overheads and it is unclear how much CPU is required and the amount of time it would take for the timestamp call to actually execute.

Windows is not a real time operating system and therefore could incur delays waiting for processing of the timestamp function, within a CPU queuing mechanism.

In both cases multi CPU servers can add complications to time retrieval, namely the CPUs may not have the same time between them or processing could switch between CPUs and incur a time cost.

CPU clocks also suffer from clock drift. This is where the clock is not keeping its time correctly and falling behind +/- 20ms is not uncommon and further drift is very possible. This is monitored and rectified by an NTPD process, which will check by default every 64 seconds but can take up to 2 minutes to rectify any clock drift on the CPU.

Software:

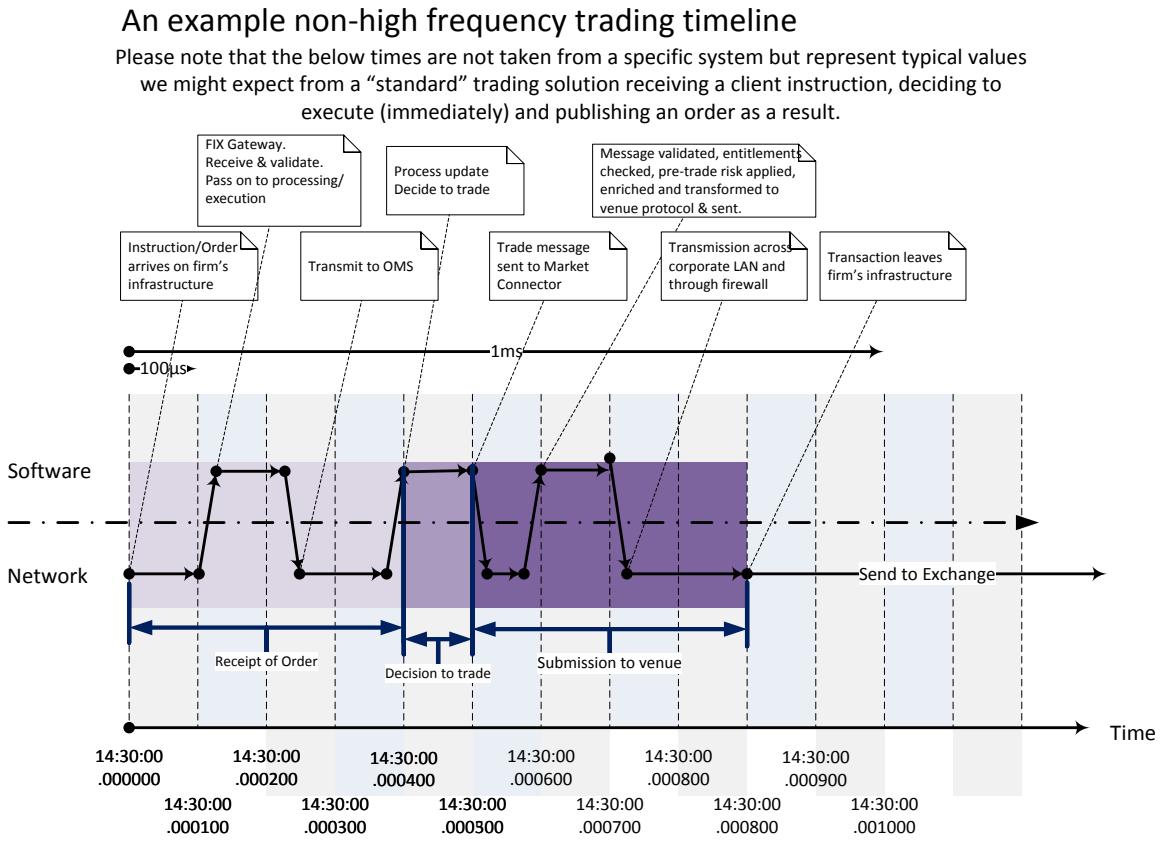
Java is a commonly used industry standard for developing trading platforms. Java has a function that will return nanosecond timestamps but clearly stipulates within its documentation:

" no guarantees are made except that the resolution is at least as good as that of currentTimeMillis()."

This means that any trading platform using Java to determine timestamps will be unable to determine the current time with an accuracy below a millisecond.

To provide a practical example of some problems with the proposed accuracy relative to the reportable events, there is no current definition of the exact point at which an event should be recorded. The CP does outline a number of events, notably, receipt of an order/instruction, a decision to trade and the dispatch of an order to an execution venue which are expected to be logged. These events are not, however, defined to a level of precision in terms of their location that matches that expected of the event times. As a result the realistic precision can only be considered as a time range depending on where in the technology path the timestamp for that event was captured.

The diagram below highlights this.



The windowed areas seek to highlight plausible interpretations of the point at which the 3 events could arbitrarily be deemed to be occurring.

For the "receipt of an order" timing point, it is legitimate to conclude that a firm would know about the receipt of a message from the moment it appears on its network (the first black dot) but equally it could be stated that the firm would not know the nature of that message until it had received it, or processed and validated it in a gateway (for example the FIX gateway - the 3rd and 4th black dots) or even until the firm had accepted it into its Order Management System (the 7th black dot). In the example above this routing spans almost 400µs, and even in a niche application of an extreme (ultra) low latency DMA system this would be likely to span multiple microseconds.

