

## ISDA MiFID DP Submission

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### 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, clearinghouses 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 web site: [www.isda.org](http://www.isda.org). ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

### We wish to signpost the following key topics within our response

- The MiFIR **definition of a liquid market** as one with 'continuous buying and selling activity' means that the thresholds for trading frequency should be set such that a liquid instrument trades every day and at least 15 - 40 times that day. We provide data analysis to support these conclusions in answer to Q116.
- ESMA must be clear about what transactions should and should not contribute to the calculations of the various thresholds, and ensure that the data it receives from trading venues / APAs / CTPs only reflects such transactions. ESMA should also be very clear about which transactions should not be subject to the post-trade transparency regime and trading obligation. We provide more detail in our answers to Q150 and Q175.
- For OTC derivative contracts, we agree with ESMA's proposal to adopt a **COFIA approach**. The assessment should be conducted **at a very granular level** in order to ensure classes of homogenous instruments. ESMA must consider the granularity of classification and the thresholds themselves as intimately linked – the more granular the approach, the greater the likelihood that the thresholds will be set at an appropriate level. We set out our proposals highlighting this granular COFIA approach in Q115.
- It is vital that the volume of transactions in illiquid instruments and liquid instruments when traded above the LIS threshold are **omitted for an extended period of time**. This is consistent with the omission of volumes in the TRACE system in the US and would be consistent with the legislative intent behind Article 11(3) (b) of MiFIR which explicitly permits an extended deferral period for volume. If ESMA chooses shorter volume

omission periods then it would be important for longer initial deferral periods to apply. We propose an amended deferral table in our answer to Q141.

- ESMA must give great consideration to the application of the various requirements of MiFID to Package Transactions, including the Pre- and Post-Trade Transparency requirements and the Trading Obligation for derivatives. Generally **we recommend that Packages containing Large-in-Scale or Illiquid components should be treated as if the entire package is Large-in-Scale or Illiquid**. This is further explained in our answer to Q103, Q150, Q158 and Q168.
- The **identity of Systematic Internalisers should not be made public** as part of any of the transparency or market data reporting proposals under MiFIR or MiFID II. We particularly note the possible avenues for direct and indirect publication of an SI's identity through some requirements related to Post Trade Transparency data reporting proposals and the Supply of Instrument Reference Data which ESMA should make all efforts to close. The reasons for this are further explained in our answer to Q133.
- **Commodity derivatives** markets are global by nature. Market participants need to hedge their risk across multiple contracts (both OTC and on-venue) and regional areas. The EU position limits regime should: a) allow netting on a broad basis in order to accurately reflect the true position, i.e. the real risk exposure; b) be as consistent as possible with other existing regimes, i.e. the US); c) be sufficiently flexible in terms of the expression of limits and measure of the market size to adapt to market changes. These concerns are at the heart of our responses notably to questions 493 (on aggregation), 495 & 497 (on the definition of economically equivalent OTC contracts), 501, 506 & 509 (measure of the market size), 502, 520 and 522 (expression of limits). ISDA members would also welcome that the reporting of end-client positions protects confidentiality and does not imply complex and onerous additional reporting systems (see questions 537 and 538).
- ISDA members would **welcome the creation of a central source listing all instruments which are traded or admitted to trading or traded on a trading venue or for which a request for admission to trading has been made, which they would be entitled to rely upon for the purpose of transaction reporting**. This is further explained in our answer to Q547, Q549 and Q550.
- On indirect clearing arrangements, we discuss the challenges which the EMIR approach, as currently understood, gives rise to, and look forward to addressing these with ESMA. See our answer to Q614.

### **Section 3.5 – Introduction to the non-equity section and scope of non-equity financial instruments**

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**Q100: No. Securitised derivatives should be treated as a sub-category of bonds rather than derivatives for the following reasons:**

- a) bonds and securitised derivatives share a similar taxonomy and are each identifiable by ISIN numbers;
- b) securitised derivatives are not covered by the definition of derivatives in EMIR. The MiFIR category of derivatives should be delineated in such a way that there is no misalignment between EMIR and MiFIR; and
- c) by including securitised derivatives in the bond category, these instruments will remain subject to the same pre-trade and post-trade transparency obligations. The inclusion of these instruments in the bond category, however, will ensure that these obligations can be calibrated in a way that is more appropriate to the characteristics of securitised derivatives. We note that ESMA is open to measuring the liquidity of bonds and derivatives in slightly different ways. The reasons put forward by ESMA for adopting an IBIA approach for bonds are, in our view, equally applicable for securitised derivatives. The COFIA approach, which we support in respect of the OTC derivatives category, is not appropriate for securitised derivatives.

We support ESMA's proposal to include structured finance products in the bond category.

**Q101: Do you agree with ESMA's proposal that for transparency purposes market operators and investment firms operating a trading venue should assume responsibility for determining to which MiFIR category the non-equity financial instruments which they intend to introduce on their trading venue belong and for providing their competent authorities and the market with this information before trading begins?**

No. To avoid inconsistent determinations across the EU, a centralised authority (such as ESMA) should make this determination, based on information provided to it by market operators and investment firms operating a trading venue.

**Q102: Do you agree with the definitions listed and proposed by ESMA? If not, please provide alternatives.**

No. ISDA considers that "contracts for difference" (CFD) are a type of "derivative contract" under (ii) and that a third segment for CFD is not needed.

### **Section 3.6 - Liquid market definition for non-equity financial instruments**

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**Q103: Do you agree with the proposed approach? If you do not agree please provide reasons for your answers. Could you provide for an alternative approach?**

No. Whilst we support the adoption of Option 3, a class of OTC derivatives should only be considered liquid if it:

- a) trades 15 to 40 times per trading day; and
- b) trades on at least every trading day during the specified period.

For all the liquidity criteria, we recommend that an assessment is undertaken on a half-yearly basis for OTC derivatives classes. A class of OTC derivatives should, therefore, trade multiple times on every trading day during a half-yearly period for it to be considered liquid.

In our view, trading less frequently than once per trading day, or not trading on all trading days, does not accord with the continuity of buying and selling interests as set out in the definition of a liquid market in Article 2(1)(17) of MiFIR.

#### **Package transactions**

Throughout its drafting of regulatory technical standards ("**RTS**"), ESMA should give due consideration to the application of the various requirements to instruments traded as part of a package. By package transaction, we mean: (i) two or more components that are priced as a package with simultaneous execution of all components; and (ii) the execution of each component is contingent on the execution of the other components (a "**Package Transaction**"). A Package Transaction is designed to provide desired risk-return characteristics effectively in the form of a single transaction with efficiencies in execution cost and reduction in risk (market and operational) achieved through concurrent execution.

Although there is no comprehensive publically available data on the significance of trading in Package Transactions we estimate that in the interest rate derivatives asset class and in the credit derivatives asset class, they account for a significant portion of the market, increasing substantially around roll dates when there is considerable activity rolling between the series.

Simultaneous execution of a Packaged Transaction with a single counterparty using a single execution method alleviates the timing and mechanical risks and lowers bid/offer costs. Inappropriate application of certain requirements, particularly pre-trade and post-trade transparency requirements and the derivatives trading obligation, will jeopardise the ability of market participants to execute the entire package (primarily because exposure of an order in one transaction gives rise to the possibility of another party unrelated to the intended package trading that component transaction).

Package transactions give rise to additional complexity because:

- (i) the price notation for the package quote is often not in the same units as the price notation of the component instruments. For example, spreads between two or more instruments on a yield curve are typically quoted in yield curve spread, whereas the underlying instruments may be quoted in price or outright yield. As another example, packages are sometimes quoted in Net Present value terms, with the quote being the monetary fee that would be required to be paid by one party to the other in order to transact the package, even if the underlying legs are quoted in yield or price terms.
- (ii) The notional size of certain legs of the transaction is often a function of the notional size of other legs and the pricing of the instruments. For example, a yield curve spread between two interest rate swaps on the same yield curve is typically quoted by reference to the size of one component transaction, with the sizes and pricing of the full package only being computed after the trade has been agreed for the purposes of post-trade processing of the package.
- (iii) The implied pricing of the component transactions is typically conditional on their being transacted as part of a package. Those implied prices may be unrepresentative of the pricing for the component instruments when traded on a standalone basis.

The above reasons create technological complexity in processing packages. For example, it may be more complex to represent orders in components derived from packages in the order books of those components when traded on a standalone basis.

Particular consideration should be given by ESMA to whether a sufficiently broad range of venues can adequately process Package Transactions, both in terms of the execution of such transactions and the post-trade processing, even where such venues offer trading in the component instruments on a standalone basis. To date, it has proven more complex for venues and central counterparties to implement processing of Package Transactions compared to the processing of standalone transactions. The technical build required to support electronic execution beyond a limited range of Package Transactions, given the number of conceivable permutations of packages, will be very challenging to market participants and venues alike, and could prove impossible for certain permutations.

Inability to execute Package Transactions will result in significantly increased costs and risks to market participants. These costs and risks arise primarily from three sources:

- a) separately trading the components of a Package Transaction increases the possibility of the market moving between execution of each component (because execution of each component cannot be precisely time-matched);
- b) there are likely to be differences in contract specifications, mode of execution, clearing/settlement workflows and relative liquidity when components of a Packaged Transaction are executed separately and/or on different venues; and

- c) accessing different sources of liquidity for the various components when traded across different venues or over-the-counter incurs additional bid/offer spreads.

The processing of Package Transactions into central clearing can, with insufficient flexibility of processing, be a source of heightened risk. For example, where scenarios such as the acceptance of one or more components of the package combined with the rejection from clearing of other components can expose the parties to those transactions to significantly increased market risk.

In general, we recommend that the application of the various requirements of MiFID II / MiFIR to the trading of components as a Package Transaction should be considered separately from the application of the requirements to those same instruments when traded on a standalone basis. This is particularly important for the application of the pre-trade and post-trade transparency requirements and the derivatives trading obligation. Generally, we recommend that each transaction comprising a package must be considered liquid in order for the package to be subject to the transparency rules or the derivatives trading obligation. The presence of illiquid instruments in the package should permit the package to benefit from waivers for pre-trade transparency, deferrals for post-trade transparency, and not be subject to the derivatives trading obligation.

For the purposes of counting frequency and volume of transactions within the test of liquidity, we recommend that each transaction which constitutes a Package Transaction be considered on a standalone basis. As a practical example, where a 5 year interest rate swap ("IRS") and a 10 year IRS are traded within the same Package Transaction, these should be considered as two distinct trades, alongside other 5 year and 10 year IRS, for the purposes of assessing liquidity. In our view, other approaches would be unfeasible for ESMA. For example, in order to consider the liquidity of Package Transactions, ESMA would have to collect data on trading in each package permutation, which would prove technically challenging if not impossible given the number of conceivable permutations.

Provided appropriate consideration is given to the application of pre-trade and post-trade transparency and the derivatives trading obligation to Package Transactions, counting each component of a Package Transaction for the purposes of assessing transaction frequency for the liquid market definition is, in our view, acceptable.

### **Technical trades**

We recommend that ESMA specify the types of transaction that should not be counted towards the determination of liquidity. There are a number of transactions, such as new trades resulting from compressions and give-ups and intra-affiliate trades purely for risk management purposes, that should not be taken into account for liquidity purposes as they do not represent a true picture of the buying and selling interests in a market. The inclusion of such transactions would give a distorted view of liquidity. In our view, these transactions can be excluded from the liquidity assessment by excluding them, or appropriately identifying them, in transaction reports and using the data from transaction reporting as the basis for the liquidity assessment.

### **Consideration of the specific market structures of OTC derivatives**

As a general comment regarding the liquid market definition and its application to OTC derivatives, we note that in assessing liquidity for the purposes of Article 9 and 18 of MiFIR (i.e. pre-trade transparency for trading venues and systematic internalisers trading respectively) Art 2(1)(17) of MiFIR requires ESMA to take "into consideration the specific market structures of the particular financial instrument." We recommend that ESMA take into consideration the following aspects of the OTC derivatives market:

- a) consideration should be given, as part of the liquidity assessment, as to whether or not a particular class of derivative has been made subject to the clearing obligation under EMIR (but clearing alone should not be definitively determinative of liquidity).
- b) whether the collateral terms of an OTC derivatives contract form part of its liquidity assessment. Non-standard collateral terms for OTC derivatives, in particular where derivatives are uncollateralised, can be a determinant of liquidity.

**Q104: Do you agree with the proposed approach? If you do not agree please provide reasons. Could you provide an alternative approach?**

No. For OTC derivatives, the average size of transactions should be calculated in accordance with Option 1 (total notional over a specified period divided by the number of transactions in that period) ("AVT").

AVT reflects the most natural reading of the Level 1 requirement to consider the average size of the transaction. Uneven distributions of transactions over time do not need to be addressed as part of this limb of the liquid market definition. It can better be addressed by the first criterion (average frequency of transactions). As described in our response to DP 103 above, the calculation of average frequency of transactions should take into account the number of days on which a particular class of OTC derivatives is traded. We would recommend that the draft RTS, which will set the parameters and methods for calculating liquidity thresholds, should require that both the average frequency and average size criteria are always met.

**Q105: Do you agree with the proposed approach? If you do not agree please provide reasons. Could you provide an alternative approach?**

No. Whilst we support the adoption of Option 1, the term market participant should be understood as any member or participant of a trading venue who is active every month and involved in at least 10 - 15 transactions over a half-yearly period. The proposed figure of one transaction is far too low and would catch a large number of predominantly inactive parties.

In addition, we would note that we strongly oppose the adoption of Option 3. In our view this would not provide a good reflection of liquidity in a particular class of OTC derivatives and, in practice, it would be difficult to implement and monitor.

**Q106: Do you agree with the proposed approach? If you do not agree please provide reasons. Could you provide an alternative approach?**

Whilst we welcome ESMA's approach to using only publically available spreads, those spreads should only be used where it is clear that they are generated from actual transactions or executable quotes (as opposed to indicative or composite measures).

No. The proposed approach raises the following issues:

- a) end-of-day spreads may not be representative of the spread incurred by market participants during the course of the trading session;
- b) end-of-day spreads may not be reliable, as they could be fed by some market participants that have no intention to trade;
- c) it is not always clear when end-of-day spreads should be taken. For example some fixed income trading venues operate on a 24 hour basis for 5.5 days a week meaning, in such markets, there is no end-of-day per se; and
- d) measuring a spread irrespective of the type, and even more importantly, of the size of the quotes, can be misleading, as a narrow spread on a very limited size should not be considered as evidence of liquidity for institutional market participants.

As an alternative approach, we would recommend that trading venues, rather than publishing "end-of-day relative bid-ask spreads", should publish averages, taken periodically over each trading session, of the observed spread. Depending on the market, spreads may vary significantly at different hours reflecting the particular core time zones which are taking the lead at that moment in time. This is particularly true of foreign exchange markets. As such, we recommend that the average should be based on a certain number of daily, randomly determined, snapshots.

In order to be meaningful, spreads should be related to available sizes. For example, relative spreads could be measured for: (i) the average value trade; and (ii) the size specific to the instrument. For new instruments, it should be sufficient for trading venues to provide a justified assurance that their expectation of the typical bid/ask spread in that instrument will fall within the definition required for "liquid".

**Q107: Should different thresholds be applied for different (classes of) financial instruments? Please provide proposals and reasons.**

Yes. Different thresholds should be applied for different classes of OTC derivative contracts, such as credit derivatives, interest-rate swaps and FX etc. It may also be necessary to apply different thresholds for intra-asset classes – for example, within the credit derivative class, different thresholds may be necessary for indices and single names.

For a market participant, the spread on a given instrument can be seen as a cost of entry into that financial instrument. This means that:

- (1) if spread thresholds are to be differentiated between financial instruments, differences should be based on the risk/return profile for the class of instrument from the investor's point of the view, not based solely on the class of financial instrument;
- (2) if the same spread threshold is to be applied to all non-equity instruments, it should be based on the acceptable spread for the less risky asset (typically short term government bonds).

It is a function of markets that different segments are characterised by different spreads. This feature should be a fundamental building block of the liquidity definition.

**Q108: Do you have any proposals for appropriate spread thresholds? Please provide figures and reasons.**

This is not data that is currently available. We would be happy to work with ESMA and advise on this in more detail once ESMA has received the data required to consider what the appropriate spread thresholds should be.

**Q109: How could the data necessary for computing the average spreads be obtained?**

In order to compute the average spreads, data should be obtained from trading venues. A broad range of trading venues should be included, including traditionally dealer-to-dealer MTFs and traditionally dealer-to-client MTFs.

Whilst we welcome ESMA's approach to using only publically available spreads, those spreads should only be used where it is clear that they are generated from actual transactions or executable quotes (as opposed to indicative or composite measures).

**Q110: Do you agree with the proposed approach? If you do not agree please provide reasons for your answer. Could you provide an alternative approach?**

No. We would recommend adopting Option 2. Average size of transactions and average frequency of transactions are the two most important liquidity criteria. We recommend that the threshold for both of these requirements should be met plus at least one of the other two requirements. Given the importance of the first two criteria, it is vital that these are set at appropriate levels.

**Q111: Overall, could you think of an alternative approach on how to assess whether a market is liquid bearing in mind the various elements of the liquid market definition in MiFIR?**

No. The ISDA data project, which is described in more detail in response to our DP 116 below, shows that data is available for frequency of transactions and average size of transactions and the data shows that these criteria are the key factors for assessing liquidity.

**Q113: Should the concept of liquid market be applied to financial instruments (IBIA) or to classes of financial instruments (COFIA)? Would be appropriate to apply IBIA for certain asset classes and COFIA to other asset classes? Please provide reasons for your answers**

For OTC derivative contracts, we agree with ESMA's proposal to adopt a COFIA approach. This approach needs to be sufficiently granular to ensure that the classes are meaningful. Please see ISDA's response to Q116. In our view, it is appropriate to apply IBIA for certain asset classes (such as bonds) and COFIA to other asset classes (such as OTC derivatives).

For OTC derivatives, the periodical assessment of the liquidity of the class should be half-yearly. Classifying OTC derivatives into homogenous groups lends itself readily to a longer assessment period since there is already an implied averaging of the liquidity properties across the class, and therefore a more frequent assessment would be unduly precise and operationally cumbersome to implement across the industry.

In regard to the means of determining the appropriate thresholds, and considering the two options proposed on page 124 of the DP, our recommendation is that ESMA adopt option 1, with expert professional judgement to be involved in setting thresholds, rather than a high-level policy based approach which would give insufficient regard to the particular considerations for each asset class.

**Q114: Do you have any (alternative) proposals how to take the 'range of market conditions and the life-cycle' of (classes of) financial instruments into account - other than the periodic reviews described in the sections periodic review of the liquidity threshold and periodic assessment of the liquidity of the instrument class, above?**

With regard to the range of market conditions, we recommend that ESMA use a minimum of two years' historical data, divided into quarterly samples. An instrument, or class of instruments, should qualify as liquid in each of the eight in-sample quarters to be deemed liquid overall. This test can be constructed in a way to distinguish lifecycle differences automatically.

Our understanding is that the liquidity qualification of an instrument can change when:

- a) its liquidity (for an IBIA instrument) or the liquidity of the class of instruments it belongs to (for a COFIA instrument) is re-assessed; or
- b) the evolution of the instrument (for a COFIA instrument) induces a migration from a liquid COFI into an illiquid COFI (or vice versa). For a bond, this can happen when the ratio residual maturity / initial maturity decreases from 100%, or gets closer to 0% (bonds are generally more liquid just after issuance and just before redemption than during the rest of their secondary life). For a derivative, this can happen when the strike / spot ratio moves away or towards 100%.

The second mechanism (described in paragraph (b) above) should effectively capture "natural" and "predictable" moves of liquidity caused by changes in the life cycle of the instrument and in market conditions. A major drawback of this mechanism, however, is that it cannot be applied to an IBIA instrument. The re-assessment mechanism (described in paragraph (a) above) can be

applied to both IBIA and COFIA instruments but, from a practical perspective, it will be difficult to run it on a frequent basis.

In order to keep the liquidity assessment effective and manageable, we recommend that ESMA implements:

- (1) an alert mechanism, by which any market participant can submit a documented request to re-assess the liquidity of an instrument / a class of instruments, when it has reasons to believe that the instrument / class of instruments no longer meets the liquidity criteria (or, conversely, now meets these criteria). This request should be assessed by ESMA within a short timeframe and the result should be published to all market participants in order to allow market participants to make appropriate adjustments in a comprehensive and timely manner; and
- (2) a link between the "temporary suspension" mechanism defined by Articles 9(4) and 11(2) of MiFIR and the liquidity re-assessment mechanism. Whilst we acknowledge that these mechanisms pursue different objectives and will have different effects, we believe that a certain level of consistency should be ensured between them. For example, it should not be possible to re-assess an instrument / class of instruments as "liquid" during a temporary suspension period. It should also be possible for the implementation of a temporary suspension period to trigger a reassessment of the liquidity of the instrument or class of instrument subject to the temporary suspension.

**Q115: Do you have any proposals on how to form homogenous and relevant classes of financial instruments? Which specifics do you consider relevant for that purpose? Please distinguish between bonds, SFPs and (different types of) derivatives and across qualitative criteria (please refer to Annex 3.6.1).**

ISDA members have considered the proposed taxonomies in Annex 3.6.1. We particularly welcome that the basis of the ESMA proposal is the ISDA Derivatives Taxonomy, which we consider to provide a reliable basis for the classification of derivatives. However, our members feel very strongly that, in order to identify homogenous classes of derivatives, ESMA must delineate to a significantly more granular degree than the basic ISDA taxonomy would permit. ISDA continues to work to re-assess the taxonomy in light of industry and market developments and would expect that revised versions of the ISDA Taxonomy would continue to and even more so be the reliable basis for the classification of derivatives for ESMA's purposes here and in other areas. Below, we consider each asset class in turn, proposing revisions to the various tables and discussing the degree of granularity we recommend ESMA to adopt for the purposes of calibrating liquidity.

Differences to ESMA's proposed taxonomy are highlighted in yellow in the tables below.