For there to be value in the recorded events at the precision defined, those events have to be defined with a corresponding precision relating to their place in the execution process.

Time synchronisation to 1 microsecond is theoretically achievable on a network given a suitably high investment in network infrastructure, it is however far from easy, and is subject to many external influences that mean that ensuring that the proscribed accuracy is maintained in all circumstances is extremely hard.

Applying that same level of accuracy to the operating system and application software however is not even possible in the vast majority of cases today as noted above, and would require dedicated hardware solutions to solve the operating system limitations and specialist software engineering to ensure compliance in the application software stack. The cost and complexity of this implementation would be extremely high, and would likely act as a prohibitive deterrent to many market participants.

The Cost Benefit Analysis (CBA) that has been published by ESMA (CBA section 8.5, pages 435-445), asserts that the timestamping rules provide significant valuable information to the authorities including cross-venue aggregation of events amounting to an audit trail, and acknowledges the high implementation cost that will be borne by the trading venues and investment firms.

However, given the above mentioned variance of the capture points of the prescribed events it is questionable as to whether these specific benefits could ever be realised to the level of accuracy expected and as such the level of accuracy required for implementation could and should be significantly reduced, which would achieve the same benefits in terms of meaningful capture of information, but at a lower implementation cost.

The CBA provides no monetary assessment of the costs. A recent survey in the US, conducted by the Financial Information Forum (FIF) consulted the industry regarding the proposed time synchronisation and logging mandated by Combined Audit Trail (CAT). It concluded that less than half the respondents were currently able to meet an accuracy of better than 50ms today, and that most respondents felt that the cost to meet better than 1ms would require an investment of at least 2.5 million USD for any member of a reasonable scale.

Going even further, as the draft RTS contemplate, and anticipating the requirement of nanosecond accuracy is extremely problematic and likely to remain technically impossible for the foreseeable future, requiring significant upgrades to the entire technology stack, network, compute platforms, operating systems and trading software before it could become a reality. As nanosecond accuracy is not currently technologically possible, even with the most advanced atomic clocks maintained by public sector bodies, we contend that it is inappropriate to introduce requirements referencing nanosecond level accuracy and precision through RTS, as it is impossible to assess the likely costs of implementing such technology in future, and hence to provide an adequate cost benefit analysis to justify the requirement.

ESMA has also acknowledged industry concerns about prescription of the specific technology that must be used for clock synchronisation, and stated a desire to avoid a monopoly. However, if a microsecond level accuracy is mandated, this outcome may be likely. There is currently only one time synchronisation technology that supports microsecond accuracy to the tolerance levels expected and that is PTP/PPS. PTP is not currently a widely used protocol and whilst capable of greater accuracy also has dependency on ideal network conditions and potentially costly network reconfiguration. NTP is currently the only widely available cross-platform protocol for synchronisation. As noted above, even if every participant were to standardise on PTP/PPS for their networks they would still face significant challenges in maintaining this accuracy within their trading system software and hardware. Reducing the precision demands would allow both IRIG-B and NTP to be used (although NTP would be operating at its known limits even at 100 microseconds).

Precision

Precision is a technically simple problem to solve in which all timestamp fields have to be able to carry up to 9 decimal places (for nano) or 6 decimal places (for micro). Technical simplicity however does not make it easy to achieve and this change will have a significant cost implication as every software component that carries a time stamp will have to be modified, a time and resource intensive process that will have large ramifications across the trading connectivity arena as each venue moves to update their protocols to accommodate the changes.

Accordingly it is vital that the rules are calibrated to require such an upgrade only for reportable events which are occurring rapidly enough to require the granularity (e.g. high volume electronic automated executions). For reportable events that originate from manual processes (e.g. voice execution) or on a scheduled date (e.g. lifecycle events) or are generated further back in the trade processing flow, detailed microsecond granularity will be of no value as the accuracy will have been eclipsed entirely by the latency associated with the manual/human processes, inherent batch orientation of the process, or queuing as part of asynchronous transaction processing flow. Even where required (e.g. high volume electronic automated executions) the fact that it can take multiples of microseconds to read the clock means that the microsecond timestamp would still be subject to inaccuracy.

Recommendation

Requirements for Trading Venues

In light of the above technical concerns, we would suggest that an accuracy of 100 microseconds be adopted as the maximum allowable divergence from UTC, but that levels of precision required could remain at the microsecond level. As such, Table 1 in Annex 1 could be amended as follows:

	Gateway-to-gateway latency time of the trading venue	Time divergence allowed from UTC	Level of granularity required for timestamps
1	1 millisecond or greater (equivalent to 1.0x10-3 seconds or higher)	1 millisecond divergence from UTC	All timestamps for reportable events shall be to the nearest millisecond
2	999 microseconds or less	100 microsecond divergence from UTC	All timestamps for reportable events shall be to the nearest microsecond.