**Interest Rate Derivatives**

<b>Financial Instrument</b>	<b>Product Types</b>	<b>Sub-Product Types</b>	<b>Recommended Liquidity sub-categories</b>	
Interest Rate Derivatives	Futures	N/A	Notional currency  Tenor  Forward-Starting Term  Plain vanilla products vs products incorporating non-standard features (e.g. embedded options, conditional notional, etc)  At the money (for options Sub-product)  Out of the money (for options Sub-product)	
	Options	ETD Options		
		Caps, floors & collars		
		Debt options		
		Swaptions		
	Interest Rate Swaps	Fixed-to-fixed		
		Fixed-to-floating (vanilla)		
		Fixed-to-floating (basis)		
		Inflation		
		OIS		
	Cross-Currency Swaps	Basis		
		Fixed-to-floating		
		Fixed-to-fixed		
Forward Rate Agreement	N/A			
Others	Exotic			

We recommend that Cross-Currency Swaps being reflected as a distinct Product Type, on the basis that their liquidity properties are very distinct from the liquidity properties of single currency Interest Rate Swaps.

Additionally we suggest the Liquidity sub-categories At-the-money and Out-of-the-money for use primarily with the Options Product Type.

Within the Liquidity Sub-Categories, we recommend that ESMA delineate granularly on the following basis in order to derive homogenous classes of Interest Rate Derivatives. As we detail in our response to Q116, ISDA has conducted an analysis to demonstrate to ESMA a viable COFIA for fixed-floating interest rate swaps (IRS), to replicate the bond study in Annex 3.6.2 of the ESMA Discussion Paper entitled ‘Preliminary analysis for bonds’ for IRS using DTCC trade

data and to help ESMA determine which IRS could be considered to have a liquid market as defined in Article 2(1)(17)(a) MiFIR. Please also refer to our response to Q116 for further details:

- (1) Notional currency
- (2) Maturity, for which two characteristics must be considered:
  - a) Tenor: the difference between the Maturity Date and the Effective Date of the derivative. Where the Tenor equates to a round number of years +/- 5 trading days, we recommend that these be classified as Integer derivatives. Otherwise, derivatives are considered 'broken dated', or fractional, and are identified as such, resulting in a schema as follows:
    - For trades with a Tenor of < 1 year :
      - 0 to 1.5 months
      - 1.5 to 3 months
      - 3 to 6 months
      - 6 months to 1 year
    - For trades with a Tenor of > 1 year :
      - Integer Tenors from 1 year to 60 years (the swap with the longest tenor in the DTCC data) (i.e. 60 categories of which only 53 had actual trades)
      - Broken Dated tenors from 1 year to 60 years (i.e. 60 categories of which only 51 had actual trades)
  - b) Forward-Starting Term: The difference between the Trade Date and the Effective Date (when the swap begins to accrue interest). All IRS with an Effective Date 0-5 trading days after the Trade Date are included as spot transactions. All IRS with an Effective Date of more than 5 days following the Trade Date are considered forward-starting and grouped according to various buckets dependant on how far in the future the Effective Date differs from the Trade Date. In the event an All IRS with an Effective Date prior to the Trade Date are identified as 'backwards-starting'. This results in a scheme as follows :
    - Backward Starting
    - Spot
    - For Forward Starting trades within a year of Trade Date :
      - 5 to 25 trading days
      - 26 to 50 trading days
      - 51 to 75 trading days
      - 76 to 125 trading days
      - 126 trading days to 1 year
    - For Forward Starting trades starting more than a year after Trade Date :
      - 1 year to 2 years
      - 2 to 3 years
      - 3 to 4 years

- And so on, out to 46 years (the furthest forward starting swap in the DTCC data)
- **Standard convention versus non-standard convention:** We define ‘standard’ versus ‘non-standard’ swaps according to the way accrued interest is calculated and when cashflows occur. There are currency and term-specific payment frequency, reset frequency and daycount conventions which market participants agree are standard in practice. For example, a ‘standard’ 10-year GBP IRS swap would be characterized by semi-annual fixed and floating leg payment frequencies, a semi-annual floating leg reset frequency and ACT/360 fixed and floating leg daycount conventions.

### Equity Derivatives

Financial Instrument	Product Types	Sub-Product Types	Recommended Liquidity sub-categories
Equity Derivatives	Futures	Equity	Type of underlying asset (Single Name / Single Index / Basket / Hybrid)
		Dividend	
		Volatility	
		Variance	
	Forwards	Equity	
	Swaps	Equity - Open	Liquidity of underlyer
		Equity - Term	Underlying Maturity
		Dividend	
		Correllation	
		Variance and Forward Variance	
		Volatility	
	Options	ETD (Listed) Options	At the money (for options Product Type)
		Equity Options (OTC)	
		Dividend	Out of the money (for options Product Type)
		Volatility	
		Variance	
	Other	Equity Multi Asset Path Dependency	

		Equity Multi Asset non-Path Dependency	
		Explicit Hybrid	
		Equity Single Asset Path Dependency	
		Other	
	Portfolio Swaps	N/A	

### Commodity Derivatives

Financial Instrument	Underlying Product (grouped for ease of illustration)		Sub-Product Types	Recommended Liquidity sub-categories
Commodity Derivatives	Metals (ME)	Underlying - to be delineated at the most granular level	Non-Exotics (Spot fwd / Future / Swap / Option / Loan lease / Transmission)	
	Energy (EN)			
	Index (IN)			
	Agricultural (AG)			Maturity
	Environmental		Exotic	
	Freights			
	Emission Allowances			

The list of Sub-Product Types shown in Annex 3.6.1 is insufficiently granular for the purposes of grouping into derivatives into homogenous classes, and also is non-inclusive (e.g. several frequently traded commodities – e.g. Rhodium are not listed). For the benefit of illustration, we have grouped the underlying products into the table above but we consider that ESMA must consider each commodity at the most granular level. By way of examples:

- a) within energy, WTI Crude Oil is a global benchmark for oil that is reasonably liquid for both exotic and non-exotic across all tenors, Louisiana Light Sweet is a US-centric grade that is significantly less liquid, particularly at longer-dated tenors (over 1-year).
- b) within Agricultural, Corn is comparatively liquid for maturities up to 3yrs, whereas Rubber is significantly less liquid across all tenors.

We recommend that Environmental, Freight and Exotic derivatives be incorporated in the taxonomy for Commodity Derivatives (as shown above). These appear in the ISDA Taxonomy for Commodities, and the inclusion of a separate table is unnecessary.

<b>Financial Instrument</b>	<b>Product Types</b>	<b>Sub-Product Types</b>	<b>Recommended Liquidity sub-categories</b>
Credit Derivatives	Single name	Corporate financial	Maturity
		Corporate non-financial IG *	
		Corporate non-financial HY **	
		Recovery CDS	
		Loans	
		Muni	
		Sovereign	
	ABS		
	Total Return Swaps	N/A	
	Swaptions	iTraxx	
		Muni	
		CDX	
		MCDX	
		Sovereign	
		Corporate	
	Exotic	Coprporate	
		Structured CDS	
		Other	
	Index Tranched	CDX	
		LCDX	
		MCDX	
		CDX Structured Tranche	
		iTraxx	
		iTraxx Structured Tranche	"on-the-run" vs "off-the-run"
		ABX	
	Index Untranched	CDX	Currency
		LCDX	
		MCDX	
iTraxx			
ABX			
CMBX			
IOS			
MBX			
PO			
PrimeX			
TRX			

\* For Investment Grade ("IG"), market convention is to consider a credit rating of BBB- or higher by Standard & Poors or Fitch or Baa3 or higher by Moody's to be Investment Grade. We recommend ESMA adopts this definition.

\*\* All single names not qualifying as IG would be deemed High Yield ("HY").

## **Other Derivatives**

ESMA may also wish to consider that Environmental, Freight and Exotic derivatives be incorporated in the taxonomy for Commodity Derivatives (as shown above). These appear in the ISDA Taxonomy for Commodities, and the inclusion of a separate table is unnecessary.

## **Contracts for Difference**

As detailed in our response to Q102, the term "contracts for difference" needs to be defined by ESMA as there is a risk that it could overlap with the definition of "derivative contract". Therefore, ESMA must indicate what types of derivatives would fall within the "contracts for difference" definition. Due to uncertainty over the intended scope of table (c), Contracts for Difference, we are not in a position to provide recommendations as to its enhancement.

**Q116: Do you think that, in the context of the liquidity thresholds to be calculated under MiFID II, the classification in Annex 3.6.1 is relevant? Which product types or sub-product types would you be inclined to create or merge? Please provide reasons for your answers**

## **Analysis of Interest Rate Swaps**

To illustrate how liquidity thresholds should be calculated for OTC derivatives to determine if a "liquid market" exists for the relevant derivative transaction, ISDA have conducted the following analysis for the interest rate derivatives asset class. The purpose of the analysis is to demonstrate to ESMA a viable COFIA for fixed-floating interest rate swaps (IRS); to provide a similar analysis to the bond study in Annex 3.6.2 of the ESMA Discussion Paper entitled 'Preliminary analysis for bonds' for IRS using DTCC trade data; and to help ESMA determine which IRS could be considered liquid as defined in Article 2(1)(17)(a) MiFIR.

ISDA hopes this will demonstrate the level of granularity that is necessary in order to classify derivatives transactions accurately for this purpose and provide ESMA with a framework which it can employ for the other derivatives asset classes. The scope of the analysis was limited to a small range of OTC derivatives and therefore ESMA should be careful to calibrate other asset classes on a case-by-case basis as use of the same thresholds for liquidity is unlikely to be appropriate for all asset classes.

The analysis of IRS takes two limbs of the definition of liquid market into account: the '*average frequency of transactions*' and the '*average size of transactions*'. We utilize a 'normal markets' assumption in this preliminary analysis. This allows for the stressing of various market conditions in future studies. As with the ESMA bond analysis, the other criteria listed under the

definition – ‘*number and type of market participant*’ and ‘*average size of spreads*’ – were not considered in this analysis, as they are not reflected in the data set we are using.

Consistent with the ESMA analysis for bonds, ISDA has used the same three metrics in order to determine how many instruments and what percentage of trading volume are captured under the different thresholds:

- (i) at least X trades per instrument during the period;
- (ii) the instrument is traded on at least X of different days during the period;
- (iii) the average daily volume of an instrument is at least X (total turnover over the period divided by the number of trading days).

Consistent with the degree of granularity of classification of IRS that we are recommending, we have run the analysis on three different scenarios. Two of these scenarios align with scenarios which ESMA have set out in annex 3.6.2 and we have added one scenario which we feel is more consistent with the view of ISDA’s members that an instrument must be actively trading 15-40 times per day and on at least every trading day in order to be considered liquid and therefore to appropriately reflect continuity of buying and selling as per the description of a liquid market in Article 2(1)(17) of MiFIR.

## **Methodology Overview**

For our study, we have used data from the DTCC SDR from April 2013 to March 2014, which results from the public reporting of trades pursuant to the Part 43 requirements of the CFTC. As part of a broader exercise, ISDA have warehoused and cleaned the DTCC data in order to bring greater transparency to the OTC derivatives market. Please do look our website [www.swapsinfo.org](http://www.swapsinfo.org) for more information on this.

This analysis looks purely at fixed-floating Interest Rate Swaps (IRS), the most liquid taxonomy from the DTCC—comprising roughly 70% of total volume reported through DTCC in the rates market. We have focussed on number of trades and notional trading volumes. The DTCC data does not show either bid-offer spreads or the number of market participants (the trades are reported anonymously). We would be happy to share our approach with ESMA in greater detail, including extending to other classes of Interest Rate Derivatives.

We were very aware that using DTCC data could be thought of as producing a US centric set of findings. However, our primary objective was to propose a COFIA schema and methodology that ESMA can replicate using European data once available. Regardless, a selection of ISDA members checked the data we are using with their own, internal (non public), and more EU centric data. Amongst these firms, the non-USD swap transactions were deemed to be a representative sample set of the overall global population in terms of distribution of trades between classes. The ratio of USD to non-USD transactions was skewed to show more USD transactions as one might expect.

Swaps data from the DTCC dataset was grouped according to the following criteria. This grouping scheme resulted in the identification of 5,661 unique classes of IRS used in the analysis. During the analysis period of 1 April 2013 to 31 March 2014 5,550 unique classes traded.

- a) **Currency:** All swaps were single current fixed-floating swaps, and were classified according to currency. ISDA's analysis has 34 currencies.
- b) **Forward-Starting Term:** The difference between the Trade Date and the Effective Date (when the swap begins to accrue interest) allows us to classify IRS by their Forward Starting Term. All IRS with an Effective Date of 0-5 trading days after the Trade Date are included as spot transactions. All IRS with an Effective Date of more than 5 days following the Trade Date are considered forward-starting and grouped according to various buckets dependant on how far in the future the Effective Date differs from the Trade Date. In the event an All IRS with an Effective Date prior to the Trade Date are identified as 'backwards-starting'. ISDA's analysis has 53 separate Forward Starting Term categories:
- Backward Starting
  - Spot
  - For Forward Starting trades within a year of Trade Date :
    - 5 to 25 trading days
    - 26 to 50 trading days
    - 51 to 75 trading days
    - 76 to 125 trading days
    - 126 trading days to 1 year
  - For Forward Starting trades starting more than a year after trade Date:
    - 1 year to 2 years
    - 2 to 3 years
    - 3 to 4 years
    - And so on, out to 46 years (the furthest forward starting swap in the DTCC data)
- c) **Tenor:** the Tenor of an IRS is defined as the difference between the Maturity Date and the Effective Date. Where the Tenor equates to a round number of years +/- 5 trading days, these are classified as Integer IRS. Otherwise, IRS are considered 'broken dated', or fractional, and are identified as such. 'ISDA's analysis has
- For trades with a Tenor of < 1 year:
    - 0 to 1.5 months
    - 1.5 to 3 months
    - 3 to 6 months
    - 6 months to 1 year
  - For trades with a Tenor of > 1 year:
    - Integer Tenors from 1 year to 60 years (the swap with the longest tenor in the DTCC data) (i.e. 60 categories of which only 53 had actual trades)

- Broken Dated Tenors from 1 year to 60 years (i.e. 60 categories of which only 51 had actual trades)
- d) **Standard convention versus non-standard convention:** We define ‘standard’ versus ‘non-standard’ swaps according to the way accrued interest is calculated and when cashflows occur. There are currency- and term-specific payment frequency, reset frequency and daycount conventions which market participants agree are standard in practice. For example, a ‘standard’ 10-year GBP IRS swap would be characterized by semi-annual fixed and floating leg payment frequencies, a semi-annual floating leg reset frequency and ACT/360 fixed and floating leg daycount conventions.

Our Research Department at ISDA have taken great care to clean up the data, so that it is more easily digested by those who choose to analyse it. We would like to stress that this is an academic exercise – it in no way has skewed or added bias to our findings. By this we mean that:

- The daily DTCC repository data we have used only includes actual price-forming transactions. It does not include novations, terminations, partial terminations, amendments, delta-neutral compressions or anything similar.
- Furthermore, the CFTC’s Part 43 rule does not require reporting of derivative transactions between different entities of the same corporate group where conducted for internal risk management purposes.
- Additionally, the CFTC’s Part 43 rule allows for allocated trades to be reported as a "block", by which we mean that where an Investment Advisor transacts a single order on behalf of multiple beneficial owner sub-accounts, these are reported to the DTCC as a single amalgamated transaction.
- This finalised dataset reflects any subsequent cancellations of or corrections to the initially-reported trade details.
- Transactions that are components of packages of multiple transactions are not distinguished from comparable transactions traded in isolation, by which we mean that a package of a 5 year IRS traded as a yield curve spread to a 10 year IRS appears in the DTCC dataset as two separate transactions (a 5 year and a 10 year).
- The Trade Date is defined by the period of time ranging from 16:01 EST on trade date T to 16:00 EST on T+1 to reflect realistic market dynamics.
- All notional amounts have been converted to US dollar amounts using Bloomberg’s last reported exchange rate on the third Wednesday of each month.

We recommend that ESMA adopt all elements of this, specifically the exclusion on transactions that are not price forming, the exclusion of transactions between different entities of the same corporate group, and the consideration of block orders at the amalgamated level.

We also recommend that ESMA not distinguish trades that form part of a package as distinct from comparable transactions traded in isolation; to do otherwise would be unnecessarily complex. However, when it comes to application of the Pre- and Post-Trade Transparency requirements, and the Derivatives Trading Obligation, such a simple approach will not be appropriate, an issue we explore in more detail in response to other questions.

## **Findings:**

- We present the results of ISDA’s analysis in the tables below. We have not replicated scenarios 1, 2, 4 and 5 since the thresholds they set are far too low. Scenarios 1,4 and 5 do not require an instrument to be trading every day, and the minimum average daily turnovers are inappropriately small.
- ISDA’s members believe that, in order for an instrument to be considered liquid, it must be actively trading 15-40 times per trading day and on at least every trading day. Trading less frequently than once per trading day, or not trading on all trading days, does not accord with continuity of buying and selling set out in the definition of a Liquid Market in Article 2(1)(17) of MiFIR.
- ISDA members consider that Scenario 7 sets more appropriate requirements for a class to be considered liquid. In Scenario 7, an IRS must be traded on at least every trading day, and on average at least 20 times per trading day (4,800/240), and requires an average daily volume of at least 100,000,000 EUR in order for a class to be considered liquid.
- Based on the data that was available to ISDA, Scenario 3 results in a set of liquid IRS that corresponds reasonably well with the set of derivatives deemed MAT by the CFTC. Generally, spot starting IRS with integer tenors at benchmark maturities across USD, EUR and GBP are liquid under these scenarios. However, there are a small number of classes from CAD and MXN which are shown to be liquid, which may reflect the US-centric dataset, as well as two AUD and one JPY class. We have also replicated Scenario 6, but, the absence of a requirement of the class exhibiting trading on all trading days, does not accord with continuity of buying and selling set out in the definition of a Liquid Market in Article 2(1)(17) of MiFIR.
- It is critical that ESMA determine liquidity correctly rather than taking a policy-based approach that seeks to scope in a pre-determined percentage of volume or transactions. Where an instrument does not have a liquid market, it qualifies for a waiver under pre trade transparency for venues, is exempt from the pre trade transparency rules for SI and is eligible for post trade transparency deferrals. Therefore, ESMA should consider where the inappropriate calibration of the liquidity threshold would be harmful to what liquidity is available in the relevant instruments were it to misclassify such instruments as illiquid.

## **Caveats and further comments**

Although our analysis has been thorough, we do note the following caveats:

- The data is US centric; we would not expect MXN trades to be so prevalent in data relating to trading between European market participants, for example, and it is possible that the DTCC dataset under-represents trading in certain European currencies. Nevertheless, it is the framework and approach that we ask ESMA to focus on.

- We focussed only on IRS. Different thresholds may be appropriate for asset classes other than Interest Rate Derivatives, due at least in part to difference in market structure.
- We did not distinguish between those swaps with on-market coupons from those traded with an off-market coupon + a fee. Nor did we distinguish between the collateral terms of otherwise identical swaps, or whether swaps were centrally cleared or traded bilaterally. We do not consider these particular determinants of a high-level determinant of liquidity. But they do factor into the liquidity of trades when considered at a very granular level, and are features that we recommend ESMA incorporate for the enhanced liquidity test required for application of the Derivatives Trading Obligation.
- DTCC data is "masked" in order to cap large notional volumes that might limit a participant from hedging their position in a timely manner. For example, a EUR 5-year plain vanilla interest rate swap notional may appear as follows: 150,000,000+. The addition of the "+" at the end of the notional value indicates this is a capped notional amount. Of the 479,855 trades observed in the analysis period, 80,763 (16.8%) are capped. Thus, these values are smaller than the actual transacted notionals, which biases dataset notional amounts lower.
- When analysing their own internal trade data, some ISDA members have found different results, which speaks to the importance of ESMA sourcing reliable, accurate European data prior to undertaking their own analysis.
- Inherent in calibrating the test for liquidity is the trade-off between degree of granularity and thresholds. A lesser degree of granularity, for example, could only be adopted with a different, higher, set of thresholds. The degree of granularity of classification and the thresholds used must be considered by ESMA to be integral to their calibration.