Requirements for members and participants of trading venues

At present the accuracy demands apply to all events to the highest precision and accuracy of any venue that a participant is using. This includes a broad range of reportable events, including manual trade reports based on the definition in the RTS and in part also derives from an imprecise definition of a trading "system". Whilst it makes sense to prescribe low latency timekeeping and microsecond accuracy for events transacted on venues at high speed, many reportable events, and in particular lifecycle events, will not be executed through venues or at high speed. In many cases, these events may be executed in different parts of a firm's system infrastructure downstream of systems used for order management or initial execution or connectivity to the venue itself. We suggest that the time divergence set out in table 1 should only apply to reportable events *meeting the definition of high frequency algorithmic trading techniques*. All other reportable events should be treated as being in either the voice or coarsest level of accuracy (milliseconds) so as to limit the number of technical platforms a participant needs to synchronise to the higher precision to those that are occurring in near real-time with market events.

	Time divergence allowed from UTC	Level of granularity required for timestamps
Voice transactions	1 second divergence from UTC	All timestamps for reportable events shall be to the nearest second
Base electronic requirement	1 millisecond divergence from UTC	All timestamps for reportable events shall be to the nearest millisecond
Order flows meeting the definition of high frequency algorithmic trading technique	100 microsecond divergence from UTC	All timestamps for reportable events shall be to the nearest microsecond.

8.6 Obligation to supply financial instrument reference data

- **Fields to be reported as instrument reference data**

Q235. Do you agree with the proposed list of instrument reference data fields and population of the fields? Please provide specific references to the fields which you are discussing in your response.

No, the proposed list of fields does not work for derivatives. Firstly, ISDA's members would note that the approach to identification and classification of the instrument will not work for OTC derivatives.

This pertains to the proposed fields: Instrument Classification, Instrument Identifier Code, *Type of Identifier of the financial instrument* and *Instrument Full Name*.

A similar approach has been proposed in a recent consultation on Review of the technical standards on reporting under Article 9 (*Reporting obligation*) for EMIR. ISDA similarly rejected this approach. For example, ISINs do not exist for OTC derivatives, and the provision of CFI codes would not be adequate either. A globally endorsed UPI should be the correct identifier for identification of OTC derivative instruments. ISDA's members would support the endorsement of the ISDA Taxonomy approach to UPI as the best choice. ISDA's members are concerned that the CFI does not allow for a sufficiently granular representation of OTC derivatives and the frequency of changes to the CFI framework is not reactive to changes or to the requirements of the market in the same way that the ISDA taxonomy is. ISDA's members hope to work with ESMA on this topic in relation to EMIR and also are engaged in global initiatives to find a solution for a globally endorsed UPI such as CPMI-

IOSCO work on the topic and would like the MiFIR transaction reporting requirements to be mindful of developments which may happen in this area.

Furthermore, the proposed fields for *Asset Class* and *Base Product* and *Sub-product*, *Transaction Type*, *Settlement Type* and *Final Price Type* are another attempt to provide a new taxonomy for certain instruments. An endorsement of a globally-consistent UPI, as mentioned above, would be the best way to achieve what is being attempted by the provision of these fields. It is also unclear what is meant by "non-financial instruments". ESMA should clarify whether the intention is to provide classification for non-securitised instruments which do not have an ISIN. Whilst ISDA's members understand the need for a way to classify such instruments, ISDA would again point to the provision of a globally-endorsed UPI and ISDA is happy to work with ESMA on this topic.

As with other field specifications in the draft RTS, details will be needed on what fields can remain blank (and under what circumstances) and also what fields would be Not Applicable for certain instruments. For example, *Issuer Identifier* is a field in Table 1 of Annex I of RTS 33 which may be blank for instruments which do not have an issuer, such as an OTC derivative. Likewise, fields related to bonds and debt would not always be applicable, though some fields are not clear (e.g. *Currency of The Reimbursement*).

- **Reasons and frequency of updates of instrument reference data**

Q236. Do you agree with ESMA's proposal to submit a single instrument reference data full file once per day? Please explain.

ISDA's members agree with ESMA's proposal to submit single instrument reference data once per day. However, ISDA's members would be grateful for ESMA's confirmation that where a trading venue does not have a specified list of financial instruments, that trading venue's obligation to "full file" would be satisfied by it submitting reference data once per day for in-scope financial instruments traded on the venue. ISDA's members believe that such clarification is necessary as Section 8.2, paragraph 13(ii) of ESMA's Discussion Paper previously stated that a full list approach was one in which "a complete reference data list for all instruments for a given venue/systematic internaliser is sent each day".

Q237. Do you agree that, where a specified list as defined in Article 2 [RTS on reference data] is not available for a given trading venue, instrument reference data is submitted when the first quote/order is placed or the first trade occurs on that venue? Please explain.

Yes, subject to ESMA's confirmation that where a trading venue does not have a specified list of financial instruments, that trading venue's obligation to make reference data submissions only extends to in-scope financial instruments and, only then, from the moment that trading commences on that in-scope financial instrument in that particular trading venue. By way of example, ISDA's members would note that systematic internalisers will almost certainly not have a specified list, particularly for their OTC derivative instruments. In these circumstances, ISDA's members understand that they will only be submitting in-scope financial instrument reference data if required when first trading, or if a change is made to the reference data. The alternative, of providing a full file of data on a daily basis for all instruments ever traded, would be very time and data consuming.

- **Usage of instrument identifiers**

Q238. Do you agree with ESMA proposed approach to the use of instrument code types? If not, please elaborate on the possible alternative solutions for identification of new financial instruments.

ISDA and its members would suggest that any product/contract identification or classification approaches for instruments which do not have an ISIN or CFI code, such as OTC derivatives, be focused on the endorsement of a globally consistent UPI. ISDA would like to note the FSB document on data aggregation, which points to UPI as a key pillar of data consistency. ISDA, via the Cross Trade Association Identifiers Steering Committee, is working with CPMI-IOSCO, who are sponsoring a working group to look at this issue and ISDA would welcome ESMA's consideration of this in their proposed technical standards for instrument code fields such as these.

ISDA is happy to work with ESMA on the UPI issue and, as mentioned above, are engaged with IOSCO on the topic of a global UPI, proposing the ISDA taxonomy as an incumbent widely used product classification system which is an ideal candidate for UPI endorsement.

9. Post-trading issues

9.1 Obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing (STP)

Q239. What are your views on the pre-check to be performed by trading venues for orders related to derivative transactions subject to the clearing obligation and the proposed time frame?

We recognise the inherent difference between OTC and ETD markets and would therefore stress that this response is applicable for OTC only. For ETD we defer to FIA Europe to advise on the appropriate STP infrastructure for those markets.

We believe that it is important that certainty of clearing (i.e. certainty that a trade intended to be cleared will be accepted for clearing) is achieved as close to execution as possible. Accordingly, we support ESMA's proposal to make pre-trade credit checks mandatory for on-venue transactions and the proposed timeframes in this regard. In fact, we note that in the US credit checks are often conducted far quicker than the maximum timeframes.

Notwithstanding our support for pre-credit checks, we would request that ESMA's proposed rules are not overly prescriptive regarding the means by which a credit check may take place. At present, Article 3(1) suggests that clearing members can only 'push' limits to the trading venue. However, market participants have already developed various mechanisms, involving screening orders against limits (including 'ping' functionality) to fulfil the CFTC's pre trade credit check requirements. For example, in the US, one option is for clearing member firms to process the pre-trade credit checks by submitting credit limits to a hub with which multiple trading venues can interact, by requesting pre-execution credit approval on an order by order basis (this is a mix of push and ping models). This has the advantage for clearing members of avoiding having to ration client limits across different execution venues. Instead the limit can be stored centrally and accessed by all enabled trading venues until it is exhausted. In our view, such mechanisms are robust, reduce systematic risk and should be expressly permitted by the RTS and furthermore that trading venues should actively facilitate such arrangements.

We note that ESMA proposes to impose an obligation on clearing members to monitor the credit-worthiness of its clients under Article 28(1)(a) of draft RTS 13. We assume that the obligation under Article 3(1) of RTS 37 is intended to suit another purpose – specifically to impose an obligation on clearing members to screen orders against limits and subsequently update the venue when limits are applied to other orders and the total limit has been reduced and/or exhausted as a result. If this is the case, we believe that clearing members can and should update the trading venue, whether directly or indirectly, as soon as technologically practicable.

We would therefore suggest amending Article 3.1 and Article 3.3 and adding a new Article 3.2 as follows:

> "*1. Subject to the provision of limit checking functionality pursuant to paragraph (2) below, a clearing member shall ~~provide~~screen orders (directly or indirectly) placed on trading venues against current ~~the~~ limits applicable to its clients ~~that are entering into transactions referred to in Article 2~~ on that trading venue and update them ~~on a regular basis~~ as soon as technologically practicable.*
>
> *2. To enable clearing members to comply with their obligations under paragraph 1, trading venues shall facilitate means and mechanisms by which clearing members can screen orders*

against limits applicable to the clients that are entering into transactions on that trading venue.

~~3.~~ 4. The trading venue shall perform the check referred to in paragraph 2:

(a) within 60 seconds from the receipt of the order when the order is entered into electronically;

(b) within 10 minutes from the receipt of the order when the order is not entered into electronically

When the order is not within the limit, the trading venue shall inform the client and the clearing member on a real time basis when the order is entered into electronically, and within 5 minutes when the order is not entered into electronically. When the order is within the limit, the acceptance of the trade by the clearing member shall be irrevocable (subject to the operation of any kill switches or other risk management functionality) and information in respect of such transaction shall be transferred in accordance with Article 4. "

Q240. What are your views on the categories of transactions and the proposed timeframe for submitting executed transactions to the CCP?

As we set out in detail below, in our view, the RTS should distinguish between three different scenarios in terms of the timeframes applying to the submission of executed transactions to the CCP:

1. those transactions which are executed on an electronic venue – for which the steps for submission occur automatically;
2. those transactions which are executed on a non-electronic venue – where the steps are not automatic and market participants should be given additional time to validate the transaction details; and
3. those transactions which are executed bilaterally - where the greatest time is required to enable market participants to submit the transactions for clearing. In this regard we note that the current timeframe of 30 minutes is insufficient.