**Table 3 – Analysis results – scenario 3 – all trades**

<b>All Trades</b>	<b>scenario 3</b>
<b>At least x trades during the 1 year period</b>	240
Traded on at least x number of different days during the 1 year period	240
Average daily volume is at least x EUR	100,000,000
<b>Total # of classes</b>	5,500
<b>total # of classes captured as liquid</b>	40
<b>Percentage of swaps captured as liquid</b>	0.7%
<b>Total # of trades</b>	479,855
<b>Total # of trades captured as liquid</b>	235,855
<b>Percentage of trades captured as liquid</b>	49%
<b>Total volume</b>	33,776,862,785,276
<b>Total volume captured as liquid</b>	14,807,709,803,624
<b>Percentage of volume qualified as liquid</b>	44%

**Table 6 – Analysis results – scenario 6 – all trades**

<b>All Trades</b>	<b>scenario 6</b>
<b>At least x trades during the 1 year period</b>	2,400
Traded on at least x number of different days during the 1 year period	120
Average daily volume is at least x EUR	1,000,000
<b>Total # of classes</b>	5,500
<b>total # of classes captured as liquid</b>	28
<b>Percentage of swaps captured as liquid</b>	0.5%
<b>Total # of trades</b>	479,855
<b>Total # of trades captured as liquid</b>	219,871
<b>Percentage of trades captured as liquid</b>	46%
<b>Total volume</b>	33,776,862,785,276
<b>Total volume captured as liquid</b>	13,352,439,990,038
<b>Percentage of volume qualified as liquid</b>	40%

**Table 7 – Analysis results – scenario 7 – all trades**

<b>All Trades</b>	<b>scenario 7</b>
<b>At least x trades during the 1 year period</b>	4,800
Traded on at least x number of different days during the 1 year period	240
Average daily volume is at least x EUR	100,000,000
<b>Total # of classes</b>	5,500
<b>total # of classes captured as liquid</b>	13
<b>Percentage of swaps captured as liquid</b>	0.2%
<b>Total # of trades</b>	479,855
<b>Total # of trades captured as liquid</b>	173,098
<b>Percentage of trades captured as liquid</b>	36%
<b>Total volume</b>	33,776,862,785,276
<b>Total volume captured as liquid</b>	11,163,015,598,709
<b>Percentage of volume qualified as liquid</b>	33%

**The following instruments are liquid under Scenario 3:**

1	EUR/spot/10 year term /standard
2	EUR/spot/2 year term /standard
3	EUR/spot/20 year term /standard
4	EUR/spot/3 year term /standard
5	EUR/spot/30 year term /standard
6	EUR/spot/4 year term /standard
7	EUR/spot/5 year term /standard

8	EUR/spot/7 year term /standard
9	GBP/spot/10 year term /standard
10	GBP/spot/30 year term /standard
11	GBP/spot/5 year term /standard
12	USD/spot/1 year term /standard
13	USD/backward starting/10 year term /standard
14	USD/spot/10 year term / non-standard
15	USD/spot/10 year term /standard
16	USD/spot/12 year term /standard
17	USD/spot/15 year term /standard
18	USD/spot/2 year term /standard
19	USD/spot/20 year term /standard
20	USD/spot/3 year term / non-standard
21	USD/spot/3 year term /standard
22	USD/spot/30 year term /standard
23	USD/spot/4 year term /standard
24	USD/spot/4-broken/ non-standard
25	USD/backward starting/5 year term /standard
26	USD/spot/5 year term / non-standard
27	USD/spot/5 year term /standard
28	USD/spot/6 year term /standard
29	USD/spot/7 year term / non-standard
30	USD/spot/7 year term /standard
31	USD/spot/8 year term /standard
32	USD/spot/9 year term /standard
33	AUD/spot/10 year term /standard
34	AUD/spot/3 year term /standard
35	CAD/spot/5 year term /standard
36	JPY/spot/10 year term /standard
37	MXN/spot/10 year term /standard
38	MXN/spot/2 year term /standard
39	MXN/spot/3 year term /standard
40	MXN/spot/5 year term /standard

**The following instruments are liquid under Scenario 7:**

1	EUR/spot/10 year term /standard
2	EUR/spot/5 year term /standard
3	GBP/spot/10 year term /standard
4	USD/backward starting/10 year term /standard
5	USD/spot/10 year term /standard
6	USD/spot/2 year term /standard

7	USD/spot/3 year term /standard
8	USD/spot/30 year term /standard
9	USD/spot/4 year term /standard
10	USD/spot/5 year term /standard
11	USD/spot/7 year term /standard
12	MXN/spot/10 year term /standard
13	MXN/spot/5 year term /standard

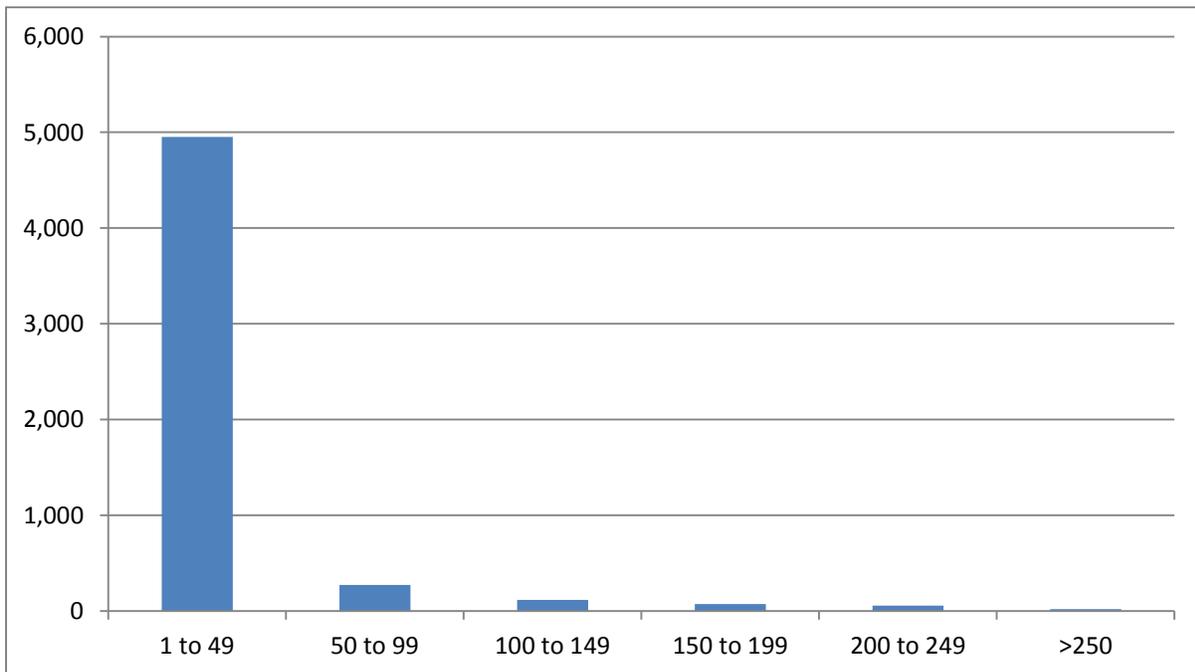
Please find the embedded spreadsheet for the data behind this exercise:



Transparency  
Framework - scenari

Additional comments about the liquidity of IRS under study:

It should be noted that the trading day thresholds used in the scenarios can be further decomposed in the DTCC data to show a more granular picture of the frequency of daily trading of the 5,500 individual combinations of IRS under study. Chart (XYZ below) highlights that 90% (4,952) of the combinations only traded between 1 and 49 days during the analysis period.



### Analysis of Credit Derivatives

ISDA has also analysed the six most liquid CDS indices. The table below shows the dramatic fall in liquidity when an on-the-run series becomes an off-the-run series. As soon as an index

becomes "off-the-run" it turns illiquid almost immediately. This dynamic should be strongly considered for both the trading obligation and the transparency requirements.

Index	Roll date	Pre-roll 5-day average trade count (old series)	Post-roll 1-5 day average trade count (old series)	Change	Post-roll 6-10 day average trade count (old series)	Change	Post-roll 11-15 day average trade count (old series)	Change	Post-roll 16-20 day average trade count (old series)	Change
Itraxx Europe 5Y	20/03/2014	171.8	28.6	-83%	16.6	-90.3%	6.4	-96.3%	7	-95.9%
Itraxx Crossover 5Y	20/03/2014	143.4	41.4	-71.1%	16.4	-88.6%	10	-93.0%	13.2	-90.8%
Itraxx Sr Fincl 5Y	20/03/2014	37.6	9.6	-74.5%	5.4	-85.6%	2.4	-93.6%	1.6	-95.7%
NA.HY 5Y	27/03/2014	160.8	62.8	-60.9%	39	-75.7%	30	-81.3%	12.6	-92.2%
NA. IG 5Y	20/03/2014	192.8	64	-66.8%	27.8	-85.6%	16.4	-91.5%	18	-90.7%
CDX. EM 5Y	20/03/2014	29	16.8	-42.1%	5.2	-82.1%	4.6	-84.1%	1	-96.6%

In this analysis, we have used the daily trade count from the publicly available DTCC SDR and Bloomberg BSDR data. The table shows that liquidity in existing credit derivative index swaps immediately declines following the date the new series begins to trade. This is evident by comparing the 5 day trading volume average before the roll date with the 5 day trading volume average after the roll date (we exclude the roll date itself since this is the event we wish to analyze).

To complete the analysis, the table also shows the additional 5-day increments of average trading volume post the roll date: days 6-10, days 11-15 and days 16-20. It appears that 75% or more of this average liquidity has drained across the entire sample as early as day 10 and by the end of the third trading week after the roll, liquidity has collapsed by over 90%. As stated above, ISDA believes that a cash or derivative instrument that does trade at least daily should be considered *ipso facto* illiquid.

The above analysis also demonstrates the degree to which an instrument is considered to be 'on-the-run' influences the market's propensity to trade it. Patterns that are similar to the above can be observed in the Single name CDS market as well (the 'on the run' SN CDS contract for a given Reference Entity is typically considered to be the one that matures at the first IMM date after 5 years have passed from trade inception). ISDA believes separating 'on-the-run' instruments from those that are 'off-the-run', in addition to separating instrument by underlying Reference Entity, is the minimum that would be required for a reliable study of liquidity patterns.

In the United States, the 'On-the-run/Off-the-run' concept has been embedded in all Made Available to Trade determinations submitted by SEFs thus far. The result of applying the trading mandate only to instruments that are truly liquid in their own right (rather than instruments that are liquid only with reference to other similar swaps) has been a relatively smooth transition to

SEF trading for those products. When less liquid products are forced onto electronic platforms, the risks of diminished liquidity and significantly higher transactions costs rise.

Please see the embedded spreadsheet for the data behind this exercise – the results of which are presented on the "Summary Table" tab.



Copy of CDS index  
roll analysis\_SwapsIn

## Analysis of Single Name CDS transactions

### Summary

The goal of this analysis is to observe single name CDS transactions over the period of one year in order to construct a framework for transparency and highlight possible implications of public reporting. In doing so our work seeks to characterize the liquidity of single name CDS contracts.

### Description of dataset

The single name CDS dataset was obtained via the Depository Clearing Trust Corporation (DTCC) Trade Information Warehouse database over the period of July 1, 2013 to June 30, 2014. DTCC Market Risk Transaction Activity (Section IV) provides users with a weekly activity table designed to describe where market participants were engaging in market risk transfer activity such as new trades between two parties, a termination of an existing agreement, or the new leg of an assignment representing the trade between the step-in party and the remaining party.

Several challenges arose when referencing this data. Although Section IV was designed to exclude transactions which do not change the market risk position of the market participants such as delta neutral compression trades, these trades are not easily identified and were initially included in the public data set. Additionally, the data only described weekly gross (USD) notional amounts and trade counts at the reference entity level, excluding more granular information such as currency, coupon and term.

ISDA collaborated with DTCC to resolve the issues described above. The resulting data is stripped of delta neutral trades and intra family transactions (which do not add to market risk) and is described according to reference entity, currency, term and coupon characteristics as shown in **Table 1**. To protect the anonymity of trading in single name CDS transactions with lower volumes, weekly notional and trade count data was only given for those reference entities which trade in excess of 50 or more contracts during the analysis period. The "dropped" single names have been aggregated according to currency, reference entity type, term, and coupon descriptors.

We will refer to the more granular dataset of single name CDS reference entities as Group A and the "dropped" CDS dataset as Group B in this analysis.

**Table 1** characterizes the descriptors used in organizing the single name CDS data:

Reference Entity	Typically a corporation or government to which the CDS contract is linked
Group A	2,891 corporate and sovereign single name CDS reference entities which traded at least 50 times during the analysis period and are characterized by currency, term, coupon, region and index constituency characteristics <sup>†</sup>
Group B	1,925 "dropped" single name reference entities that traded fewer than 50 times during the analysis period; These are aggregated by currency, term, coupon, and reference entity type characteristics <sup>††</sup>
Currency	Denomination of the contract which includes USD, EUR, JPY and "other" (NOTE: GBP was purged from Group A due to the 50 contract limitation and is included only in Group B)
Term	Scheduled Term minus Effective Date bucketed as follows: <ul style="list-style-type: none"> <li>• Under 1 year grouped together as "&lt;1Y"</li> <li>• Over 10 years grouped together as "&gt;10Y"</li> <li>• Between 1 and 10 years is displayed on a 1 year range basis. For example, 5Y-6Y would represent the 5 year mark up to and excluding 6Y, 6Y-7Y would include the 6Y mark up to and excluding 7Y, and so on...)</li> </ul>
Coupon	Segregates 100 and 500 basis point (bps) coupons and groups all other coupon types as "other"

<sup>†</sup> Region and index constituency characteristics of Group A are included in the Appendix

<sup>††</sup> Each series of a mortgage backed CDS contract is considered a unique reference entity (NOTE: most issues have several series, some more than 20); Reference entity type characteristics of Group B are included in the Appendix

Referencing **Table 2**, we see that there are 847,975 contracts included in the DTCC dataset. The majority of contracts (745,144, 87.9%) belong to Group A having traded at least 50 times in the analysis period. Thus, we are able to describe these in greater depth at the reference entity level. The remaining Group B "dropped" contracts (102,831 12.1%) are aggregated across currency, term and coupon descriptors.

The majority of total single name CDS trading was denominated in US dollar (62.7%) and euro currencies (34.7%). Contract terms were concentrated in 3- to 6-year buckets, with the majority of activity (58.8%) occurring in 5Y – 6Y term bucket. More than half of the single name CDS had 100 basis points coupons (65.5%).

There were some interesting differences between the Group A single name reference entity characteristics when compared to the Group B "dropped" CDS dataset. For example, while the

Group B contracts also consisted of mostly USD and EUR currencies, GBP and "other" non-G4 currencies were present in the data. The concentration of terms also varied between these two groups. While the Group A contracts were overwhelmingly concentrated in the 5Y – 6Y term bucket, the Group B "dropped" contracts were distributed across the <1Y to 4Y – 5Y term buckets. Finally, the Group B "dropped" contracts unsurprisingly consisted of a relatively higher amount of non-standard coupons when compared to Group A.

**Table 2** aggregates the dataset of single name CDS according to currency, term, and coupon:

	<b>Group A Reference Entitles</b>	<b>Group A Contracts</b>	<b>Pct</b>	<b>Group B Contracts</b>	<b>Pct</b>	<b>Total Contracts</b>	<b>Pct</b>
<b>Total</b>	2,891	745,144	87.9%	102,831	12.1%	847,975	100.0%
<b>Currency</b>							
USD	1683	464,872	62.4%	66,447	64.6%	531,319	62.7%
EUR	1107	263,635	35.4%	30,733	29.9%	294,368	34.7%
JPY	101	16,637	2.2%	5,244	5.1%	21,881	2.6%
GBP	-	-	-	261	0.3%	261	0.03%
Other	-	-	-	146	0.1%	146	0.02%
<b>Term</b>							
< 1Y	170	23,084	3.1%	17,546	17.1%	40,630	4.8%
1Y - 2Y	300	34,475	4.6%	17,612	17.1%	52,087	6.1%
2Y - 3Y	425	49,975	6.7%	15,428	15.0%	65,403	7.7%
3Y - 4Y	533	71,409	9.6%	14,315	13.9%	85,724	10.1%
4Y - 5Y	629	136,427	18.3%	10,888	10.6%	147,314	17.4%
5Y - 6Y	746	421,253	56.5%	9,509	9.2%	430,762	50.8%
6Y - 7Y	25	1,665	0.2%	5,742	5.6%	7,407	0.9%
7Y - 8Y	32	2,935	0.4%	5,804	5.6%	8,739	1.0%
8Y - 9Y	5	384	0.1%	1,417	1.4%	1,801	0.2%
9Y - 10Y	9	850	0.1%	1,235	1.2%	2,084	0.2%
> 10Y	17	2,688	0.4%	3,338	3.2%	6,026	0.7%
<b>Coupon</b>							
100	1,969	485,172	65.1%	70,192	68.3%	555,364	65.5%
500	831	242,636	32.6%	19,182	18.7%	261,817	30.9%
Other	91	17,336	2.3%	13,457	13.1%	30,793	3.6%

### Single Name CDS Liquidity

The previous section described the characteristics of Group A and Group B "dropped" contracts according to currency, term and coupon descriptors. In this section we attempt to characterize the liquidity of Group A using volume and trade frequency metrics as described in **Table 3**. As

mentioned, Group B reference entities traded fewer than 50 times during the analysis period and were dropped from the more granular dataset provided by DTCC.

**Table 3** characterizes the liquidity metrics used to describe Group A reference entities:

Gross Notional	The gross notional of the respective reference entity transacted in the analysis period
Average Daily Notional	The average notional traded each trading day defined as: Gross Notion/Days Traded
Average Trade Size	The average "clip" or amount traded in each transaction defined as: Gross Notional/Total Contracts
Total Contracts	The total number of contracts transacted in the analysis period
Days Traded	The number of unique days a reference entity traded in the analysis period
Average Trades per Day	The average number of transactions per day of each reference entity defined as: Total Contracts/250

For many Group A single name CDS reference entities, the combination of low and variable trading frequency with potentially large gross notional values presents mixed messages about the liquidity of the CDS market. For example, if we reference **Table 4** below, we observe that the dispersion of average trade sizes is rather tight, while other metrics such as the number of Total Contracts traded, Days Traded in the Period, and Gross Notional vary widely.

**Table 4** organizes Group A reference entity liquidity metrics by percentile values:

Percentile	90%	75%	50%	25%	10%
Gross Notional	2,789,183,082	1,336,542,951	664,516,397	388,620,000	244,200,000
Average Daily Notional	31,537,674	22,754,536	16,436,067	11,018,472	7,726,250
Average Trade Size	8,936,286	6,663,441	4,962,722	3,691,085	2,804,749
Total Contracts	568	243	122	76	59
Days Traded in Period	139	76	43	27	20
Average Trades per Day	2.3	1.0	0.5	0.3	0.2

Simply observing the total number of contracts traded during the analysis period also provides a murky picture of CDS liquidity. Two additional metrics, Average Trades per Day and Days Traded in Period, offer additional insight.

The Average Trades per Day metric allows us to get a more granular view on the frequency of trading assuming 250 trading days. **Chart 1** is a histogram which compares bucketed Average Trades per Day along the X axis. As is evident in the chart, most reference entities (2,149,

74.3%) fall into the "<1" bucket which means they do not even trade once per day as the average is a fraction.

The **Chart 2** histogram describes the frequency of Group A Days Traded in Period. Referencing Table 4 figures, consistency of trading is extremely low as the median number of days is only 43. It should be noted that the addition of the 1,925 Group B "dropped" reference entities would implicitly fall to fewer than 50 days as a group, providing further evidence of sparse trading in single name CDS contracts.

The marked variation in the trading of reference entities likely reflects the changing credit outlook of various countries, sectors or firms. This has a "clustering" effect on the majority of CDS transactions, making them liquid when the reference entity is in play and illiquid otherwise. This condition should be strongly considered by ESMA in the trade reporting process.

For example, if we examine the top 5 Group A reference entities by Total Contracts and unique Days Traded metrics, much of the volume observed during the analysis period can be attributed to macroeconomic and/or political events as described in **Table 5**. Thus it is straightforward to expect considerably more activity in such contracts when such events occur versus unstressed periods.

**Table 5** describes some of the recent country themes influencing sovereign CDS volumes higher

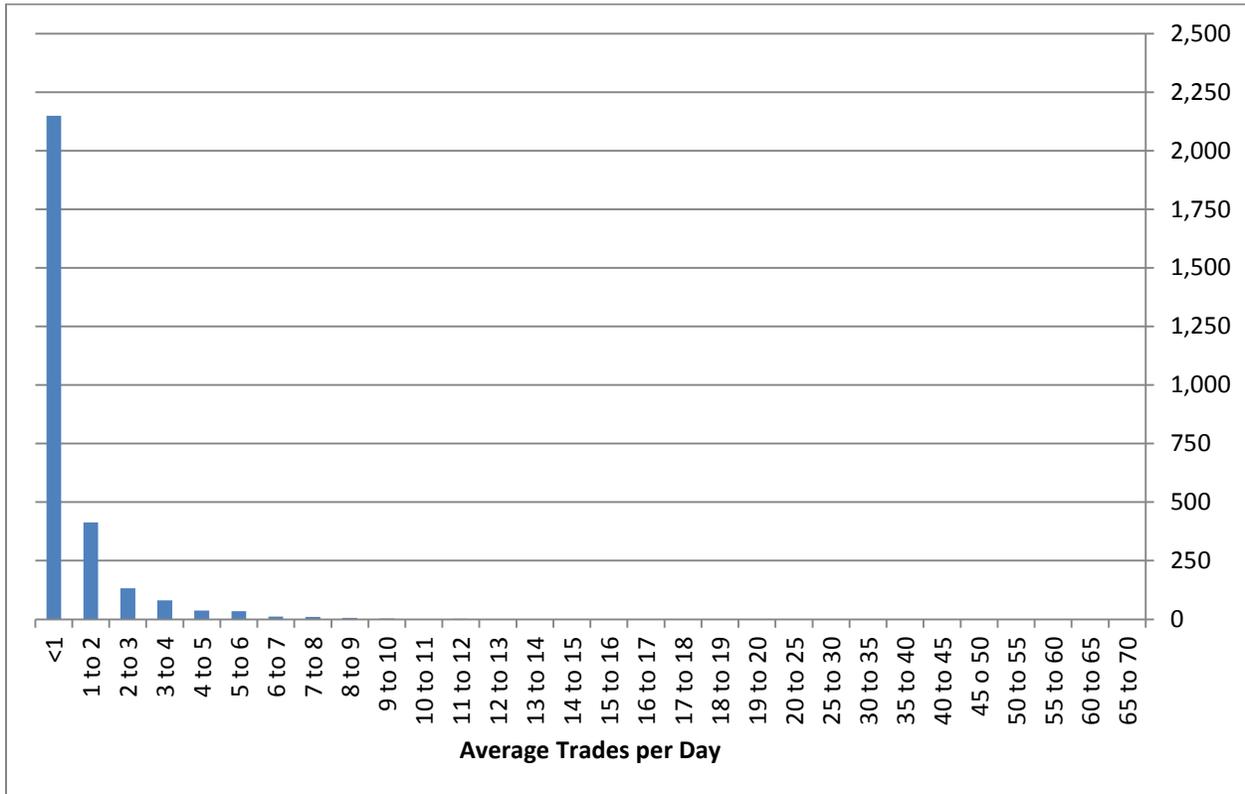
<b>Sovereign CDS</b>	<b>Event Type</b>	<b>Description</b>
Federal Republic of Brazil	Macroeconomic Political	The Brazilian economy has recently shifted further towards stagflation as macro imbalances and the sharp erosion of confidence indicators during 2Q2014 point to growing risks that the economy downshifts further. The upcoming 5 October 2014 presidential election creates additional uncertainty.
Russian Federation	Political	Ukraine political uncertainty and the Crimea crisis remain in the headlines as the potential for US and EU sanctions beginning in March 2014 increase risks.
Republic of Turkey	Macroeconomic Political	Turkey's current account deficit has been declining, however this improvement is likely unsustainable with the appreciation of the lira. On the political front, unrest since the end of 2013 has been a key issue as the 10 August 2014 election represents the country's next important event.
People's Republic of China	Macroeconomic	Chinese growth has slowed to a pace below 6% in Q12014, leading policymakers to institute additional easing efforts to help bolster the economy. New reforms contribute both upside and downside risks to growth forecasts.
United Mexican States	Macroeconomic	Economic recovery is expected to firm in the coming quarters but the still-significant slack in

		the economy and abundant inexpensive labor reduces the need to add significant new production capacity in the short term.
Republic of Indonesia	Political	Presidential elections were held of 9 July and 22 July 2014. Joko Widodo claimed victory, however Prabowo claimed the official results were fraudulent.

\*Top 5 reference entities by Total Contracts include: Federal Republic of Brazil, Russian Federation, Republic of Turkey, People’s Republic of China, and United Mexican States

\*\*Top 5 reference entities by unique Days Traded include: People’ s Republic of China, Federal Republic of Brazil, Republic of Indonesia, Russian Federation, and United Mexican States

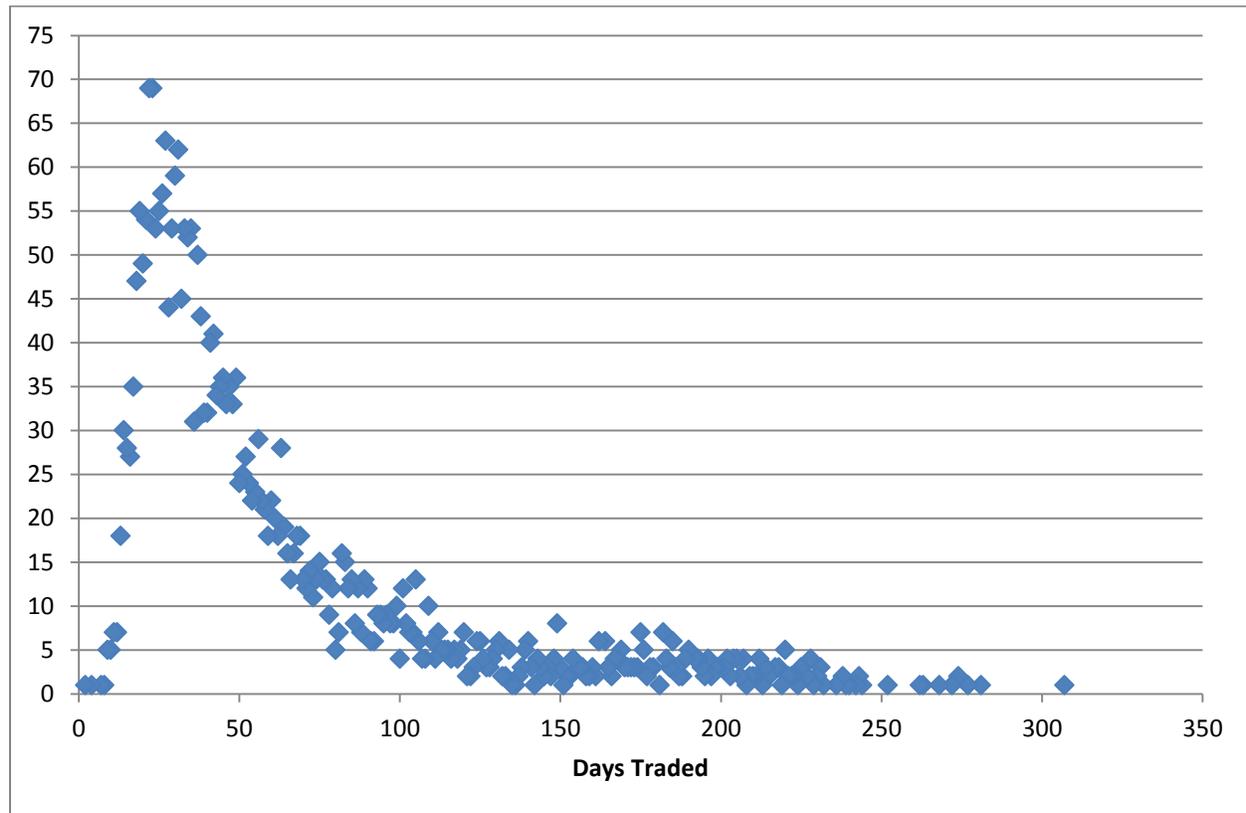
**Chart 1** describes the frequency of Group A Average Trades per Day



\*Average Trades per Day equals Total Contracts during the analysis period/250

\*\*Data has been bucketed by day intervals: "<1" includes fractions up to but not including 1, "1 to 2" includes figures ranging from one up to but not including 2, "2 to 3" includes figures ranging from one up to but not including 3, and so on.

**Chart 2** describes the frequency of Days Traded of Group A reference entities



\*Days traded describes the number of unique days a reference entity traded during the analysis period

\*\*The distribution of Group B Days Traded was not available for this study

#### Appendix Items:

Single name CDS data (Group A) can be further characterized by region and index constituent status.

The region describes the predominant trading style associated with each reference entity name based on the documentation type of the underlying trades. For example, transactions traded as StandardNorthAmericanCorporate would be associated with the Americas region. Where more than 25% of the transactions are associated with a region, that region has been included. In some cases two regions are used. If the reference entity is a sovereign of governmental entity, it is identified as "sovereign", regardless of whether the entity is a country, state or city.

If a reference entity is included in one of the broad market indices traded in the credit derivative marketplace as of March 19, 2014, it is tagged as such in the dataset. For the purposes of this analysis, the latest series of the following indices were included: CDX Investment Grade and High Yield indices, iTraxx Europe, CDX Emerging Market and Emerging Market Diversified, as well as the iTraxx SovX CEEMA and Western Europe indices. These indices are administered by Markit.

<b>Region</b>			
Americas	1377	321,857	43.2%
Americas, Europe	5	782	0.1%
Asia ex-Japan	18	2,175	0.3%
Australia NZ	28	6,299	0.8%
Europe	1118	265,680	35.7%
Japan	105	16,890	2.3%
Sovereign	240	131,461	17.6%
<b>Index Constituent as of March 19, 2014</b>			
Y	2640	708,099	95.0%
N	251	37,045	5.0%

**Q117: Do you agree with the proposed approach? If not, please provide rationales and alternatives.**

No. Whilst we agree that NCAs should have regard to both quantitative and qualitative data, greater emphasis should be given to qualitative arguments. In particular, we believe that it would be dangerous to limit NCAs powers by imposing a quantitative test which must be met before NCAs can exercise their powers of temporary suspension. In particular, we believe that it is unlikely that such data could be provided in a timely enough fashion for the temporary suspension powers to be utilised effectively in an emergency. NCAs should be able to exercise this power quickly if market factors necessitate this and they should not be required to wait until they have all the data they need to be sure that the quantitative threshold has been met. However, we do think that if the underlying of a derivative is listed and that underlying loses its listing or is suspended then the corresponding derivative should be suspended as well.

**Q118: Do you agree with the proposed thresholds? If not, please provide rationales and alternatives.**

No. We believe that the proposed thresholds are set too high. Even for the most liquid instruments a decline of 50% would be regarded as a severe decline in liquidity by market participants. We would reiterate again that qualitative factors should be given precedence over quantitative thresholds, as it is vital that NCAs have the flexibility to act quickly should market factors necessitate this.

### Section 3.7 - Pre-trade transparency requirements for non-equity instruments

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**Q119: Do you agree with the description of request-for-quote system? If not, how would you describe a request-for-quote system? Please give reasons to support your answer.**

No. The following amendment should be made to the definition of a request-for-quote system to better reflect the fact that a requesting counterparty is the only counterparty entitled to trade on the responding party's quotes:

"A trading system where a quote or quotes are only provided to a member or participant in response to a request submitted by one or more other members or participants. The quote is exclusively provided to the requesting member or market participant and is indicated to be a firm quote. The requesting member or participant may conclude a transaction by accepting the quote or quotes provided to it on request".

**Q120: Do you agree with the inclusion of request-for-stream systems in the definition of request-for-quote system? Please give reasons to support your answer.**

Yes, provided always that the stream is firm, then we agree with the inclusion of request-for-stream systems in the definition of RFQ system. Request-for-stream systems are part of the RFQ family – they are a continuous stream of implicit RFQ's from the client to which the dealer continuously responds. Request-for-stream systems are used particularly for those instruments the value of which evolves on a real-time basis, making it impossible for a responding participant or member to maintain its price over a predefined period.

**Q121: Do you think that – apart from request-for-stream systems – other functionalities should be included in the definition of request-for-quote system? If yes, please provide a description of this functionality and give reasons to support your answer.**

No. In our view the proposed definition is sufficiently broad to capture all RFQ systems, regardless of the protocol and/or technology used.

**Q122: Do you agree with the description of voice trading system? If not, how would you describe a voice trading system?**

No. We would recommend expanding the definition to allow for the employees of a voice trading system to use computer technology, including free text, electronic chat rooms and instant messenger systems, in the matching of client orders. ESMA should, however, ensure that the definition does not inadvertently capture the transmission of orders to the trading venue. We would, therefore, propose the following definition:

"A trading system where transactions between members or participants are arranged actively by the operator of the trading venue through voice negotiation or any medium that replicates voice negotiation."

**Q123: Do you agree with the proposed table setting out different types of trading systems for non-equity instruments?**

We recommend removing the requirement for the operator of a quote-driven trading system to maintain quotes in certain sizes. We propose amending the definition as follows:

"A system where transactions are concluded on the basis of firm quotes that are continuously made available to participants, ~~which requires the market makers to maintain quotes in a size that balances the needs of members and participants to deal in a commercial size and the risk to which the market maker exposes itself.~~"

Subject to our comments above and also to our recommendation to expand the definition of a voice trading system to allow for the employees of a voice trading system to use computer technology (including free text, electronic chat rooms and instant messenger systems) then we agree with the proposed table setting out the different types of trading systems for non-equity instruments. We agree that it is useful to include trading systems not covered by the first five rows as it ensures that the definition of trading system does not rule out any functionality or impose a minimum functionality.

**Q124: Do you think that the information to be made public for each type of trading system provides adequate transparency for each trading system?**

The RTS should clearly state that only information about price needs to be published and that venues should not publish the identity of the trading venue member or participant which has offered this price. For price formation purposes, it is not necessary for the market to know which firms are quoting what prices.

Provided that the pre-trade transparency waivers are calibrated appropriately, we believe that the information proposed to be made public for each type of trading system provides adequate transparency for each trading system. However, without proper calibration of the waiver regime, the information to be made public will expose market makers to undue risk and could impede effective hedging strategies which may deter the provision of liquidity in these markets.

**Package Transactions**

ESMA should give due consideration to the pre-trade transparency obligations for instruments traded as part of a Package Transaction. By Package Transaction, we mean: (i) two or more components that are priced as a package with simultaneous execution of all components; and (ii) the execution of each component is contingent on the execution of the other components.

Our recommendation is that where a component transaction of the package benefits from a pre-trade transparency waiver, the entire package should benefit from the waiver. This is consistent with our recommended treatment of packages for post-trade transparency (a Package Transaction should benefit from a post-trade deferral where at least one component transaction benefits from a deferral) and for the derivatives trading obligation (a Package Transaction should not be subject to the trading obligation unless all component transactions are mandated for clearing and deemed sufficiently liquid).

**Q125: Besides the trading systems mentioned above, are there additional trading models that need to be considered for pre-trade transparency requirements in the non-equity market space?**

No, we believe that the table covers all trading models.

**Q126: If you think that additional trading systems should be considered, what information do you think should be made public for each additional type of trading model?**

Not applicable. We do not think that additional trading systems should be added to the table.

**Q129: Do you agree with ESMA's approach in relation to the content, method and timing of pre-trade information being made available to the wider public?**

Provided that the pre-trade transparency waivers are calibrated appropriately (including for Package Transactions where the availability of a waiver for one component of the package should extend the waiver to all other transactions in the package) we agree with ESMA's approach in relation to the content, method and timing of pre-trade information being made available to the wider public by operators of voice trading systems.

**Q130: Do you agree with the above mentioned approach with regard to indicative pre-trade bid and offer prices which are close to the price of the trading interests? Please give reasons to support your answer**

Whilst we are generally supportive of the proposed approach with regard to the publication of indicative pre-trade bid and offer prices by operators of request-for-quote and voice trading systems in accordance with Article 9(1)(b) of MiFIR, we would recommend that the RTS imposes an obligation on operators of these venues to ensure that the methods they use to determine the indicative bid and offer prices are as formulaic as possible to ensure that operators are not given too much discretion, thus reducing the risk of market manipulation.

**Q131: If you do not agree with the approach described above please provide an alternative**

Not applicable.

Whilst we are generally supportive of the proposed approach with regard to the publication of indicative pre-trade bid and offer prices by operators of request-for-quote and voice trading systems in accordance with Article 9(1)(b) of MiFIR, we would recommend that the RTS imposes an obligation on operators of these venues to ensure that the methods they use to determine the indicative bid and offer prices are as formulaic as possible to ensure that operators are not given too much discretion, thus reducing the risk of market manipulation.

### **Section 3.8 - Post-trade transparency requirements for non-equity instruments**

**Q132: Do you agree with the proposed content of post-trade public information? If not, please provide arguments and suggestions for an alternative.**

In the spirit of global consistency and harmonisation of post-trade transparency regimes, ISDA considers that:

- Instrument Identifier should have UPI as an allowable value
- The details of the public information listed should align with the transaction reporting fields so the same values can be used from the same sources for reporting both post-trade transparency and transaction reporting purposes, in terms of definition and value types allowed (notably Price, Price notation, Quantity Notation and Quantity)

In relation to the scope of application of the post-trade transparency regime to investment firms, ISDA would welcome confirmation from ESMA that post-trade transparency obligations on investment firms set out in Articles 20 and 21 MiFIR are not intended to apply if the relevant transaction is executed on a trading venue (which transaction would therefore be made public by the relevant trading venue in accordance with Articles 6 and 10 MiFIR).

ISDA notes that the current post-trade transparency requirements under Article 28 MiFID are clearer in this respect than the obligations under MiFIR, although (i) the closing words of Article 20(2) and 21(4) MiFIR provide support for an interpretation that limits Articles 20 and 21 to transactions executed outside a trading venue, and (ii) Articles 20 and 21 contain provisions aimed at preventing duplication of post-trade transparency reporting (at Article 20(3)(c) and Article 21(2) and (5)(c)), which provisions would be undermined if a transaction executed on a trading venue had to be made public separately by the investment firm party to the transaction and the trading venue.

ISDA assumes that any changes in drafting to the post-trade transparency obligation between MiFID and MiFIR were not intended to result in duplicate post-trade reporting of trades executed on a trading venue, which would be confusing to the market and national regulators alike. ISDA would suggest that ESMA embed such a clarification in the recitals to the Regulatory Technical Standards it drafts.

**Q133: Do you think that the current post-trade regime for shares on the systematic internaliser's identity should be extended to non-equity instruments or that the systematic internaliser's identity is relevant information which should be published without exception?**

In ISDA's view, the identity of the SI should not be published under the post-trade transparency regime for non-equity instruments.

This is because publishing the name of the SI alongside each trade would have the effect that observers would be able to reconstruct the trading activity of the SI and so would jeopardise confidential and commercially-sensitive information in respect of the capital advanced by the SI. It may instead provide others with an opportunity to trade in a way that would take advantage of the knowledge that a significant SI has accumulated risk in a particular instrument. Furthermore, this effect would be asymmetric in the sense that the identity of the SI would be disclosed to the market but the identity of the SI's customer would not. This would unfairly benefit the SI's client and the rest of the market at the expense of the SI providing the liquidity.

This may also have the effect of disincentivising SIs from advancing their own capital, meaning that liquidity in relevant financial instruments will naturally decrease and that end investors will find it harder to hedge their risks and will face wider spreads when doing so. In this commercial activity outlined above ISDA must reiterate that an SI is a counterparty to a trade and is not a trading venue. By way of comparison, ISDA notes that both the CFTC and SEC rules on post-trade transparency expressly prohibit the dissemination of the identities of counterparties to a trade.

In terms of the counterargument discussed by ESMA in paragraph 16 (that the SI quotes are made public and therefore the information is already available), ISDA strongly disagrees with the comparison between pre- and post-trade transparency. This is because the pre-trade transparency regime for SIs is designed to inform the market of the prices available. It is not intended to give the market an understanding of how many investors have responded to those quotes nor the SI's pattern of execution. In addition, the pre-trade transparency requirements for SIs only apply at sizes below the Size Specific to the Instrument in Liquid Instruments, whereas post-trade transparency will result in trades of all sizes being published regardless of liquidity (either immediately or after the deferral period). This invalidates the comparison between pre- and post-trade transparency.

To reiterate, in ISDA's view the identity of the SI should not be published under the post-trade transparency regime for non-equity instruments. If ESMA does mandate SIs to provide aggregate data reports for non equity instruments, ISDA recommends that this be achieved by SIs providing aggregate volume statistics on a periodic basis. Under the current equities regime, SIs are obliged to make such information public on a quarterly basis, no later than one month after the end of each quarter. With respect to non-equity instruments, ISDA recommends that SIs' aggregate reports should be staggered by a quarter. Accordingly, Q4 reports should not be required to be made public in January, but rather in Q2. Without such a gap, market makers will be more exposed to undue risk in the positions they take on as part of their role of facilitating liquidity in the market during the end of a quarter.

**Q134: Is there any other information that would be relevant to the market for the above mentioned asset classes?**

In the spirit of global consistency and harmonisation of post-trade transparency regimes, ISDA considers that:

- Instrument Identifier should have UPI as an allowable value

- The details of the public information listed should align with the transaction reporting fields so the same values can be used from the same sources for reporting both post-trade transparency and transaction reporting purposes, in terms of definition and value types allowed (notably Price, Price notation, Quantity Notation and Quantity)

In relation to the scope of application of the post-trade transparency regime to investment firms, ISDA would welcome confirmation from ESMA that post-trade transparency obligations on investment firms set out in Articles 20 and 21 MiFIR are not intended to apply if the relevant transaction is executed on a trading venue (which transaction would therefore be made public by the relevant trading venue in accordance with Articles 6 and 10 MiFIR).

ISDA notes that the current post-trade transparency requirements under Article 28 MiFID are clearer in this respect than the obligations under MiFIR, although (i) the closing words of Article 20(2) and 21(4) MiFIR provide support for an interpretation that limits Articles 20 and 21 to transactions executed outside a trading venue, and (ii) Articles 20 and 21 contain provisions aimed at preventing duplication of post-trade transparency reporting (at Article 20(3)(c) and Article 21(2) and (5)(c)), which provisions would be undermined if a transaction executed on a trading venue had to be made public separately by the investment firm party to the transaction and the trading venue.

ISDA assumes that any changes in drafting to the post-trade transparency obligation between MiFID and MiFIR were not intended to result in duplicate post-trade reporting of trades executed on a trading venue, which would be confusing to the market and national regulators alike. ISDA would suggest that ESMA embed such a clarification in the recitals to the Regulatory Technical Standards it drafts.

**Q135: Do you agree with the proposed table of identifiers for transactions executed on non-equity instruments? Please provide reasons for your answer.**

No. The storage of many new flags in numerous order and execution systems for every asset class and product type will be a huge technological change of great cost, although ISDA agrees that it would be helpful to include "Cancellation" and "Amendment" flags.

ISDA considers that technical trades and give-up/give-ins should be out of scope of the post-trade transparency regime, as they do not contribute to the price formation process. Therefore, the associated flags would not be required.

Finally, ISDA considers that flags relating to deferrals should not be required, as it would already be evident from the trade time that a deferral was used.

**Q136: Do you support the use of flags to identify trades which have benefitted from the use of deferrals? Should separate flags be used for each type of deferral (e.g. large in scale deferral, size specific to the instrument deferral)? Please provide reasons for your answer.**

To the extent that publication of all post-trade information is delayed until the end of any applicable deferral period, ISDA does not consider that the flags relating to deferred publication

are necessary, as it would be evident that a deferral was used from the trade time, which would already be included in the information published.

However, to the extent firms benefitting from a post-trade deferral publish some post-trade information during the deferral period but omit volume information from the initial publication, then ISDA considers it would be appropriate to use a flag to indicate that volume information has been omitted due to availability of a deferral. If ESMA does decide to use a deferral flag, ISDA considers that ESMA could gain sufficient information by just having one flag to indicate that a deferral waiver was used, rather than a separate flag for each deferral.

**Q137: Do you think a flag related to coupon payments (ex/cum) should be introduced? If yes, please describe the cases where such flags would be warranted and which information should be captured.**

ISDA's view is that if this information is available from other public data providers who hold reference data for the instrument then it should be sourced there, and not included in the post-trade publication. For example, coupon payments for bonds could be sourced from Bloomberg.

**Q138: Do you think that give-up/give-in trades (identified with a flag) should be included in post-trade reports or not made public? Please provide reasons for your answers.**

ISDA considers that 'give-up' and 'give-in' trades should not be included at all in the post-trade transparency regime at all for the following reasons:

- The original transaction between the executing broker and its client will have been trade reported.
- Subsequent give-in/give-up trades are operational in nature and not representative of price forming transactions.
- The massive number of additional trades which would be subject to post-trade transparency would have impact on infrastructure and reliability as well as difficulties to implement for little benefit.
- Give-up and give-in trades are usually effected via processes in back office systems and not execution systems where client orders are typically routed and so including give-up/give-in information in post-trade disclosure would require huge technological change.

ISDA should also be grateful for clarification from ESMA that intragroup transactions undertaken for the purposes of transferring risk within corporate groups are not subject to the post-trade transparency requirements – i.e. an investment firm transferring risk in this way to another group entity should not be considered to have concluded a transaction for the purposes of Article 20 and 21 MiFIR. This is because such transactions facilitate the appropriate risk management within a financial group, and do not have any relevance to the price formation process.