The same rules should apply to voluntarily cleared trades and mandatorily cleared trades

We do not agree that the timeframe for the submission of the derivative transactions to the CCP can only relate to transactions that are subject to a clearing obligation. As a general principle, we believe the straight through processing requirements should apply as broadly as possible in order to reduce the risks involved in clearing. This is in line with the text of Article 29(2) of MiFIR which specifically extends the straight through processing obligation to voluntarily cleared derivatives.

Accordingly, the current text of RTS 37 should be amended as follows:

- Recital 8 should be deleted.

- Article 2: the title of Article 2 should be changed to "Cleared transactions" and we suggest the current text is deleted and replaced with the following:

  "*Chapter II of this RTS should be applied to a transaction which is either i) cleared in accordance with Article 29(1) of Regulation (EU) No 600/2014, ii) subject to the clearing obligation in accordance with Article 4 of Regulation (EU) No 648/2012 or iii) voluntarily cleared. Section 1 shall only apply to trades that are executed on a trading venue*."

The title of Chapter II, Section 1 should be amended to read "Cleared transactions executed on a trading venue";

- The references to "referred to in Article 2" in Articles 3,1, 4.1 and 4.2 should be deleted;
- The title of Chapter II, Section 2 should be amended to read "Cleared transactions executed on a bilateral basis"; and
- Section 3 and Article 6 should be deleted.

Timeframes for transactions executed on venue

We believe that the timeframes for trades executed on a trading venue should be dependent on whether the trade is executed electronically or non-electronically. At present it is not possible to remediate errors once a trade is cleared – thus the parties need to be absolutely sure that the details are correct prior to submission. Where a trade is executed electronically, the information captured by the trading venue is an accurate representation of the intended transaction at the point of trade and the post trade processes should be sufficiently automated to allow the trade to proceed to a cleared, or rejected state, in a very short space of time (i.e. seconds) with no opportunity for manual error. There is therefore no need for a manual affirmation of the trade details (a step which typically introduces significant latency to the clearing process). By contrast, where a trade is executed via non electronic means through a venue there are additional steps that need to be completed in order for the executing parties to have certainty that the trade is accurate before commencing the downstream clearing process. These steps justify a longer-time frame for completion of the process.

In determining the correct timeframes, it is helpful to consider the consequences of any trade that fails to clear:

- Electronic orders executed on a trading venue – post trade processes between each step are automated. Therefore it is appropriate to have very short timeframes for processing and to mandate that such trade is void if it fails to clear. In this case we agree that the time of 10 seconds for transfer of information from the trading venue to the CCP is appropriate and the trade should be void if it fails to clear.
- Non-electronic orders executed on a trading venue - execution for such trades is not automatic and parties need to complete a number of steps prior to submission. Specifically the trading venue needs to relay the details of a trade for post-trade affirmation and the parties need to complete the relevant affirmation process. These steps should be processed as quickly as possible but only at such a speed which enables market participants to verify the details of the trade. Until the submission of non-electronic trades can be automated it is not feasible to expect submission of such trades to be as quick as for electronic trades. Accordingly, we support the 10 minute proposal. However, we would note that the longer time frame required for clearing in a non-automated fashion exposes market participants to additional market risk. Given this, it is problematic to mandate that such trades should be voided if rejected as this would exacerbate the risk. Therefore, we believe that the rules of the relevant trading venue should govern the manner in which such rejections should be addressed. Provided such rules are clear and market participants have clarity regarding any associated transaction risk, the rules should enable the trading venue to provide for

appropriate remediation of trades based on the circumstances of the rejection, without unduly exposing market participants to unnecessary market risk beyond their control.

To address these points, the current text of RTS 37 should be amended as follows:

- Article 7.2 should be deleted and replaced with the following:

  "*Where a derivative contract other than those referred to in Article 7.1 is concluded on a trading venue and is rejected by the CCP, the rules of the trading venue shall determine its treatment following a rejection by the CCP*"

- Article 7.1 should be amended to insert the words "by electronic means" after trading venue.

Timeframes for transactions executed bilaterally (i.e. not executed on a trading venue)

For transactions executed bilaterally, we believe that the timelines should be agreed between the parties and not prescribed in the RTS. Whilst all market participants will have an incentive to reduce the timeframes to the extent possible it will not always be possible for operational or logistical reasons to meet a 30 minute deadline (particularly for smaller entities or entities who are new to clearing). Further, the US and EMEA versions of the ISDA/FIA cleared derivatives execution agreement (the "CDEA") already provide a helpful, consistent and widespread legal framework for counterparties to a trade which is intended to be cleared: the provisions go beyond submission timelines, setting out clearly and in detail the obligations on each party in order to submit the trade to clearing, the options available to the parties should a trade fail to clear and the parties wish to resubmit, and the process to be followed where the trade is instead to be retained bilaterally or terminated. Any benefits associated with reducing the timeframe for submission to 30 minutes are outweighed by the significant operational restructuring and repapering exercise that compliance with that timeframe would entail. In addition this 30 minute deadline would introduce a conflict with equivalent CFTC rules, which do not legislate on this point and instead allow market participants to agree bilateral terms. Accordingly, in our view the reference to a mandatory time period in Article 5.1 should be deleted and Article 5.1 should be amended as follows:

> "*1. For ~~cleared~~ transactions that are executed on a bilateral basis which are intended to be cleared transactions ~~and subject to the clearing obligation in accordance with Article 4 of Regulation (EU) No 648/2012~~, the executing parties ~~clearing member~~ shall ensure that the ~~counterparties send the~~ information related to the trade is submitted to the CCP by their respective clearing member(s) within ~~30 minutes from~~ the ~~execution of~~ timeframe agreed by the ~~transaction~~ parties.*"

We would also note that the CDEA provide a robust, widespread and relatively standardised solution to breakage risk between execution counterparties to a bilateral/off-venue transaction. We therefore support Article 7.3 which makes clear that the treatment of a bilaterally agreed trade which is subsequently rejected by a CCP shall be determined by the contract between the parties.

Erroneous cleared derivatives

Whilst clearing members, trading venues and other market participants seek to minimise the number of erroneous trades, the occurrence of such trades can not be reduced to nil. Accordingly, we believe it is incumbent on all parties to reduce the impact of such erroneous trades. Currently, to remove or rectify erroneously cleared derivatives it is often necessary for market participants to clear offsetting trades which is operationally burdensome, results in increased trade volumes and

has the potential to exacerbate market risk. In our view CCPs should be obligated to facilitate trade rectification efforts which cause least market impact. Accordingly, we would advocate the inclusion of a new Article 7, as follows:

> "Article 7
>
> **Erroneous cleared derivatives**
>
> CCPs shall maintain a cancellation policy in relation to cleared derivatives which have been erroneously accepted or allocated for clearing, including measures to facilitate the remediation of such cleared derivatives or removal of such cleared derivatives from clearing (as appropriate)."

Q241. What are your views on the proposal that the clearing member should receive the information related to the bilateral derivative contracts submitted for clearing and the timeframe?

We agree that for bilateral derivative contracts the clearing member should receive the information relating to the executed transaction as quickly as possible after the CCP has received the contract for clearing. We agree that the proposed 60 seconds for the information to be provided by the CCP to the clearing member and 60 seconds for the clearing member to accept or reject the transaction are appropriate. However, we would again note that for trades that are executed on a bilateral basis there are inevitable delays in a trade reaching a cleared or rejected state due to the inevitable latency between execution and submission to the CCP. For this reason, the consequences of a rejection should be subject to bilateral agreement between the parties and not subject to voidance or further prescribed by legislation.

Q242. What are your views on having a common timeframe for all categories of derivative transactions? Do you agree with the proposed timeframe?

We agree that there should be a common timeframe for CCP acceptance/ rejection for all categories of transactions and further agree that 10 seconds is the appropriate timeframe.

Q243. What are your views on the proposed treatment of rejected transactions?

As indicated in our response to question 240, it is important to carefully consider consequences of a failed trade carefully alongside the process and in particular, the timeframes, for a trade to move from execution to the point at which it is rejected for clearing. In this regard we believe that any trade that is not cleared on a real time basis exposes market participants to market risk. For this reason we would propose that only where a trade is executed electronically on a trading venue and is subject to complete automated processing through each step in the clearing process should it be subject to voidance upon rejection by a CCP. For any other transaction executed on a trading venue (i.e. non electronic) there are necessary process steps to ensure the trade is accurate before completing the downstream clearing process. These steps may cause delay in the trade reaching a cleared or rejected state. Whilst industry participants continue to develop ways to reduce this delay and increase levels of straight through processing, the current and projected near term infrastructure will not provide sufficient certainty of information and speed of processing to mitigate the potential losses attributable to the executing parties for a rejected trade. Therefore, we believe that rejection of these trades by the CCP should be subject to the relevant trading venue rules which should not be prescribed by legislation.

We agree with Article 7.4 of the RTS that, in all cases, there should be an opportunity for the parties to resubmit the transaction for clearing where it fails to clear for technical reasons following initial submission. However, for the ability to re-submit to be effective the resubmission window should be longer than the 10 seconds proposed in the draft RTS. Within the current infrastructure the executing parties would be unlikely know that the trade has failed to clear, the reason behind such failure and how to rectify it within such a short time frame. We would suggest 30 minutes (which aligns with the equivalent CFTC rules) is therefore more appropriate in respect of transactions executed electronically on a trading venue and that such time period as set out in the agreement between the parties or the rules of the trading venue (as applicable) is more appropriate in respect of transactions executed bilaterally and on a non-electronic trading venue.