By way of example: Group entity A (an investment firm) purchases some bonds from its client. Such bonds are then immediately sold, on a back-to-back (i.e. same price, same quantity) basis, to group entity B because group entity B is where the group's risk in respect of the relevant product is housed. ISDA considers that the trade between group entity A and its client is the only trade which should be made public in this instance, on the basis that it is this trade which is important to the price formation process, rather than the second trade which is purely undertaken for the purposes of intragroup organisational purposes. Similarly, where group entity A purchases such bonds through a trading venue, rather than directly from a client, and then enters into a back-to back risk transfer transaction in respect of such bonds with Group entity B, only one trade should be disclosed to the market. That trade should, per the discussion above, be made public by the relevant trading venue.

**Q139: Do you agree that securities financing transactions should be exempted from the post-trade transparency regime?**

Yes. ISDA agrees that repos or securities financing transactions should be exempted from the post-trade transparency regime under MiFIR. Transfers under such arrangements are irrelevant for price formation purposes and therefore making public post-trade information about such transfers would not provide the market with valuable information, but would be at the cost of providing unnecessary data and further implementation challenges for investment firms.

**Q140: Do you agree that for the initial application of the new transparency regime the information should be made public within five minutes after the relevant non-equity transaction? Please provide reasons for your answer.**

No. ISDA considers that the information should be made public as close to real time as technically possible (as per the Level 1 text) but in any case, no later than 15 minutes after the relevant non-equity transaction.

ISDA notes that requirements for post-trade transparency information to be made public as close to real time as technically possible (or similar) are seen in other jurisdictions. ISDA considers that 15 minutes is a reasonable timeframe in most cases and aligns with the US requirements. In this respect, ISDA is unaware of substantial differences in technology, market structure or market practice between the EU and the US that could justify a different interpretation of what is meant by as close to real time as (or as soon as) technically possible.

However, in certain scenarios, some of the information required for post-trade transparency disclosure may not be available within this time frame. For example, in the case of block trades, the allocations of trade size may not be available within the 15 minute window for making the post-trade transparency information public. Since firms may only determine which group entity trades are booked against once allocations have been confirmed, certain allocations may fall outside the scope of the MiFIR post-trade transparency regime. Therefore, ISDA would welcome clarification from ESMA on whether firms should delay publication of post-trade transparency information until allocations are available (which would appear to be in line with the Level 1 requirement that post trade reports are submitted as soon as technically possible), or whether firms would still need to publish post-trade information within the 15 minute window. In the

latter case, ISDA considers that there is a risk of over- or under-publication of post trade information.

**Q141: Do you agree with the proposed text or would you propose an alternative option? Please provide reasons for your answer.**

No. We disagree with the proposed text for the following reasons:

*(i) An extended time period of deferral should be permitted for the publication of volume*

We believe that the proposed text conflates the provisions of Article 11(1) of MiFIR, which permit deferred publication of any trade details based on the size or type of transaction, with Article 11(3)(b) of MiFIR which permits, in conjunction with an authorisation of deferred publication, the omission of the volume of an individual transaction during an extended time period of deferral. The proposed text takes a very limited view of what constitutes an "extended" time period of volume omission as permitted by Article 11(3)(b) of MiFIR. The time periods for volume omission proposed by ESMA are too short and, as such, we propose extending these to the degree necessary to ensure that market makers have sufficient time to hedge their positions and protect themselves from the risks they take by providing liquidity to the market.

In particular, it is vital that the size of transactions in illiquid instruments and liquid instruments when traded above the large in scale ("**LIS**") threshold are masked for an extended period of time. For those classes of derivatives which are determined to be liquid, we believe that transactions which are above the LIS threshold should be subject to the same volume omission period as transactions in illiquid derivative classes. This reflects the fact that even "liquid" instruments are only liquid up to a certain size because of the small number of market participants willing and able to take large positions. MiFIR recognises this in the context of assessing the liquidity of derivatives for the trading obligation: Article 32(3) of MiFIR states that a class of derivatives "may only be sufficiently liquid in transactions below a certain size".

Whilst we appreciate that ESMA does not have the power to permit an indefinite masking of size (as per the US CFTC regime) we would urge ESMA to exercise its powers pursuant to Article 11(4)(d) of MiFIR to provide for the masking of trade size for a sufficiently long period of time to ensure that liquidity providers can de-risk effectively. In many illiquid markets it can take several months for liquidity providers to hedge their exposures and, in liquid markets, large trades are often only proxy-hedged initially, then warehoused by liquidity providers for significant periods of time. For example, large trades in a single instrument are often managed on a market maker's book by hedging them with a broad range of other instruments with varying degrees of correlation. Until this position has been reduced, information as to the exact position of a market maker will be extremely detrimental to its ability to work its way out of the position. It can take weeks or months to fully exit such positions. The inability to de-risk before the size of a LIS or illiquid trade is made public will act as a significant deterrent to the provision of liquidity.

For price formation purposes there is little value to general market participants in knowing the exact size of a trade, particularly compared to the adverse consequences to liquidity providers of excessive transparency of trade size. It should be sufficient for the market to know that a large or

illiquid trade has taken place and this can be achieved by including an appropriate "flag" when the other details of the trade are published after the initial, shorter, deferral period.

In addition to ensuring that market-makers and other liquidity providers have sufficient time to hedge their exposures, there are other reasons why an extended time period of deferral is needed in respect of volume. There are circumstances in which the publication of trade size may contribute to market instability. A planned cross-border corporate take-over by one corporation of another corporation is a practical example of this. Such transactions have significant exchange rate risk and it is common for the take-over to be preceded by large foreign exchange forward transactions (sometimes conditional on completion of the transaction) some days or weeks in advance of expected finalisation of the take-over. In the absence of extended volume omission, a very large foreign exchange transaction would be published, which would give rise to rumour and speculation, could result in distortion of other market prices, and could even imply a leakage of material non-public information. The period of volume omission needs to extend at least beyond the typical tenors of these transactions. Similarly, pre-hedging of new bond issues can give rise to activity in interest rate swaps, and large trades being published post-trade without volume omission would give rise to rumour, speculation and ultimately market instability.

*(ii) Proposed deferral periods*

For LIS transactions and transactions in illiquid instruments, we recommend that ESMA adopt an initial deferral period of in line with the table below, after which all details of the trade should be published except size. Following an extended time period of deferral also indicated in the table below, size should be published. This would be consistent with the unmasking of volumes in the TRACE system in the US and would be consistent with the legislative intent behind Article 11(3)(b) of MiFIR, which explicitly permits an extended deferral period for volume. We wish to emphasize that for ISDA, the duration of volume masking is critical. The shorter initial deferral periods that we suggest in the table below assume that ESMA agrees with our proposed longer volume omission periods. If ESMA chooses shorter volume omission periods then it would be important for longer initial deferral periods than outlined in the table below to apply.

Bearing in mind our comment above about the primacy of the volume omission period, with respect to the initial deferral period for illiquid instruments, we believe that the proposed "end of day +1" concept is unsuitable and we propose instead simpler deferral periods as outlined in the table. Many financial markets are open for 24 hours a day and do not have an end-of-day *per se*. An end-of-day concept also has potential to create distortionary effects as market participants try to time transactions to delay their appearance on the tape. Our proposed period has the benefit that transactions will be published on a continuous basis which contributes to the smooth running of the market, as opposed to allowing the publication of many transactions at the same point in the day (end-of-day). As indicated above, the publication of volume should be delayed for an extended time period of deferral (18 months).

With regard to transactions above the size specific to the instrument ("**SSTI**") threshold, we believe that the proposed 60 to 120 minute range proposed for the initial deferral period is unnecessarily complicated. To ensure that the deferral regime is effectively implemented we would propose applying an initial deferral period of 60 minutes, after which all details of the

trade should be published except volume, and an extended time period of deferral of 60 minutes, after which volume should be published.

In terms of investment firms' compliance with their post-trade disclosure obligations under Article 21 of MiFIR, MiFIR requires information about the volume and price of transactions to be made public through an APA. In practice, we understand that firms will report all necessary details of their transactions to an APA, including volume, and that the APA will disclose this information to the public in accordance with any permitted deferral periods. This means that, where an extended time period of deferral is permitted for volume, there is no opportunity for firms to inadvertently fail to update the information disclosed after the end of the initial deferral period with the size of the transaction. This information will already be held with the APA, awaiting publication in accordance with applicable deferral periods.

To ensure that the post-trade deferral regime addresses the concerns outlined above, we would propose the following deferral regime for derivatives:

Size of transaction	Deferral period, (if deferral authorized by Competent Authority)	Details to be published <u>after</u> the deferral period	Details to be published <u>during</u> the deferral period if requested by the Competent Authority
<b>Derivatives assessed as having a Liquid Market</b>			
Size is below the thresholds for the <b>size specific to the instrument</b> and large in scale	None	Publication of all details within 15 minutes	N/A
Size is equal to or above <b>size specific to the instrument</b> but below the <b>large in scale threshold</b>	60 minutes	All details to be published after the deferral period is over	All details to be published as close to real time as technically possible and no later than 15 minutes, <b>except volume, which can be omitted (indicated by a flag) until expiry of the extended time period (60 minutes)</b>
Size is equal to or above <b>large in scale threshold</b>  <i>(recognizing MiFIR Article 32.3 where a class of derivatives is</i>	120 minutes  With 18 months volume omission	All details except volume to be published after the deferral period is over  Actual volume made public after 18	All details to be published as close to real time as technically possible and no later than 15 minutes except volume, which can

<i>only sufficiently liquid in transactions below a certain size)</i>		months	be omitted (indicated by a flag) for 18 months
<b>Derivatives assessed as not having a Liquid Market</b>			
<b>Illiquid instruments</b>	48 hours  With 18 months volume omission	All details except volume to be published after the deferral period is over. Actual size made public after 18 months	All details to be published after 48 hours <b>except volume, which can be omitted (indicated by a flag) for 18 months.</b>

We highlight that inconsistencies between different Competent Authorities in post-trade transparency requirements will result in competitive differences across the EU, and could disincentivise cross-jurisdictional trading. We request that ESMA strive to minimise differences between the requirements of different Competent Authorities to the extent permitted.

**Q142: Do you agree that the intra-day deferral periods should range between 60 minutes and 120 minutes?**

No. For transactions above the SSTI but below the LIS threshold, we recommend an initial deferral period of 60 minutes, after which all details of the trade should be published. We believe that a range is unnecessarily complicated.

**Q143: Do you agree that the maximum deferral period, reserved for the largest transactions, should not exceed end of day or, for transactions executed after 15.00, the opening of the following trading day? If not, could you provide alternative proposals? Please provide reasons for your answer.**

No. For transactions above the LIS threshold, we recommend an initial 120 minute deferral period during which no details are published. After the expiry of the 120 minutes deferral all details except size should be published, and an extended time period of deferral of 18 months, after which size should be published.

**Q144: Do you consider there are reasons for applying different deferral periods to different asset classes, e.g. fixing specific deferral periods for sovereign bonds? Please provide arguments to support your answer.**

Whilst we appreciate that it may be appropriate to apply different deferral periods for bonds, structured finance products, emission allowances and derivatives, we recommend applying the same deferral period to all classes of OTC derivatives. This will make it easier for market participants to understand and comply with the rules. Many market participants will have to contend with multiple transparency regimes (including, for example, the MiFIR regime for equities and third country post-trade transparency regimes). The post-trade transparency regime will only be effective if market participants understand the rules and comply with them. Setting

different deferral periods for different classes of OTC derivatives will add unnecessary complexity. We would urge ESMA to focus instead on setting suitable deferral periods based on the liquidity and/or size of the transaction.

**Q145: Do you support the proposal that the deferral for non-equity instruments which do not have a liquid market should be until the end of day + 1? Please provide reasons for your answer.**

No. For transactions in illiquid OTC derivatives classes, we recommend an initial 48 hour deferral period, after which all details except size should be published, and an extended time period of deferral of 18 months, after which size should be published. We think that the initial deferral period should be set at 48 hours rather than "end of day + 1" because many markets remain open 24 hours a day and no "end of day" is identifiable.

**Q146: Do you think that one universal deferral period is appropriate for all non-equity instruments which do not have a liquid market or that the deferrals should be set at a more granular level, depending on asset class and even sub asset class. Please provide reasons for your answer.**

We recommend that a universal deferral period should be adopted for all OTC derivative classes which do not have a liquid market.

**Q147: Do you agree with the proposal that during the deferred period for non-equity instruments which do not have a liquid market, the volume of the transaction should be omitted but all the other details of individual transactions must be published? Please provide reasons for your answer.**

No. For transactions in illiquid OTC derivatives classes, we recommend an initial 48 hour deferral period, after which all details except size should be published, and an extended time period of deferral of 18 months, after which size should be published.

**Q150: In your view, could those transactions determined by other factors than the valuation of the instrument be authorised for deferred publication to the end of day? Please provide reasons for your answer.**

### **Technical trades**

We recommend that ESMA specify the types of transaction that should not be subject to the post-trade transparency obligations. There are a number of transactions, such as new trades resulting from compressions and give-ups and intra-affiliate trades purely for risk management, that should not be subject to the post-trade transparency obligations as they do not represent a true picture of the buying and selling interests in a market.

### **Package Transactions**

ESMA should give due consideration to the post-trade transparency obligations for instruments traded as part of a Package Transaction. By Package transaction, we mean: (i) two or more

components that are priced as a package with simultaneous execution of all components; and (ii) the execution of each component is contingent on the execution of the other components.

Our recommendation is that where a component transaction of the package benefits from a deferral, the entire package should benefit from the same period of deferral. Because the package is priced as a whole, the pricing of individual components may not be comparable to the pricing of comparable instruments in the market when traded on a stand-alone basis, and therefore we expect it to be of benefit to market participants for the whole package to be made public at the same time. This would also be consistent with our recommended treatment of packages for pre-trade transparency (a Package Transaction should not be subject to the pre-trade transparency obligations where at least one component transaction benefits from a waiver) and for the derivatives trading obligation (a Package Transaction should not be subject to the trading obligation unless all component transactions are mandated for clearing and deemed sufficiently liquid).

### **Section 3.9 - The transparency regime of non-equity large in scale orders and transactions**

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#### **Q151: Do you agree with the proposed option? Which option would be more suitable for the calibration of the large in scale requirements within an asset class?**

We support ESMA's proposal to adopt a COFIA approach for OTC derivatives and recommend that a granular approach is taken to segmenting this category. The segmentation should be of such granularity that each class consists of financial instruments with a homogenous liquidity pattern. This would mean that it is unnecessary to segment the classes further into different liquidity bands. Based on our support for the COFIA approach, we agree that Option 2 is the most appropriate option for setting the LIS threshold for derivative contracts.

#### **Q152: Do you consider there are reasons for opting for different options for different asset classes? Please provide arguments.**

We support the COFIA approach for OTC derivatives, for the reasons set out by ESMA in the DP. We recognise, however, that there may be good reasons to adopt an IBIA approach for other financial instruments in the non-equity category and, therefore it may be suitable to have a COFIA approach for some asset classes and an IBIA approach for others. For the same reasons, it should be possible for Option 1 to be adopted in respect of one asset class, where this is the most suitable approach taking into consideration the characteristics of that asset class, and Option 2 for other asset classes.

#### **Q153: Do you agree that the choice between the two options should be consistent with the approach adopted for the assessment of liquidity? If not, please provide arguments.**

Yes. Option 2 appears most viable where COFIA is used for the assessment of liquidity. We consider that either option could be made workable where the IBIA is used.

**Q154: Do you agree with the proposed approach? If no, which indicator would you consider more appropriate for the determination of large in scale thresholds for orders and transactions?**

No. Whilst we agree with ESMA's suggestion that the measurement of size for the LIS threshold should be consistent with the measurement of size for the purposes of the liquidity definition, we consider that AVT is the most appropriate calculation method for both.

**Q155: Do you agree that the proxy used for the determining the large in scale thresholds should be the same as the one used to assess the average size of transactions in the context of the definition of liquid markets? Please provide arguments.**

Whilst we agree that the proxy used for determining the LIS threshold should be the same as the one used to assess the average size of transactions in the context of the definition of liquid markets, we would recommend that AVT be used as the proxy in both cases.

**Q156: In your view, which option would be more suitable for the determination of the large in scale thresholds? Please provide arguments.**

Option 1 would be the most suitable measure for the determination of the LIS threshold. However, we would recommend that Option 1 is measured by the use of quartiles or the median, rather than the mean which can be skewed by outlier transactions.

**Q157: Alternatively which method would you suggest for setting the large in scale thresholds?**

Not applicable. We support Option 1.

**Q158: In your view, should large in scale thresholds for orders differ from the large in scale thresholds for transactions? If yes, which thresholds should be higher: pre-trade or post-trade? Please provide reasons to support your answer.**

Yes. They should differ. Pre-trade thresholds should be lower because that is the only way to protect initiators of transactions yet to occur.

### **Application of LIS to Package Transactions**

ESMA should give due consideration to the pre-trade transparency requirements for instruments traded as part of a Package Transaction.

We recommend that where one or more component transactions of the package benefit from a waiver, the entire package should benefit from the waiver.

Simultaneous execution of a package with a single counterparty using a single execution method alleviates the timing and mechanical risks and lowers bid/offer costs. Exposing one component transaction to pre-trade transparency requirements will jeopardise the ability of market participants to execute the entire package (primarily because exposure of an order in one transaction gives rise to the possibility of another party unrelated to the intended package trading

that component transaction). Inability to execute packages will result in significantly increased costs and risks to market participants. These costs and risks arise primarily from three sources:

- a) separately trading the components of a Package Transaction incurs the possibility of the market moving between executions of each component because such executions cannot be precisely time-matched;
- b) there are likely to be differences in contract specifications, mode of execution, clearing/settlement workflows and relative liquidity when components of a Package Transaction are executed separately and/or on different venues; and
- c) accessing different sources of liquidity for the various components when traded across different venues or over-the-counter incurs additional bid/offer spreads.

Therefore it is imperative that the entire transaction benefit from a waiver from pre-trade transparency in order that the entire package can be agreed between participants away from a venue (with any relevant legs being registered to a venue if required, as would be the case with any components that are ETDs or derivatives subject to the derivative trading obligation). This would also be consistent with our recommended treatment of packages for post-trade transparency (a Package Transaction should benefit from a post-trade deferral where at least one component benefits from a deferral) and for the derivatives trading obligation (a Package Transactions should not be subject to the trading obligation unless all component transactions are mandated for clearing and deemed sufficiently liquid).

**Q159: Do you agree that the large in scale thresholds should be computed only on the basis of transactions carried out on trading venues following the implementation of MiFID II? Please, provide reasons for the answer.**

The introduction by MiFID II of the OTF will, in practice, mean that more non-equity trading will be brought onto trading venues. This will have the result that trading data taken from trading venues (RMs, MTFs and OTFs) will be suitably representative of the level of trading in the non-equities market.

Prior to the introduction of the OTF, trading will continue to occur both OTC and on a range of trading venues which are not currently regulated as MTFs or OTFs. We understand that ESMA proposes to use OTC data to calculate the LIS threshold. In this regard, we would like to highlight the risk that the inclusion of OTC data pre-MiFID II could skew the dataset as such trades will not necessarily be representative of "liquid" or "traded on a venue". Additionally, we query how practicable the collection of this data will be given that there is no uniform mechanism to collect such data under the existing MiFID I rules.

As an alternative to using pre-MiFID II OTC data, ESMA should look at transactions conducted on existing trading venues as most of these venues will likely need to become MTFs or OTFs after the implementation of MiFID II. Thus, the trading which currently takes place on these venues will be more representative of the MiFID II trading venue data than OTC data.

**Q160: Do you think that the condition for deferred publication of large in scale transactions currently applying to shares (transaction is between an investment firm that deals on own account and a client of the investment firm) is applicable to non-equity instruments? Please provide reasons for your answer.**

No. Non-equity markets function very differently to equities markets and, as such, elements from the equity transparency regime should not be introduced into the transparency regime for non-equities simply because such element is present in the equities regime. There needs to be strong justification, based on the characteristics of the non-equity markets, to limit the applicability of the large in scale waiver.

In particular, we would note that the argument traditionally put forward to support this condition in the equity context (and put forward by ESMA in the DP) is not reflective of certain non-equity products. For example, parties to a derivative contract are not usually regarded as clients of each other. However, the liquidity concerns which the deferral regime is intended to address are nevertheless present in the derivative market and warrant the availability of the LIS regime regardless of who the parties to the transaction are.

We would recommend permitting deferred publication of LIS transactions without imposing the condition that the transaction is between an investment firm that deals on own account and a client of the investment firm. We would recommend that this aspect of the transparency regime be subject to an automatic review two years after the implementation of MiFID II through which ESMA can evaluate two years worth of post-trade data to see whether the absence of this condition has led to any detrimental effects on transparency in the non-equities markets.

**Q161: Do you agree that the large in scale regime should be reviewed no earlier than two years after application of MiFIR in practice?**

We are broadly supportive of a two year review period. However, we would recommend the inclusion of a mechanism to ensure that a review can be conducted earlier if it is clear that the transparency regime, or certain parts of it, is not working as envisaged. For example, wording could be added along the lines of the following: "unless there is widespread and systematic use of the temporary suspensions mechanism suggesting that the thresholds should be reviewed" or "ESMA can instigate a review at any time should market conditions dictate, in the interests of supporting the liquidity and workability of European markets'.

### **Section 3.10 - Size specific to the instrument**

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**Q162: Do you agree with the above description of the applicability of the size specific to the instrument? If not please provide reasons for your answer.**

We agree with the description of the applicability of the SSTI.

**Q163: Do you agree with the proposal that the size specific to the instrument should be set as a percentage of the large in scale size? Please provide reasons for you answer.**

No. The SSTI threshold could be set as a percentage of the LIS threshold, but to do so feels like a significant derogation of the requirements of Article 9(3)(d) of MiFIR which requires that ESMA set the level of the SSTI threshold so that it reflects the ability of a liquidity provider to hedge their risks and the average trade size for retail investors. Once these required considerations are taken account of, if the SSTI percentage were expressed as a percentage of the LIS threshold we would expect it to be a low single digit percentage.

**Q164: In your view, what methodologies would be most appropriate for measuring the undue risk in order to set the size specific threshold?**

We would suggest that ESMA consider both the size at which a systematic internaliser needs to adjust its prices, as it may be held to this price by other clients, and the size to which a large transaction would need to be split down in order to hedge without incurring undue cost. In our view, these factors are intrinsically linked and ESMA should have regard to both factors.

We would urge ESMA to ensure that any methodology chosen to measure undue risk retains sufficient flexibility to reflect the fact that measuring undue risk is a very difficult task which is heavily sensitive to current market conditions.

**Q165: Would you suggest any other practical ways in which ESMA could take into account whether, at such sizes, liquidity providers would be able to hedge their risks?**

No.

**Q166: Do you agree with ESMA's description of how the size specific to the instrument waiver would interact with the large in scale waiver? Please provide reasons for your answer.**

No. We believe that the LIS waiver will still be necessary, even where a waiver may be available on a "size specific to the instrument" basis. This is because a waiver granted for RFQ and Voice Systems above the size specific to the instrument under Art 9.1(b) MiFIR is only a partial waiver (that is, these venues will still be required under Art 8(4) MiFIR to publish indicative pre trade bid and offers even when they have been granted such a waiver). In contrast, there is no such requirement to publish indicative pre trade bid and offers when the LIS waiver has been granted so we disagree with ESMA's statement in paragraph 13 of Section 3.10 DP that "in practice, the

large in scale waiver will not be necessary where a waiver has been granted at the size specific to the instrument threshold.”

**Q167: Do you agree with ESMA’s description of how the size specific to the instrument deferrals would interact with the large in scale deferrals? In particular, do you agree that the deferral periods for the size specific to the instrument and the large in scale should differ and have any specific proposals on how the deferral periods should be calibrated? Please provide reasons for your answer.**

The deferral periods for the LIS deferral and the SSTI deferral should be different (with the LIS deferral period being longer than the SSTI deferral period).

*(i) An extended time period of deferral should be permitted for the publication of volume*

We believe that the proposed text conflates the provisions of Article 11(1) of MiFIR, which permit deferred publication of any trade details based on the size or type of transaction, with Article 11(3)(b) of MiFIR which permits, in conjunction with an authorisation of deferred publication, the omission of the volume of an individual transaction during an extended time period of deferral. The proposed text takes a very limited view of what constitutes an "extended" time period of volume omission as permitted by Article 11(3)(b) of MiFIR. The time periods for volume omission proposed by ESMA are too short and, as such, we propose extending these to the degree necessary to ensure that market makers have sufficient time to hedge their positions and protect themselves from the risks they take by providing liquidity to the market.

In particular, it is vital that the size of transactions in illiquid instruments and liquid instruments when traded above the large in scale ("**LIS**") threshold are masked for an extended period of time. For those classes of derivatives which are determined to be liquid, we believe that transactions which are above the LIS threshold should be subject to the same volume omission period as transactions in illiquid derivative classes. This reflects the fact that even "liquid" instruments are only liquid up to a certain size because of the small number of market participants willing and able to take large positions. MiFIR recognises this in the context of assessing the liquidity of derivatives for the trading obligation: Article 32(3) of MiFIR states that a class of derivatives "may only be sufficiently liquid in transactions below a certain size".

Whilst we appreciate that ESMA does not have the power to permit an indefinite masking of size (as per the US CFTC regime) we would urge ESMA to exercise its powers pursuant to Article 11(4)(d) of MiFIR to provide for the masking of trade size for a sufficiently long period of time to ensure that liquidity providers can de-risk effectively. In many illiquid markets it can take several months for liquidity providers to hedge their exposures and, in liquid markets, large trades are often only proxy-hedged initially, then warehoused by liquidity providers for significant periods of time. For example, large trades in a single instrument are often managed on a market maker's book by hedging them with a broad range of other instruments with varying degrees of correlation. Until this position has been reduced, information as to the exact position of a market maker will be extremely detrimental to its ability to work its way out of the position. It can take weeks or months to fully exit such positions. The inability to de-risk before the size of a LIS or illiquid trade is made public will act as a significant deterrent to the provision of liquidity.

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

In addition to ensuring that market-makers and other liquidity providers have sufficient time to hedge their exposures, there are other reasons why an extended time period of deferral is needed in respect of volume. There are circumstances in which the publication of trade size may contribute to market instability. A planned cross-border corporate take-over by one corporation of another corporation is a practical example of this. Such transactions have significant exchange rate risk and it is common for the take-over to be preceded by large foreign exchange forward transactions (sometimes conditional on completion of the transaction) some days or weeks in advance of expected finalisation of the take-over. In the absence of extended volume omission, a very large foreign exchange transaction would be published, which would give rise to rumour and speculation, could result in distortion of other market prices, and could even imply a leakage of material non-public information. The period of volume omission needs to extend at least beyond the typical tenors of these transactions. Similarly, pre-hedging of new bond issues can give rise to activity in interest rate swaps, and large trades being published post-trade without volume omission would give rise to rumour, speculation and ultimately market instability.

*(ii) Proposed deferral periods*

For LIS transactions and transactions in illiquid instruments, we recommend that ESMA adopt an initial deferral period of in line with the table below, after which all details of the trade should be published except size. Following an extended time period of deferral also indicated in the table below, size should be published. This would be consistent with the unmasking of volumes in the TRACE system in the US and would be consistent with the legislative intent behind Article 11(3)(b) of MiFIR, which explicitly permits an extended deferral period for volume. We wish to emphasize that for ISDA, the duration of volume masking is critical. The shorter initial deferral periods that we suggest in the table below assume that ESMA agrees with our proposed longer volume omission periods. If ESMA chooses shorter volume omission periods then it would be important for longer initial deferral periods than outlined in the table below to apply.

Bearing in mind our comment above about the primacy of the volume omission period, with respect to the initial deferral period for illiquid instruments, we believe that the proposed "end of day +1" concept is unsuitable and we propose instead simpler deferral periods as outlined in the table. Many financial markets are open for 24 hours a day and do not have an end-of-day *per se*. An end-of-day concept also has potential to create distortionary effects as market participants try to time transactions to delay their appearance on the tape. Our proposed period has the benefit that transactions will be published on a continuous basis which contributes to the smooth running of the market, as opposed to allowing the publication of many transactions at the same point in the day (end-of-day). As indicated above, the publication of volume should be delayed for an extended time period of deferral (18 months).

With regard to transactions above the size specific to the instrument ("**SSTI**") threshold, we believe that the proposed 60 to 120 minute range proposed for the initial deferral period is unnecessarily complicated. To ensure that the deferral regime is effectively implemented we would propose applying an initial deferral period of 60 minutes, after which all details of the trade should be published except volume, and an extended time period of deferral of 60 minutes, after which volume should be published.

In terms of investment firms' compliance with their post-trade disclosure obligations under Article 21 of MiFIR, MiFIR requires information about the volume and price of transactions to be made public through an APA. In practice, we understand that firms will report all necessary details of their transactions to an APA, including volume, and that the APA will disclose this information to the public in accordance with any permitted deferral periods. This means that, where an extended time period of deferral is permitted for volume, there is no opportunity for firms to inadvertently fail to update the information disclosed after the end of the initial deferral period with the size of the transaction. This information will already be held with the APA, awaiting publication in accordance with applicable deferral periods.

To ensure that the post-trade deferral regime addresses the concerns outlined above, we would propose the following deferral regime for derivatives:

Size of transaction	Deferral period, (if deferral authorized by Competent Authority)	Details to be published <u>after</u> the deferral period	Details to be published <u>during</u> the deferral period if requested by the Competent Authority
<b>Derivatives assessed as having a Liquid Market</b>			
Size is below the thresholds for the <b>size specific to the instrument</b> and large in scale	None	Publication of all details within 15 minutes	N/A
Size is equal to or above <b>size specific to the instrument</b> but below the <b>large in scale threshold</b>	60 minutes	All details to be published after the deferral period is over	All details to be published as close to real time as technically possible and no later than 15 minutes, <b>except volume, which can be omitted (indicated by a flag) until expiry of the extended time period (60 minutes)</b>

<p>Size is equal to or above <b>large in scale threshold</b></p> <p><i>(recognizing MiFIR Article 32.3 where a class of derivatives is only sufficiently liquid in transactions below a certain size)</i></p>	<p>120 minutes</p> <p>With 18 months volume omission</p>	<p>All details except volume to be published after the deferral period is over</p> <p>Actual volume made public after 18 months</p>	<p>All details to be published as close to real time as technically possible and no later than 15 minutes except volume, which can be omitted (indicated by a flag) for 18 months</p>
<p>Derivatives assessed as <b>not</b> having a <b>Liquid Market</b></p>			
<p><b>Illiquid instruments</b></p>	<p>48 hours</p> <p>With 18 months volume omission</p>	<p>All details except volume to be published after the deferral period is over. Actual size made public after 18 months</p>	<p>All details to be published after 48 hours <b>except volume, which can be omitted (indicated by a flag) for 18 months.</b></p>

We highlight that inconsistencies between different Competent Authorities in post-trade transparency requirements will result in competitive differences across the EU, and could disincentivise cross-jurisdictional trading. We request that ESMA strive to minimise differences between the requirements of different Competent Authorities to the extent permitted.

## Section 3.11 - The Trading Obligation for Derivatives

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### **Q168: Do you agree that there should be consistent categories of derivatives contracts throughout MiFIR/EMIR?**

We generally agree that the categories should be largely consistent and overlap between the categories is to be expected however:

- The precise scope of the EMIR clearing obligation classes is still uncertain and only once those classes are known with certainty (following the clearing obligation consultation) can we properly comment on the extent to which alignment of the MiFIR classes is desirable.
- As ESMA appears to acknowledge, not everything that becomes subject to the clearing obligation will necessarily pass the venue and/or liquidity tests outlined in the DP. We think that the EMIR and MiFIR classes should not be forced into alignment and we expect that there may be contracts that are mandatorily clearable but which do not become subject to the trading obligation, as is the position in the US. In this respect we would refer ESMA to the Federal Reserve Bank of New York report, "An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting" (March 2012), a copy of which is accessible at the link below:

[http://www.newyorkfed.org/research/staff\\_reports/sr557.html](http://www.newyorkfed.org/research/staff_reports/sr557.html)

Whether under EMIR or MiFIR, market certainty requires that class specifications and product lists are sufficiently detailed to enable market participants to know with certainty and without the need for further enquiry: (i) into which class a particular individual transaction belongs; and (ii) whether that class is affected by the relevant obligation (i.e. trading and/or central clearing) or not.

When it comes to the consultation on the RTS, ESMA must pay special attention to Package Transactions.

### **Application of the Derivatives Trading Obligation to Package Transactions**

At a high level, we identify three relevant categories of transactions (a) standalone transactions where the derivative is subject to the Derivatives Trading Obligation (b) Package Transactions comprised entirely of derivatives subject to the Derivatives Trading Obligation (c) Package Transactions comprised of at least one components subject to the Derivatives Trading Obligation and of at least one other component. It should be obvious that category (c) is extremely broad, with an enormous number of conceivable permutations including but not limited to packages consisting of cash equities, cash bonds, Exchange Traded Derivatives, and all other types of OTC derivative (including those subject to mandatory clearing under EMIR, those not subject to mandatory clearing but otherwise generally accepted for clearing at several CCPs, and those not clearable at any CCP).

Simultaneous execution of a Package with a single counterparty using a single execution method alleviates the timing and mechanical risks and lowers bid/offer costs to those of the intended risk of the package. Exposing one component transaction to the Derivatives Trading Obligation will jeopardise the ability of market participants to execute the entire package, particularly where no trading venue offers trading in the intended package (a likely scenario, given the enormous number of conceivable permutations of packages).

Inability to execute packages will result in significantly increased costs and risks to market participants. These costs and risks arise primarily from three sources: (1) separately trading the components of a Packaged Transaction incurs the possibility of the market moving between executions of each component because such executions cannot be precisely time-matched, (2) there are likely to be differences in contract specifications, mode of execution, clearing/settlement workflows and relative liquidity when components of a Packaged Transaction are executed separately and/or on different venues, and (3) accessing different sources of liquidity for the various components when traded across different venues or over-the-counter incurs additional bid/offer spreads.

Therefore, we consider that the trading obligation should only bite where all component transactions in the package are themselves subject to the Derivatives Trading Obligation, categories (a) and (b) highlighted above. However, as an alternative, ESMA could consider a phased implementation of the Derivatives Trading Obligation to category (c), Package Transactions containing component transactions not otherwise subject to the Trading Obligation, relative to the timelines mandated for categories (a) and (b), with the phasing varying by package type and by counterparty type. Given the breadth of category (c), application of the Derivatives Trading Obligation to these types of Package transactions should give due regard to the full and widespread availability of processing of Package Transactions in terms of both the execution of such Packages on venues, and the processing of such packages by central counterparties for clearing, which could require an extremely long phase-in in some cases, and may not be appropriate at all in many cases.

**Q169: Do you agree with this approach to the treatment of third countries?**

We are concerned about the potential for conflicting international rules and encourage ESMA to work with its international peers to ensure a harmonized approach internationally. We agree with ESMA's general approach to third countries, subject to the following:

1. We reiterate the concerns we raised in our response to the ESMA Consultation Paper 2013/892 (i.e. in the context of EU financial counterparty guarantees, the technical standards should only refer to legal arrangements in the form of a guarantee and should not require counterparties to verify the enforceability of such guarantee).
2. We note that, in its discussion paper, ESMA still refers to its consultation paper on draft Regulatory Technical Standards on contracts having a direct, substantial and foreseeable effect within the Union and non-evasion of provisions of EMIR. We believe the discussion paper should refer to the final version of the RTS (Commission Delegated Regulation 285/2014, the "EMIR RTS").

3. We note that the scope proposed in the discussion paper differs from the scope of the EMIR RTS. The EMIR RTS only applies to EU branches of non-EU financial counterparties. By contrast, in the DP, ESMA also refers to non-financial counterparties in 9(ii). We do not believe the proposed RTS under MiFIR should apply more broadly than the EMIR RTS. Given 3.11.9 states that "...the resultant framework should be enforceable, and offer legal certainty for financial counterparties" it may be that this reference to non-financial counterparties is not intentional. However, we would appreciate clarification on this point and would reiterate that in our view the RTS issued under Article 28 of MiFIR (the "**MiFIR RTS**") should align with the EMIR RTS on this issue.
  
4. We note that pursuant to Article 13 of EMIR the Commission can declare the regimes of third countries to be equivalent and thereby exempt the relevant counterparties from the requirements imposed by EMIR (including the clearing obligation). In our view it is not necessary or appropriate for the trading obligation to apply to third country entity to third country entity trades where the clearing obligation under EMIR does not apply to the relevant transactions. 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. We would note that recognising 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.

**Q170: Do you agree with the proposed criteria based anti-avoidance procedure?**

We agree that a criteria based approach as similar as possible to the one adopted in relation to the clearing obligation is appropriate. We welcome the fact that in its final EMIR report on this issue (ESMA 2013/1657) ESMA has had regard to concerns raised by ISDA and BBA that fulfilment of criteria should not automatically lead to a conclusion that an arrangement is deliberately designed to evade. We have similar concerns in the current context; the criteria based assessment must take account of the counterparties' subjective intentions. For example, a group of entities engaged in a series of intra-group transactions for centralized risk management purposes should not be automatically captured by the anti-avoidance framework made pursuant to Article 28 of MiFIR unless competent authorities can demonstrate a deliberate attempt to evade.

**Q171: Do you think it would be reasonable for ESMA to consult venues with regard to which classes of derivatives contracts are traded on venue? Do you think venues would be well placed to undertake this task?**

No. While it would be reasonable for ESMA to consult with venues on technical questions relating to operational feasibility of ESMA's proposals, we are concerned that the overall process should not be 'venue-led' and ESMA should not delegate its responsibility for assessing liquidity and which classes of derivatives are traded on venue. Venues will have a commercial incentive to nominate a large numbers of contracts, many of which would potentially fail the liquidity test

of which ESMA is the ultimate arbiter. Experience in the US has highlighted the weakness and risks of a venue-led approach, including venues proposing derivatives of which they do not even technically support trading.

**Q172: The discussion in section 3.6 on the liquid market for non-equity instruments around ‘average frequency’, ‘average size’, ‘number and type of active market participants’ and average size of spreads is also relevant to this chapter and we would welcome respondent’s views on any differences in how the trading obligation procedure should approach the following:**

i. Whether ‘average frequency’ should be understood to refer to the number of trades over a given time period, the number of days on which trading occurred over that time period or both.

The issues raised by this question have been addressed by our response to Q103.

We also draw ESMA’s attention to the analysis provided in our response to Q116 which demonstrates a viable approach for classification of derivatives and calibrating the liquidity test. We believe that this will also be helpful to ESMA when formulating the enhanced test for the purposes of calibrating the Derivatives Trading Obligation. In particular, we draw ESMA’s attention to one of the caveats given under Q116, specifically the need to distinguish between those swaps with on-market coupons from those traded with an off-market coupon + a fee which factors into the liquidity of trades when considered at a very granular level. For the sake of convenience we have copied our response to Q116 (in full) in response to (ii) below.

ii. The extent to which the given time period will need to vary by asset class.

We would draw ESMA’s attention to the analysis provided in response to Q116 which demonstrates a viable approach for classification of derivatives and calibrating the liquidity test. We believe that this will also be helpful to ESMA when formulating the enhanced test for the purposes of calibrating the Derivatives Trading Obligation. In particular, we draw ESMA’s attention to one of the caveats given under Q116, specifically the need to distinguish between those swaps with on-market coupons from those traded with an off-market coupon + a fee which factors into the liquidity of trades when considered at a very granular level.

iii. Whether the ‘average size’ should be based on the notional and the number of trades in the given period, the notional and the number of trading days, or some other measure.

The issues raised by this question have been addressed by our response to Q104.

iv. The most appropriate data for calculating ‘spreads’.

The issues raised by this question have been addressed by our responses to Q106 to Q109.

**Q173: Do you have a view on how ESMA should approach data gathering about a product's life cycle, and how a dynamic calibration across that life cycle might work? How frequently should ESMA revisit its assumptions? What factors might lead the reduction of the liquidity of a contract currently traded on venue? Are you able to share with ESMA any analysis related to product lifecycles?**

Assessing and re-assessing the liquidity of a derivative (particularly OTC derivatives such as credit and rates) poses challenges for ESMA which are different from those faced in assessing the liquidity of fixed income instruments that have a naturally decaying liquidity as the instrument approaches maturity.

Derivatives are different from bonds. Moreover, all derivatives are different from one another and their prices and overall market liquidity will be affected by a variety of different factors. For example, the liquidity of certain derivatives in agricultural commodities may fluctuate according to the seasons. Liquidity in credit derivative markets is sensitive to sovereign shocks while similar political and macro-economic factors (monetary and fiscal policy moves of governments) will affect liquidity of rates products.

Accuracy pleads in favour of constant recalibration to reflect constantly changing liquidity. This is clearly not practicable however and efficiency demands periodic reassessment of liquidity. For rates and credit derivatives we think that this should occur every six months. The appropriate interval for other types of derivative (notably commodities) may vary.

We share ESMA's concerns (elaborated at paragraph 28 of the DP) and within the scope of powers given to it, ESMA should seek to design a framework that minimizes or eliminates the risk of liquidity recalibration leading to de facto bans on trading instruments no longer capable of being traded on venue due to a lack of liquidity.

**Q174: Do you have any suggestions on how ESMA should consider the anticipated effects of the trading obligation on end users and on future market behaviour?**

Pursuant to Article 32 of MIFIR ESMA must consider the effect of imposing the trading obligation on an instrument already traded on a venue and which would otherwise satisfy the liquidity requirement. Evidence from other markets (in particular US SEFSs trading instruments which have been declared "made available to trade" ("MAT")) has shown that liquidity in a normally liquid instrument can be materially reduced simply by virtue of the imposition of a trading obligation (either on a short term basis, with the result that liquidity returns eventually to its pre-trading levels or on a long-term basis, resulting in a permanent reduction of liquidity). It will therefore be imperative to fully assess the anticipated effects of imposing a trading obligation. In this regard we would stress the need for ESMA to seek views of end-users and relevant trade bodies representing end-users.

We would therefore encourage ESMA to conduct a detailed study of the effect the obligation to trade certain derivatives (those subject to the MAT rule) on SEFs had on the relevant class of derivatives.

ISDA's research suggests that the imposition of the MAT rule has led to substantial market fragmentation. The research notes are accessible at the link below:

<http://www2.isda.org/functional-areas/research/research-notes/>



Fragmentation study  
FINAL.pdf

We also suggest that following a determination that a class or sub-class is subject to the trading obligation, ESMA should regularly monitor (perhaps on a three months basis) the impact on end users and market behaviour.

**Q175: Do you have any other comments on our overall approach?**

### **Importance of size in determination of applicable thresholds**

We strongly support proposals from ESMA to take into account the co-legislators' desire to set thresholds based on size for certain products when determining the sub-set of derivatives which are to be subject to the trading obligation. This would ensure alignment with the US regime and is a factor which must be considered pursuant to Article 32(3)(a) of MIFIR though such a commitment is currently missing from the Discussion Paper.

### **Application of exemptions to clearing obligation to third country entities**

We note that Article 28(2) of MIFIR extends the trading obligation to transactions entered into 'with third-country financial institutions ("FIs") or other third country entities that would be subject to the clearing obligation if they were established in the Union'. Regrettably, the language used in MIFIR deviates from the language of the corresponding application provision in EMIR. Article 4(1)(a)(iv) of EMIR extends the clearing obligation to transactions:

"between a [FC] and a[n NFC+] and an entity established in a third country that would be subject to the clearing obligation if it was established in the Union"

Under EMIR it is clear that (i) transactions with third country entities (either FIs or otherwise) are only caught if the third country entity would be subject to clearing obligation if it was established in the Union and (ii) intra-group transactions are therefore exempt provided they meet the conditions specified in Article 4(2) of EMIR. By contrast it is unclear whether Article 28(2) applies to third country FIs whether or not they would be subject to the clearing obligation if they were established in the Union and therefore calls into question whether the group exemption can be relied in connection with third country FIs under Article 28(2).