As a further point we would request that in all cases when a trade is accepted or rejected by the CCP it is imperative that both of the original counterparties to the trade are informed on a real time basis. The RTS currently uses the term "clearing member" generally, without acknowledging that the clearing member firm may be acting in either an executing broker or clearing member capacity. The RTS should be amended to include an explicit obligation on all relevant parties to inform the original counterparties (i.e. executing broker -which may also be a clearing member of the relevant CCP - and client) of trade rejection on a real-time basis. This applies in particular to each of currently numbered Articles 3.3, 4.3, 5.3 and 6.2 of the draft RTS 37. With this in mind it should be a requirement that all CCPs and trading venues develop communication methods that support STP. To address this we would suggest the following changes to the draft RTS:

- The following should be inserted as a new second sentence to Article 4.3:

  "*The trading venue should develop, and be required to use, appropriate communication tools to inform the counterparties of the acceptance/rejection of the trade on a real time basis and to facilitate the re-execution of a replacement transaction in accordance with Article 6(4) below*".

- Article 7.4 should be amended as follows:

  "*Notwithstanding ~~Without prejudice to~~ paragraphs~~s~~ 1 ~~to 3~~, when the rejection is due to a technical problem or for operational reasons, the transaction could be re-submitted for clearing once within ~~10 seconds~~ 30 minutes from the previous submission.* "

For ease of review, we have created a composite markup of the RTS showing the changes we would propose to make thereto:

33362-3-402 v0.1 compared with...

9.2 Obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing (STP)

Q244. Do you agree with the proposed draft RTS? Do you believe it addresses the stakeholders concerns on the lack of indirect clearing services offering? If not, please provide detailed

explanations on the reasons why a particular provision would limit such a development as well as possible alternatives.

In summary, our responses to the proposed draft RTS are:

(1) We welcome the proposed draft RTS as a positive development in establishing criteria for indirect clearing structures which seek to acknowledge legal and commercial realities, whilst continuing to deliver choice and transparency of protection to users of clearing infrastructure.

(2) There are however key areas where the current consideration of exchange-traded derivative clearing structures does not automatically or helpfully map across to OTC client clearing under EMIR.

(3) Whilst we strongly support similar reconsideration of indirect clearing as it applies in the context of the EMIR clearing obligation, it is essential to note that it will not be possible simply to copy across the settled form of the MiFID RTS as part of the EMIR Review for the reasons set out below.

(4) We expect this topic to be addressed for OTC client clearing as part of an open and transparent consultation process under the EMIR Review, once that formally commences, and are keen to ensure that there is no suggestion that this topic is being addressed once and for all in the current MiFID consultation.

(5) The following aspects in particular dictate potentially different or additional considerations in an EMIR context:

- The nature of the EMIR clearing obligation is different in substance to that contemplated under MiFID II. Under EMIR, it is arguable that indirect clearing structures which are not expressly recognised as permissible will simply not be available for use by those looking to satisfy the EMIR clearing obligation, narrowing means of access.

- Indirect clearing must also be made to work for access to non-EU EMIR-recognised CCPs, and through non-EU brokers, so that these can equally be used by those looking to satisfy their EMIR clearing obligation.

If it is ESMA's intention to settle its policy regarding OTC client clearing as part of the existing MiFID consultation process, we would welcome early clarification on this so that the industry is able to engage effectively in considering in detail any additional issues as to the viability of the proposals in relation to OTC client clearing in particular as soon as possible.

In any event, we would welcome express acknowledgement of these additional EMIR challenges now, and confirmation that they will be appropriately considered in adapting the present proposals in the context of OTC client clearing as part of the EMIR review.

Detailed comments regarding differentiating features of OTC and exchange-traded derivatives clearing under EU legislation

In many respects, the submissions being made in the context of exchange-traded derivatives are equally helpful for OTC client clearing in refining the nature of what an indirect client clearing

structure might look like. In this regard, in the context of exchange-traded derivatives specifically, we refer to and endorse the key submissions of FIA Europe. In particular, we support revisions for MiFID indirect clearing which address the following:

- The need for the RTS to clarify its geographical scope, limiting its application to services involving EU-authorised CCPs and EU-established indirect clients.

- Ongoing permissibility of clearing services beyond the three-party chain contemplated in the draft RTS.

- Consideration of an appropriate disclosure regime in circumstances where client choice results in the application of a regime other than that contemplated for "onshore" EU business.

- Clarification as to the extent of the practical obligations upon a clearing member in returning assets directly to indirect clients, so that it is clear this is only relevant in relation to GOSA services and that appropriate acknowledgement is given to limitations under applicable law.

However, as noted above, there are certain key areas where the current consideration of exchange-traded derivative clearing structures does not automatically or helpfully map across to OTC client clearing under EMIR.

The nature of the EMIR clearing obligation is different in substance to that contemplated under MiFID II. Entities subject to the EMIR clearing obligation may only meet that obligation by being a clearing member, a direct client of a clearing member or an indirect client "*provided that those arrangements do not increase counterparty risk and ensure that the assets and positions of the counterparty benefit from protection with equivalent effect to that referred to in Articles 39 and 48*". It is for ESMA to specify the types of indirect contractual arrangements that meet these conditions.

EMIR makes clear that EMIR-recognised third-country CCPs are an equally viable way of satisfying the EMIR clearing obligation. Any EMIR solution to indirect clearing must therefore equally solve for access to those CCPs, allowing indirect clients to use those CCPs to satisfy EMIR clearing obligations whilst taking appropriate account of the differing home state regimes to which the CCPs and their local clearing members are likely to be subject.