In our view it would be counterintuitive and harmful to the proper functioning of the markets if the trading obligation applied in respect of transactions with third country FIs which would not be subject to the clearing obligation if it was established in the Union. Therefore, in the interests of clarity, we would be grateful if ESMA could confirm that it agrees that the underlined

qualifier in Article 28(2) of MIFIR applies to both third country FIs and other third country entities and therefore aligns with Article 4(1)(a)(iv) of EMIR.

### **Clarification regarding scope of the Trading Obligation**

In addition we would be grateful if ESMA could confirm, for the avoidance of doubt, the trading obligation will not apply to:

1. **Systemic risk mitigation services:** processes such as ‘trade compression’ (eg. as operated by providers such as Trioptima) are advocated for OTC derivatives under EMIR and are viewed as important systemic risk mitigation techniques. Accordingly, any ‘new’ transactions in liquid instruments which result from such processes should not additionally be subject to the ‘on venue’ trading obligation requirement as they do not entail price formation. Also, we expect that integrating such processes into the trading venue execution infrastructure would present operational hurdles which would limit the efficacy and performance of those processes.
2. **OTC Clearing services:** for reasons similar to above, ‘new’ transactions in liquid instruments arising between counterparties as a result of the operation of OTC clearing should not additionally be subject to an ‘on venue’ trading obligation requirement.

### **International harmonization and end-user input**

We wish to re-emphasise the importance of avoiding internationally conflicting standards and engaging and consulting with end-users.

### **Section 3.13 - Article 22, MiFIR: Providing information for the purposes of transparency and other calculations**

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#### **Q178: Do you have any comments on the content of requests as outlined above?**

We note that:

1. ESMA will have a difficult task in collecting accurate and appropriate data for the purposes of calculating the SI threshold and the various pre/post-trade transparency waiver thresholds.
2. It is therefore critically important that ESMA is clear about what transactions should contribute to the calculations of such thresholds, and ensures that the data it receives from trading venues / APAs / CTPs only reflects such transactions.
3. We have expressed our opinions elsewhere in our response to ESMA’s papers as to what categories of trade should not contribute to the relevant threshold calculations.

4. We emphasise that the following transactions, which are not price-forming/are "technical" in nature, should not be included in the relevant calculations for the SI thresholds: (i) inter-affiliate trades undertaken purely for risk management purposes, (ii) give-ins/give-ups, (iii) trades arising out risk mitigation/trade compression (Trioptima), (iv) settlements under a repo agreement, (v) OTC clearing flows, and (v) post-trade allocations of transactions amongst multiple beneficial owners where the collection of transactions was originally transacted as a block trade.
5. To the extent that such transactions are in fact mandated to be trade reported (although we do not consider that they should be), guidance is given that all such trades should be populated with a "Technical" trade flag, so as to allow ESMA to differentiate between the different types of transactions being reported and therefore use.

We emphasise that ESMA should give careful thought to how it intends to collect data from all appropriate sources, such that the information it collects is accurate and pertains to the entire market (and not just a sub-set which would skew the results). For example, in order to calculate whether a firm is an SI, the firm needs to know the total amount of trading in a particular instrument in the EU, which means ESMA needs to have a way to collate this information correctly and from all the EU venues.

## Section 7.2 - Position Limits

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**Q491: Do you agree with ESMA’s proposal to link the definition of a risk-reducing trade under MiFID II to the definition applicable under EMIR? If you do not agree, what alternative definition do you believe is appropriate?**

Regarding OTC contracts, we agree that hedges excluded from the position limits regime should remain consistent with hedges excluded from the clearing threshold under EMIR and, therefore, agree that the definition of risk reducing trade under MiFID II should be the same as under EMIR, i.e. article 10(3) of EMIR and article 10 of the EMIR regulatory technical standards (EU N° 149/2013).

We also think that, since position limits is a tool for maintaining orderly markets, the exemption should also cover trades on exchange and not just OTC. We note that the primary purpose of EMIR is risk mitigation and central clearing of OTC derivatives and that for this reason on-venue contracts are not covered. MiFID aims to apply to both on-venue and OTFC contracts.

**Q492: Do you agree with ESMA’s proposed definition of a non-financial entity? If you do not agree, what alternative definition do you believe is appropriate?**

We agree that the definition of non-financial entity (NFE) under the MiFID II position limits regime should be aligned with the definition of non-financial counterparty (NFC) under article 2(9) of EMIR, which excludes entities which must obtain licence under existing European financial services legislation as set out in the definition of ‘financial counterparty’ under article 2(8) of EMIR (i.e. investment firms, credit institutions, insurance companies, UCITS and their asset management companies, AIFs and their management companies, pension funds).

However, we note with concern ESMA's proposal in paragraph 14 that MiFID II would use the existing comparable definition within EMIR of non-financial counterparty. The definition of NFE does not currently appear to consider application to third country entities. A third country credit institution with no presence in the EU will not be required to seek authorisation under the Banking Directive, and so under the current definition would qualify as a NFE. For the purpose of alignment with the EMIR NFC concept, the definition should be amended to cover entities established in the EU which are not required to seek authorisation under the relevant directives, and entities established outside the EU which would not have been required to seek authorization if they had been established in the EU.

We also note that if the definitions of economically equivalent OTC contracts and of netting are not sufficiently broad, an entity that may be required to be licensed under MiFID II (and which therefore would no longer be an NFE) will not be able to rely on the hedging exemption to the position limits regime and that this prohibition will materially limit its ability to manage the risks associated with its commercial activities effectively.

**Q493: Should the regime for subsidiaries of a person other than entities that are wholly owned look to aggregate on the basis of a discrete percentage threshold or on a more subjective basis? What are the advantages and risks of either approach? Do you agree with the proposal that where the positions of an entity that is subject to substantial control by a person are aggregated, they are included in their entirety?**

In principle, we agree that the notion of control should be the basis of the proposed regime for aggregation of group positions and support the view that provided controlled undertakings can demonstrate through objective criteria that they operate independently from their parent company, they should be able to disaggregate.

On disaggregation, we particularly agree with the statement of ESMA that aggregation with fellow subsidiaries of a mutual parent or ultimate holding company should not be required.

We also call for the development of other exemptions from aggregation for: (1) certain limited partners, shareholders or other commodity pool participants; (2) accounts held by investment firms, brokers, and similar market intermediaries; (3) accounts carried by an independent account controller; (4) positions held in connection with underwriting activity or a broker-dealer acquired in the normal course of business; and (5) information sharing where prohibited by law or regulation.

In the draft RTS dated 20 March 2014 under the revised Transparency Directive (2013/50/EU amending 2004/109/EC) - for the purpose of shareholdings calculation notably through derivatives - ESMA proposes that the parent undertaking of an entity wishing to benefit from the exemption in relation to holdings sets a list of the effectively controlled entities with their competent authorities and a statement that these controlled entities do not receive any direct or indirect instructions from the parent undertaking in the exercise of the voting rights. In addition, we understand that the exemption applies to non-EU groups and non-EU controlled undertakings where it can be demonstrated that the relevant undertaking's market making and trading activities as well as its asset management activities meet the independence criteria on an on-going basis as set out in the draft RTS under the Transparency Directive.

Although the purpose of the Transparency Directive is different from the MiFID position limits regime (exercise of voting rights versus positions on commodities), we believe that the definitions of the aggregation of positions at a group level should be aligned. We however do not support that any ownership percentage between 50% and 100% automatically involves aggregation of positions between the parent undertaking and the subsidiary without any consideration to independence in investment strategies or trading businesses.

**Q494: Should the regime apply to the positions held by unconnected persons where they are acting together with a common purpose (for example, “concert party” arrangements where different market participants collude to act for common purpose)?**

In principle, we support rules aiming at tracking 'concert parties'.

We note that the Level 1 text sets out in article 57(12) of MiFID II that ESMA is required to draft RTS only in respect of limited circumstances. Specifically with respect to aggregation, it is required to draft "*the methods to determine when positions of a person are to be aggregated within a group*".

As this notion of ‘concert parties’ is not referenced in article 57(12), ESMA may not be able to introduce level 2 measures on this point. In any case, if ESMA was to introduce such rules, we would support alignment with principles that were enforced under the legislative texts that already use this concept. We also believe that "*the circumstances where it is appropriate to aggregate positions even for unconnected persons where they are tied together in a common purpose*" (page 409 of the Discussion paper, Paragraph 20) must be proved by the competent authority in charge of enforcing the position limits regime.

**Q495: Do you agree with the approach to link the definition of economically equivalent OTC contract, for the purpose of position limits, with the definitions used in other parts of MiFID II? If you do not agree, what alternative definition do you believe is appropriate?**

Position limits apply to commodity derivatives contracts covered by the MiFID II definition of financial instruments (as stated in article 57 as well as recitals 127, 130 and 131).

However to accurately reflect the net risk-exposure of market participants, underlying physical positions, including non-derivative contracts, should be taken into account.

With this in mind, we highlight the following points:

- ESMA should set a list of EU listed contracts subject to the limits in order to bring legal certainty to the scope of the position limits regime.
- It is essential that written contracts from different location should have the same notion of equivalence to ensure that the commodity risk exposures are accurately reflected. Since position limits will apply to net positions, netting must be allowed also between underlying physical (non-derivative) contracts and the on-venue contract subject to the position limits.
- ESMA should not impose an artificial restriction on the ability to net cash-settled and physically-settled non-derivative contracts if the contracts are economically equivalent. The level 1 text accurately sets that the economic equivalence is in the heart of the calculation of a position and not a legal equivalence. The purpose of level 1, clearly stated in article 57.1 (a), is to ‘prevent market abuse’ and ‘support orderly pricing and settlement conditions’. These objectives go with a definition of netting that reflects the reality of these global markets.
- The industry strongly supports a mechanism that is sufficiently broad and legally clear (i.e. measurable). In this respect we believe that the first approach is not sufficiently broad because the criteria are cumulative. We also think that the implementation in the European Union of the second approach would need to be tailored to meet a much broad pool of contracts rather than the list of 28 contracts but potentially to all on-venue

contracts. But we believe that the second approach offers a more practicable set of equivalence criteria by setting out the specific types of contracts which could be considered to be equivalent and that this type of approach would facilitate implementation. We suggest that ESMA considers defining qualitative criteria (which may be the same for certain commodities) per asset class, i.e. a) Oil, b) Gas and power, c) Metals, d) Agriculture.

- We note with concern that ESMA's comments in the discussion paper indicate that it intends to interpret economically equivalent OTC contracts as meaning only MiFID financial instruments. In order to ensure a workable netting regime, market participants should be allowed to net against the underlying physical positions, including contracts that are not commodity derivatives (e.g., certain REMIT instruments and other physical contracts, e.g. coal and oil, or spot contracts). This greater pooling of positions and the provision of netting to allow bona fide hedges to be offset against physically settled transactions would therefore facilitate the accurate presentation of commodity risk levels.
- In addition, a wider definition along the lines noted above is consistent with how the market hedges physical transactions which generally do not qualify as MiFID financial instruments (for example, (i) physically delivered metal forwards and options not traded on an MTF, not being for commercial purposes or having characteristics of other derivative financial instruments are hedged with LME futures; (ii) wholesale energy products subject to the REMIT carve out are hedged with power futures on European power exchanges; and (iii) OTC physically settled Loco London good delivery gold can be hedged with COMEX (non-EU venue) futures).
- Also, we encourage ESMA to consider the need for "proxy hedging" when considering economically equivalent OTC contracts. Proxy hedging occurs when a risk related to a particular product is managed by hedging with a different product. For example, a participant may choose to hedge jet fuel exposure with ICE Europe Gas Oil Futures Contracts, since this ICE futures contract is both a key price determinant in European jet fuel markets and a highly liquid risk management tool. For the market to function as efficiently as possible and for all participants to have the ability to continue to offer, and benefit from, price risk management services, the position limit regime should allow for netting between proxy hedging contracts as economically equivalent contracts.

We recognise that there are challenges in defining proxy hedging contracts and in this regard refer ESMA to the CME Group rules and guidance on Exchange for Related Position (EFRP) transactions. EFRP's are used by market participants to establish, move or liquidate exchange positions by executing the exchange product versus an OTC contract. There are several types of EFRPs, including an Exchange of Futures for Physical (EFP), which is defined as, "*the simultaneous execution of an Exchange futures contract and a corresponding physical transaction or a forward contract on a physical transaction.*" In determining what may qualify for the physical component of the EFP the CME Group provides the following in its guidance (see link provided):

*"The related position component of the EFRP must involve the product underlying the Exchange contract or a by-product, related product or OTC derivative instrument that is reasonably correlated to the corresponding Exchange instrument.*

*The related position component of an EFRP may not be a futures contract or an option on a futures contract.*

*Where the risk characteristics and/or maturities of the related position differ from the instrument underlying the Exchange contract, the parties to the EFRP may be required to demonstrate the correlation between the products and the methodology used in equating the futures to the related position. In all cases, the related position transaction must be comparable with respect to quantity, value or risk exposure of the corresponding Exchange contract."*

<http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/files/RA1311-5.pdf>

The CME Group rules and guidance highlight both the need for proxy hedging capabilities and a general level of accepted market practice. ESMA requests suggested amendments to the second approach to determining economically equivalent OTC contracts (see Q497). We suggest that the CME Group rules and guidance on EFP transactions could be considered as the basis of an additional proxy hedging criterion for economically equivalent OTC contracts under the second approach.

**Q496: Do you agree that even where a contract is, or may be, cash-settled it is appropriate to base its equivalence on the substitutability of the underlying physical commodity that it is referenced to? If you do not agree, what alternative measures of equivalence could be used?**

We generally agree that it would be appropriate to base equivalence on the substitutability of the underlying commodity for such contracts. This is consistent with the legislative text in MiFID II which calls for a determination of economic equivalence. We emphasise that there must be genuine *economic* substitutability, i.e. fungibility, between cash-settled and physical-delivery contracts. Netting across cash-settled and physical delivery contracts is critical as segregating cash settled and physically delivered contracts could fragment the market and could push liquidity towards fewer markets.

**Q497: Do you believe that the definition of “economically equivalent” that is used by the CFTC is appropriate for the purpose of defining the contracts that are not traded on a trading venue for the position limits regime of MiFID II? Give reasons to support your views as well as any suggested amendments or additions to this definition.**

See our response to question 495.

**"Position limits apply to commodity derivatives contracts covered by the MiFID II definition of financial instruments (as stated in article 57 as well as recitals 127, 130 and 131).**

**However to accurately reflect the net risk-exposure of market participants, underlying physical positions, including non-derivative contracts, should be taken into account.**

**With this in mind, we highlight the following points:**

- ESMA should set a list of EU listed contracts subject to the limits in order to bring legal certainty to the scope of the position limits regime.
- It is essential that written contracts from different location should have the same notion of equivalence to ensure that the commodity risk exposures are accurately reflected. Since position limits will apply to net positions, netting must be allowed also between underlying physical (non-derivative) contracts and the on-venue contract subject to the position limits.
- ESMA should not impose an artificial restriction on the ability to net cash-settled and physically-settled non-derivative contracts if the contracts are economically equivalent. The level 1 text accurately sets that the economic equivalence is in the heart of the calculation of a position and not a legal equivalence. The purpose of level 1, clearly stated in article 57.1 (a), is to ‘prevent market abuse’ and ‘support orderly pricing and settlement conditions’. These objectives go with a definition of netting that reflects the reality of these global markets.
- The industry strongly supports a mechanism that is sufficiently broad and legally clear (i.e. measurable). In this respect we believe that the first approach is not sufficiently broad because the criteria are cumulative. We also think that the implementation in the European Union of the second approach would need to be tailored to meet a much broad pool of contracts rather than the list of 28 contracts but potentially to all on-venue contracts. But we believe that the second approach offers a more practicable set of equivalence criteria by setting out the specific types of contracts which could be considered to be equivalent and that this type of approach would facilitate implementation. We suggest that ESMA considers defining qualitative criteria (which may be the same for certain commodities) per asset class, i.e. a) Oil, b) Gas and power, c) Metals, d) Agriculture.
- We note from ESMA’s comments in the discussion paper that it intends to interpret economically equivalent OTC contracts as meaning only MiFID financial instruments. In order to ensure a workable netting regime, market participants should be allowed to net against the underlying physical positions, including contracts that are not commodity derivatives (e.g., certain REMIT instruments and other physical contracts, e.g. coal and oil, or spot contracts). This greater pooling of positions and the provision of netting to allow bona fide hedges to be offset against physically settled transactions would therefore facilitate the accurate presentation of commodity risk levels.
- In addition, a wider definition along the lines noted above is consistent with how the market hedges physical transactions which generally do not qualify as MiFID financial

instruments (for example, (i) physically delivered metal forwards and options not traded on an MTF, not being for commercial purposes or having characteristics of other derivative financial instruments are hedged with LME futures; (ii) wholesale energy products subject to the REMIT carve out are hedged with power futures on European power exchanges; and (iii) OTC physically settled Loco London good delivery gold can be hedged with COMEX (non-EU venue) futures).

- Also, we encourage ESMA to consider the need for "proxy hedging" when considering economically equivalent OTC contracts. Proxy hedging occurs when a risk related to a particular product is managed by hedging with a different product. For example, a participant may choose to hedge jet fuel exposure with ICE Europe Gas Oil Futures Contracts, since this ICE futures contract is both a key price determinant in European jet fuel markets and a highly liquid risk management tool. For the market to function as efficiently as possible and for all participants to have the ability to continue to offer, and benefit from, price risk management services, the position limit regime should allow for netting between proxy hedging contracts as economically equivalent contracts.

We recognise that there are challenges in defining proxy hedging contracts and in this regard refer ESMA to the CME Group rules and guidance on Exchange for Related Position (EFRP) transactions. EFRP's are used by market participants to establish, move or liquidate exchange positions by executing the exchange product versus an OTC contract. There are several types of EFRPs, including an Exchange of Futures for Physical (EFP), which is defined as, "*the simultaneous execution of an Exchange futures contract and a corresponding physical transaction or a forward contract on a physical transaction.*" In determining what may qualify for the physical component of the EFP the CME Group provides the following in its guidance (see link provided):

*"The related position component of the EFRP must involve the product underlying the Exchange contract or a by-product, related product or OTC derivative instrument that is reasonably correlated to the corresponding Exchange instrument.*

*The related position component of an EFRP may not be a futures contract or an option on a futures contract.*

*Where the risk characteristics and/or maturities of the related position differ from the instrument underlying the Exchange contract, the parties to the EFRP may be required to demonstrate the correlation between the products and the methodology used in equating the futures to the related position. In all cases, the related position transaction must be comparable with respect to quantity, value or risk exposure of the corresponding Exchange contract."*

<http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/files/RA1311-5.pdf>

The CME Group rules and guidance highlight both the need for proxy hedging capabilities and a general level of accepted market practice. ESMA requests suggested amendments to the second approach to determining economically equivalent OTC

contracts (see Q497). We suggest that the CME Group rules and guidance on EFP transactions could be considered as the basis of an additional proxy hedging criterion for economically equivalent OTC contracts under the second approach.

In addition, we would like to highlight that the CME Group rules and guidance highlight both the need for proxy hedging capabilities and a general level of accepted market practice. In response to ESMA's request for amendments to the second approach to determining economically equivalent OTC contracts, we suggest that the CME Group rules and guidance on EFP transactions could be considered as the basis of an additional proxy hedging criterion for economically equivalent OTC contracts under the second approach.

We generally support this second approach as it is aligned more closely to the idea that limits should apply to the commodity risk levels and the economics of the underlying positions. It is also consistent with CFTC rules which will facilitate implementation for the many market participants that operate on both the EU and the US. We believe that the CFTC definition is appropriate for contracts that are not traded on a trading venue for the position limits regime of MiFID II, subject to ESMA recognising a wide definition of economically equivalent as highlighted in our response to question 495. Alignment of the two definitions would ensure global regulatory consistency in a global market. The definitions provide a logical sub-set of contracts to ensure that the resulting application of position limits would meet the European Parliament and Council's aims of preventing market abuse and supporting orderly pricing. A consistent approach across jurisdictions also greatly reduces the complexity of systems and controls required by global firms subject to both the CFTC and EU regimes.

We also reiterate that if ESMA's intention is to limit the definition of economically equivalent OTC contracts to MiFID II financial instruments, it is not clear whether broad netting (to accurately reflect commodity risk levels) can be achieved.

**Q498: What arrangements could be put in place to support competent authorities identifying what OTC contracts are considered to be economically equivalent to listed contracts traded on a trading venue? ?**

Once the definition of economically equivalent OTC contracts is set with sufficient width and certainty, then the implementation and supervision will be much easier. We therefore believe that the response to this question largely depends upon the definition of economically equivalent OTC contracts. We also believe that CCPs and trading venues will be essential in conveying the necessary data for determining economically equivalent positions to listed contracts. Competent authorities may consider publishing examples of what they consider to be economically equivalent OTC contracts by commodity asset class as this would facilitate consistent interpretation and implementation (based on qualitative criteria par asset class). The lists would not be exhaustive but would aim to provide guidance.

**Q499: Do you agree with ESMA’s proposal that the “same” derivative contract occurs where an identical contract is listed independently on two or more different trading venues? What other alternative definitions of “same” could be applied to commodity derivatives?**

The intention of article 57(6) of MiFID II is to apply a single position limit across multiple trading venues where "the same" contract is traded. However, as a practical matter, we question if ESMA will be able to monitor and to resolve disputes with respect to position limits, in respect of trading venues located outside the EU. The example used in paragraph 35, page 412, of the discussion paper, is of the KOSPI 200 contract traded on Eurex and the Korea Exchange, is helpful however we do not see how the German regulator could impose its own position limits on the South Korean trading venue where there is no such regime.

We agree that the 'same' derivative contract is a subset of economically equivalent contract and that in addition to the criteria for recognising economically equivalent contracts, other elements have to be taken into account such as the settlement process.