We look forward to engaging on this topic in detail as part of the EMIR review but highlight some of those key differentiating elements below, by way of illustration only.

1) Scope – Territorial

a) Application to non-EU-incorporated EMIR-recognised CCPs

We believe that a key territorial limitation in the context of the draft MiFID RTS must be that the form of "permissible" indirect clearing described in Article 29 MiFIR is only applicable in relation to EU-incorporated EMIR-authorised CCPs, for the reasons more fully set out in the FIA Europe response. Such a limitation has the effect of allowing existing structures for the provision of access to non-EU markets to continue in accordance with existing practices.

In the context of EMIR however, it is not an obvious solution simply to exclude certain arrangements with non-EU EMIR-recognised CCPs when setting out provisions regarding "compliant" indirect clearing, unless it is made clear that such indirect arrangements may continue to be used by an

indirect client in order to satisfy its EMIR clearing obligation. Any other approach would risk the effect of making EMIR-recognised CCPs largely if not entirely unavailable to indirect clients (on the assumption that the recognised CCP's home state regime and/or that of local clearing members would be unlikely to track fully the detailed expectations of the draft MiFID RTS, particularly in relation to GOSA structures).

Whilst it is recognised that permitting indirect clearing through EMIR-recognised CCPs might not fully deliver protections equivalent to Article 39 EMIR, such an approach is a necessary element of acknowledging the differences in applicable regimes and the client choice that should remain available to indirect clients wishing to use those EMIR-recognised CCPs. In support of such a flexible approach, we would note that:

- ESMA's EMIR Q&A CCP Q8(i) already contemplates a similar approach in the context of non-EU clearing members where the local insolvency regime is incompatible with the requirements of Article 39 EMIR;

- Article 39 EMIR does not apply to EMIR-recognised CCPs and, by implication, does not apply to clearing members of such CCPs when providing clearing services to clients;

- EU financial services licensing restrictions make it difficult for local clearing members of a non-EU CCP to provide clearing services directly to an EU client, hence the likely reliance on indirect clearing structures in this context.

A solution to this issue for OTC client clearing is not necessarily straightforward and we would welcome further engagement with ESMA on this topic but we would recommend consideration of a flexible approach based on the considerations above.

b) Application to non-EU based indirect clients

Again, an important submission in the context of exchange-traded derivatives clearing under the draft MiFID RTS is that the form of indirect clearing described should only applicable in relation to EU-based indirect clients, for the reasons more fully set out in the FIA Europe response. Applying such a territorial limitation should also assist in reducing materially the potential existence of cross-border insolvency challenges to successful indirect clearing structures and the level of related diligence that clearing members and clients would need to undertake.

By contrast, the EMIR clearing obligation can apply equally to entities inside and outside the EU. Any "compliant" indirect clearing structure therefore needs to take account of a potentially far wider range of clearing member, client and indirect client jurisdictions inside and outside the EU (and their applicable insolvency regimes) in circumstances where, inter alia, Recital (5) of the draft MiFID RTS which purports to address concerns arising from applicable insolvency regimes would provide no assistance[3].

We would argue that in any revision of indirect clearing under the EMIR Review there must be appropriate acknowledgement of potential complications regarding applicable insolvency regimes, and regulatory regimes, where a direct client and / or clearing member is based in a non-EU jurisdiction and services are provided to an indirect client who may not be established in the EU but is still subject to the EMIR clearing obligation. We note here again that EMIR already permits non-EU

[3] As noted in the FIA Europe response, the effectiveness of such a Recital, even in a European context, is questionable.

members to offer services to direct clients other than in compliance with Article 39, on the basis of ESMA's EMIR Q&A CCP Q8(i) and would encourage a similar approach in the context of indirect clearing under the EMIR Review.

2) Increasing access to OTC client clearing - GOSA and NOSA offerings

ISDA and its members remain committed to developing, with CCPs and regulators, methods of increasing access to OTC clearing utilising a range of arrangements, including possible reliance on agency-style elements, CCP-based solutions for wider direct membership/participation and indirect clearing where the requirements for compliant indirect clearing take appropriate account of legal and practical complexities.

In this regard, ISDA welcomes the flexibility which has been shown in the draft MiFID RTS, supports the development of that approach in accordance with the key submissions of FIA Europe, and looks forward to further consideration of those arrangements in due course under the EMIR Review so that they may be tailored to address the particularities of the EMIR clearing obligation as discussed above. We believe that a revised EMIR approach will allow the natural development of commercially viable indirect clearing offerings in due course, with the benefit of the further time available as a result of the likely timing and phase-in provisions for the EMIR clearing obligation.

Q245. Do you believe that a gross omnibus account segregation, according to which the clearing member is required to record the collateral value of the assets, rather than the assets held for the benefit of indirect clients, achieves together with other requirements included in the draft RTS a protection of equivalent effect to the indirect clients as the one envisaged for clients under EMIR?

Yes, subject to the points made in our response to Question 244.