We also strongly believe that the concept of ‘same contract’ is to be used only for the purpose of article 57(6) and shall not be used for the purpose of netting and calculation of net positions aggregated at a group level)

**Q500: Do you agree with ESMA’s proposals on aggregation and netting? How should ESMA address the practical obstacles to including within the assessment positions entered into OTC or on third country venues? Should ESMA adopt a model for pooling related contracts and should this extend to closely correlated contracts? How should equivalent contracts be converted into a similar metric to the exchange traded contract they are deemed equivalent to?**

On aggregation of contracts (for aggregation at a group level, please see our response to question 493), we agree that same contracts and OTC economically equivalent contracts should be included within the calculation. When facilitating client trades where there is limited liquidity in the specific underlying contract, Investment Firms use hedging strategies across many geographies, markets, products and time horizons to manage their residual risk. The regime should allow for this approach.

On netting, we consider that the calculation of a market participant's position should be with respect to its net position on a portfolio basis for identical or correlated commodities (e.g. gasoil / oil, power / emissions) across different commodity markets and on third country venues (if considered significant for EU markets for example, COMEX or WTI) in order to accurately represent commodity risk levels.

Naturally, we would caution against any extra-territorial application of EU position limits to contracts on third country venues; this would not be supported by the level 1 text and, practically speaking, if implemented could lead to conflicting rules and requirements applying to the same position.

With respect to cross-commodity hedges, we recommend that ESMA reviews and takes into account the CFTC rules for cross-commodity hedges including quantitative (i.e. setting of correlation limits) and qualitative (i.e. commercial relationship between target commodity and commodity underlying the derivative contract) factors. We note, however, that ESMA should not impose a rigid quantitative test for determining what constitutes a permissible cross-commodity hedge e.g. a specific correlation requirement. While this may seem an attractive policy option it has major limitations due to the fact that many commodity markets do not have liquid exchange-traded derivatives that can be used as a hedge. In such cases, market participants must hedge their risk using related derivatives products even though these hedges are not perfect i.e. ICE's Brent Contract is used to hedge a significant number of energy commodities. A qualitative test that is based on specific facts and circumstances and defers to the reasonable judgment of market participants is most appropriate.

**Q501: Do you agree with ESMA's approach to defining market size for physically settled contracts? Is it appropriate for cash settled contracts to set position limits without taking into account the underlying physical market?**

Deliverable supply is the right metric for physically settled spot month contracts. For cash settled spot-month contracts, we believe that the metric should be the open interest.

We also believe that although they are expressed as percentage of open interest, limits on cash-settled spot month contracts should be as aligned as possible with limits applied to physically-settled spot month contracts.

In relation to the use of open interests for limits on physical and cash settled non-spot month contracts, as the MiFID II regime applies to a broader range of commodity derivatives than just futures and will include economically equivalent OTC contracts, it will be necessary to adjust the open interests (given is a futures related metric) to add the notional volumes of swaps relating to the relevant on-venue contract. It is also the case that certain commodities may not have a related futures contract and competent authorities will need to estimate the open interests based on notional amounts of swaps.

We also call ESMA to provide further detail on how they intend to determine the overall market size for securities contracts with a commodity underlying.

We highlight that there are significant implementation issues that need to be considered further. In particular: (i) the definition of deliverable supply/open interest and (ii) ensuring that the deliverable supply/open interest is based on reliable, accurate and current information. For example:

*For ICE Europe Brent crude oil futures contract "...is a deliverable contract based on EFP delivery with an option to cash settle against the ICE Brent Index price for the last trading day of the futures contract. The Exchange shall publish a cash settlement price (the ICE Brent Index price) on the next trading day following the last trading day for the contract month"*

This ICE Europe futures example highlights the difficulty in determining deliverable supply for a particular contract as effectively any crude oil can form the basis of an EFP transaction for the purposes of settling the ICE Europe Brent crude oil futures contract. This example also highlights the difficulty in sourcing reliable, accurate and current data to determine deliverable supply.

Also, the difference between commodities means some 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).

We note, even though question 501 does not address this issue, that in this section the discussion paper addresses the notification and approval of exemptions (paragraph 43, page 413). It is very unclear how such mechanism should work in practice without being burdensome and potentially disruptive of markets and hedging conditions. For the sake of effective and smooth implementation and supervision, we strongly support a notification process that works on the basis of assumption that the exemption is approved until and unless is explicitly rejected. In other words: market participants shall notify the competent authority before breaching the position limit; the notification should be based on a web service; the exemptions shall be considered as accepted by until and unless is explicitly rejected. Upon rejection, the market participant is required to reduce its positions in a reasonable timeframe. This solution would allow markets to continue to hedge their commercial exposure whilst mitigating the burden and potentially adverse consequences of the approval procedure.

**Q502: Do you agree that it is preferable to set the position limit on a contract for a fixed (excluding exceptional circumstances) period rather than amending it on a real-time basis? What period do you believe is appropriate, considering in particular the factors of market evolution and operational efficiency?**

We agree that amending the position limit on a real-time basis is not only unnecessarily but unfeasible and that setting it for a fixed (excluding exceptional circumstances) period is preferable. With regard to the period itself, we propose that position limits on a contract are fixed for an initial period of two years and with annual reviews thereafter with amendments to the limits only where necessary.

We also believe that spot month limits generally should not be determined at the time a contract month becomes the spot month. Determining a position limit for the spot month contract on the first day that such contract is available for trade is impractical as it would require notice of a limit to be provided when that contract has already commenced trading (open interest calculations are usually published after trading has begun each day) and when parties may already be holding positions that are in breach of that new position limit. Requiring parties to trade out of positions to comply with the new position limits may lead to artificial volatility and a disorderly market.

For instance, the LME have daily Prompt date contracts and thus have daily settlements. The LME already impose a pseudo position limit when the contract is coming up to prompt (settlement) in that it has a rule that stipulates that if the accumulated net long positions of a

particular participant or member, two days before settlement, exceeds 50% of LME warranted stock, the long position holder(s) has to reduce the positions to below 50% of LME stock at a pre-determined set premium (price). It is possible to have a forward position that adds up to more than 100% of LME warranted stock. It is then up to the position holder to manage his positions over the two day period before settlement to ensure it is holding less than 50% of LME stock. LME stock figures are published each day at 09:00 UK time. We believe this is the method enshrined in the LME Lending Guidance rules that LME has been operating since 1998 is an effective tool in ensuring orderly markets and in effect imposes a pseudo position limit on LME contracts that are physically settled on the exchange. An explanation of the Lending Guidance can be found here:

[http://www.lme.com/~media/Files/Notices/2011/2011\\_10/11\\_293\\_A286\\_R008\\_Explanation\\_of\\_Metal\\_Lending\\_Guidance.pdf](http://www.lme.com/~media/Files/Notices/2011/2011_10/11_293_A286_R008_Explanation_of_Metal_Lending_Guidance.pdf)

The implementation of a position limits regime will significantly affect the functioning of the commodity markets and for this reason an initial two year period is necessary to ensure that orderly trading conditions are maintained during the transition.

The measure of the deliverable supply for a period of time is challenging and ESMA and national regulators should rely on data gathered by exchanges and on existing database aiming to ensure transparency in physical markets. A one-size fits all approach such as the "three months expiry cycle" as proposed by ESMA may not fit the fundamentals of certain commodity markets.

We also highlight that data used for the purpose of defining the deliverable supply period per commodity type should span over a period of a minimum of three years and should have a granular view on a monthly basis. When calculating the deliverable supply period per commodity type, different factors must be included, among which, a basic taxonomy (i.e.: storable versus non-storable), weather, supply chain optimization level, demand and offer curve, geographical location-distance, seasonality, growth, and market concentration, as well as the trading cycles per each commodity market. As there would be differences across commodities and that some factors are outside of the control of either of the parties to the physically-settled contract, a +/- margin should be added to the averaged/estimated delivery supply period. This +/- margin could be set at no less than 15% of the overall delivery supply period.

**Q503: Once the position limits regime is implemented, what period do you feel is appropriate to give sufficient notice to persons of the subsequent adjustment of position limits?**

It may depend on the underlying commodity and on the liquidity of the affected physical and financial markets.

The period must be sufficient to ensure that the adjustment does not disrupt the market. Many commodity derivatives markets are by nature illiquid. If the period is too short, then the sudden adjustment that a major market participant might need to make could create stressed conditions in the concerned market.

We support that the notice/ adjustment period should be at least half the time of the fixed period however if grandfathering is allowed then a 3 to 6 month adjustment period should be manageable.

**Q504: Should positions based on contracts entered into before the revision of position limits be grandfathered and if so how?**

Yes, we strongly support grandfathering of contracts entered into before the revision of position limits. The immediate application of new stringent rules can adversely impact illiquid markets. Many commodity derivatives markets are illiquid by nature and the immediate application of limits to existing contracts may increase the disruption of the markets and create the conditions for higher volatility and price spikes which is exactly what the position limits regime aims to prevent or mitigate.

We also believe that staged compliance could be implemented following revision of position limits to ensure that market disruption is minimised.

**Q505: Do you agree with ESMA's proposals for the determination of a central or primary trading venue for the purpose of establishing position limits in the same derivative contracts? If you do not agree, what practical alternative method should be used?**

Yes. We agree that the application of the rule should be limited to the same commodity derivatives contract that is traded on two or more trading venues within the EU.

We agree with the method proposed by ESMA to assess whether the contract is traded in significant volumes in another jurisdiction. We also agree that the measure of the largest volume of trading shall be based on the largest volume of open interests measured in the number of lots of the relevant contracts.

Lastly, we reiterate that the concept of 'same contract' is to be used only for the purpose of article 57(6) and shall not be used for the purpose of netting and calculation of net positions aggregated at a group level.

**Q506: Should the level of "significant volume" be set at a different level to that proposed above? If yes, please explain what level should be applied, and how it may be determined on an ongoing basis?**

No. We agree with the approach proposed by ESMA. We obviously recognise that the revision of the measure of the 'significant volume' should be subject to the same principles as the revision of the position limits itself.

See our response to question 502:

We agree that amending the position limit on a real-time basis is not only unnecessarily but unfeasible and that setting it for a fixed (excluding exceptional circumstances) period is preferable. With regard to the period itself, we propose that position limits on a contract are fixed

for an initial period of two years and with annual reviews thereafter with amendments to the limits only where necessary.

We also believe that spot month limits generally should not be determined at the time a contract month becomes the spot month. Determining a position limit for the spot month contract on the first day that such contract is available for trade is impractical as it would require notice of a limit to be provided when that contract has already commenced trading (open interest calculations are usually published after trading has begun each day) and when parties may already be holding positions that are in breach of that new position limit. Requiring parties to trade out of positions to comply with the new position limits may lead to artificial volatility and a disorderly market.

For instance, the LME have daily Prompt date contracts and thus have daily settlements. The LME already impose a pseudo position limit when the contract is coming up to prompt (settlement) in that it has a rule that stipulates that if the accumulated net long positions of a particular participant or member, two days before settlement, exceeds 50% of LME warranted stock, the long position holder(s) has to reduce the positions to below 50% of LME stock at a pre-determined set premium (price). It is possible to have a forward position that adds up to more than 100% of LME warranted stock. It is then up to the position holder to manage his positions over the two day period before settlement to ensure it is holding less than 50% of LME stock. LME stock figures are published each day at 09:00 UK time. We believe this is the method enshrined in the LME Lending Guidance rules that LME has been operating since 1998 is an effective tool in ensuring orderly markets and in effect imposes a pseudo position limit on LME contracts that are physically settled on the exchange. An explanation of the Lending Guidance can be found here: [http://www.lme.com/~media/Files/Notices/2011/2011\\_10/11\\_293\\_A286\\_R008\\_Explanation\\_of\\_Metal\\_Lending\\_Guidance.pdf](http://www.lme.com/~media/Files/Notices/2011/2011_10/11_293_A286_R008_Explanation_of_Metal_Lending_Guidance.pdf)

The implementation of a position limits regime will significantly affect the functioning of the commodity markets and for this reason an initial two year period is necessary to ensure that orderly trading conditions are maintained during the transition.

The measure of the deliverable supply for a period of time is challenging and ESMA and national regulators should rely on data gathered by exchanges and on existing database aiming to ensure transparency in physical markets. A one-size fits all approach such as the "three months expiry cycle" as proposed by ESMA may not fit the fundamentals of certain commodity markets.

We also highlight that data used for the purpose of defining the deliverable supply period per commodity type should span over a period of a minimum of three years and should have a granular view on a monthly basis. When calculating the deliverable supply period per commodity type, different factors must be included, among which, a basic taxonomy (i.e.: storable versus non-storable), weather, supply chain optimization level, demand and offer curve, geographical location-distance, seasonality, growth, and market concentration, as well as the trading cycles per each commodity market. As there would be differences across commodities and that some factors are outside of the control of either of the parties to the physically-settled

contract, a +/- margin should be added to the averaged/estimated delivery supply period. This +/- margin could be set at no less than 15% of the overall delivery supply period.

**Q507: In using the maturity of commodity contracts as a factor, do you agree that competent authorities apply the methodology in a different way for the spot month and for the aggregate of all other months along the curve?**

We fully agree that competent authorities apply the methodology in a different way for the spot month and to all other months along the curve, considered in aggregate. We highlight that not all commodity markets follow the same vanilla date structure. For instance, the LME does not have a spot month, e.g. for the Primary Aluminium contract there exists daily prompt dates out to 3 months, weekly: 3 out to 6 months and then Monthly : 7 out to 123 months. (The 3rd Wednesday being the monthly prompt).

Therefore we believe that ESMA should clarify how to interpret the definition of spot month when taking into account markets with daily prompts.

**Q508: What factors do you believe should be applied to reflect the differences in the nature of trading activity between the spot month and the forward months?**

Financial markets are structured to achieve price convergence between physical and financial commodity markets, and for futures markets to act as effective risk hedging venues for physical commodities. Settlement prices typically converge with physical market prices at expiry.

'Spot' or 'delivery' month limits restrict how many contracts a participant can hold in the period during which delivery of the physical commodity is to be made. This is where dominant market positions can have the most acute effect.

For instance, LME key metal contracts have daily prompt dates and daily settlement. Copper and Aluminium contracts go out to 10 years. A squeeze can only happen near the time of settlement when LME warrants have to be sourced in order to prepare for delivery. Further out the curve for contracts that are for further forward prompt dates have little impact on settlement and position limits are less relevant.

Further down the curve however, position limits may be less effective given reduced liquidity for long-dated contracts. If a market participant holds a large position further 'down the curve' markets have sufficient time to react. Therefore, in our view the main focus of the position limit regime should be on the spot month and to the extent that limits needs to be applied to other months they should sufficient to allow the normal functioning of the market and not unnecessarily restrict liquidity.

We also believe that it is important to take account of contract design and related specifications in addition to deliverable supply. Market distortions do not simply arise due to the size of the position built by a market participant in a particular commodity but also can arise due to the manner in which a contract is designed.

In certain cases, using deliverable supply alone as the single determining factor when setting a position limit for a commodity is insufficient as it is also necessary to take into account specific characteristics of that commodity, for example, logistical constraints i.e. ease with which the commodity can be delivered or extracted given contract delivery points.

**Q509: Do you agree with ESMA’s proposal for trading venues to provide data on the deliverable supply underlying their contracts? If you do not agree, what considerations should be given to determining the deliverable supply for a contract?**

Yes, we fully agree that in the first instance the competent authority of the jurisdiction where a trading venue is located should obtain and use the data on deliverable supply that is maintained by that trading venue.

However, we consider that the competent authority should adjust the level of the deliverable supply as stated by the trading venue in order to reflect some other factors such as industry research or governmental statistics where it is difficult to get an accurate measure of the supply or for global markets. Also, for gas and power markets where system operators exist, the ENTSOs should be considered, either directly or through the intermediation of trading venues.

Further where a contract is a key benchmark and is used as a proxy hedge for other commodities e.g. ICE Gasoil contract is used to hedge jet derivatives, then the position limit regime should reflect this wider market.

This is because the exchange’s view of deliverable supply will be focused on the specifics of its contract, whereas the MiFID position limit regime covers a wider universe.

We also fully support the G20 initiatives aiming to enhance the transparency in physical commodity markets (production and storage) though we highlight that on some commodities (precious metals and rare earths for instance) such a transparency does not yet exist, primarily because of the reluctance of some countries in a dominant position to publish relevant data on a regular basis.

**Q510: In the light of the fact that some commodity markets are truly global, do you consider that open interest in similar or identical contracts in non-EEA jurisdictions should be taken into account? If so, how do you propose doing this, given that data from some trading venues may not be available on the same basis or in the same timeframe as that from other trading venues?**

Yes, we believe that a harmonised regime globally for key economically-linked contracts both exchange traded and OTC is critically needed where the fundamentals of the underlying commodity markets are global. It would be a grave concern if a global commodity such as, for instance, gold, which is traded on different markets, to have different position limits depending on whether it falls within the CFTC regulation or the EU MiFID regime.

Coordination between relevant EU and non-EU competent authorities having access to regional or national trade repositories is essential to measure the overall size of the relevant commodity derivatives markets. In other words, open interest in similar or identical contracts in non-EU

jurisdictions should be taken into account. Imposing limits that do not reflect the global nature of commodity markets would cause substantial fragmentation and would be detrimental to beneficial risk management activities.

**Q511: In the absence of published or easily obtained information on volatility in derivative and physical commodity markets, in what ways should ESMA reflect this factor in its methodology? Are there any alternative measures that may be obtained by ESMA for use in the methodology?**

We in general believe that volatility is not a relevant criterion for the purpose of the calculation methodology of limits and we do not clearly see at this time how ESMA proposes to incorporate volatility into position limit calculations.

Volatility is natural to markets and reflects the market adjusting to new information. If regulators believe that the effect is driven by some sort of abuse they have sufficient powers under MAR to take action. We do not believe that position limits prevent volatility. There is evidence that in some cases limits may even lead to increased volatility if they are inappropriately calibrated.

The presence of volatility in a market generally leads participants to seek risk management solutions and any restriction on participants' ability to do so through the use of position limits may prohibit participants from effectively managing their risks. Further, where limits are revised down at short notice in response to increasing volatility, this may further exacerbate volatility as participants are forced to close down positions to meet the new limits. Historically, regulated markets have used margin methodologies to manage volatility. Parties unable to maintain positions in volatile markets may have to reduce positions due to margin call, but there is no artificial constraint in their ability to participate.

We therefore request ESMA to undertake a further review of the impact of volatility before including any volatility based adjustment factor in the position limit methodology.

At the very least ESMA should clarify whether volatility in this particular context is intended to refer to price volatility or to the amount of the commodity available in the market.

We agree that the absence of accurate data on all physical markets makes it difficult to measure volatility of these markets. Given that volatility usually results from a lack of liquidity, we believe that position limits should be set high enough to take into account volatility of the physical markets and the consequences that volatility has on trading volumes e.g. fewer new market participants the higher the volatility.

**Q512: Are there any other considerations related to the number and size of market participants that ESMA should consider in its methodology?**

We agree with ESMA's views on the size and number of market participants and do not see any other consideration. We also support ESMA's statement on page 419, paragraph 77 of the discussion paper: "*Concentration of positions in a market will particularly be a factor in national gas and power markets, which may need to set limits to reflect the existence of 'national champions', depending on the extent of fragmentation of former state-owned incumbents and the*

*terms of any market maker schemes operated by venues as necessary for proper market operation. This is accommodated in the use of separate factors for different asset classes, which can reflect the individual market structures".*

We also 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.

**Q513: Are there any other considerations related to the characteristics of the underlying commodity market that ESMA should consider in its methodology?**

We agree with ESMA's views 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. 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.

**Q514: For new contracts, what approach should ESMA take in establishing a regime that facilitates continued market evolution within the framework of Article 57?**

Firstly, we recognise there will be difficulty in determining position limits for new contracts. We therefore encourage ESMA to consider mechanisms to ensure that the limits do not damage 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, so approach 1.

We also think that, instead of position limits, ESMA should consider relying on the position management powers available to national regulators and trading venues. 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 hedgers 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.

**Q515: The interpretation of the factors in the paragraphs above will be significant in applying ESMA's methodology; do you agree with ESMA's interpretation? If you do not agree with ESMA's interpretation, what aspects require amendment?**

We broadly agree with ESMA's views on the various factors that should be taken into account in the calculation methodology. We however reiterate that volatility is probably not a relevant tool for this purpose.

**Q516: Are there any other factors which should be included in the methodology for determining position limits? If so, state in which way (with reference to the proposed methodology explained below) they should be incorporated.**

Where a liquid benchmark contract is used as a proxy or a generic hedge for a range of contracts, the position limits should be set at a level to allow this bona fide hedging activity to continue.

**Q517: What do you consider to be the risks and/or the advantages of applying a different methodology for determining position limits for prompt reference contracts compared to the methodology used for the position limit on forward maturities?**

We strongly believe that different methodologies should be applied for determining position limits for prompt reference contracts compared to position limits on forward maturities.

In terms of forward maturities an alternative methodology to imposing position limits is to instead require market participants to disclose their position upon coming within a certain range and then to explain the reason for having that position to the relevant NCA. This promotes greater transparency for the market and regulators while not artificially restricting liquidity in contracts that are not subject to logistical constraints associated with the delivery period (expiration).

We also note that the CFTC's proposed position limits regime differentiate spot and forward maturities as follows: Spot month limit levels are set at 25% of estimated deliverable supply (separately for physical-delivery and cash-settled Reference Contracts) determined by the exchange that lists the Core Referenced Futures Contract, unless CFTC chooses to rely on its own estimate – and may not be greater than 25% of such supply but not less than 1,000 lots for agricultural commodities and not less than 5,000 lots for energy / metal commodities. Each month (i.e. single month) and all-months-combined limits, which are set at the same level, are based on largest average annual open interest in Reference Contracts in the preceding two years (10% of open interest for first 25,000 contracts and 2.5% thereafter).

**Q518: How should the position limits regime reflect the specific risks present in the run up to contract expiry?**

The position limits regime could introduce "telescoping" limits to avoid market disruption. This would involve stating limits in the immediate period prior to contract expiry.

**Q519: If a different methodology is set for the prompt reference contract, would it be appropriate to make an exception where a contract other than the prompt is the key benchmark used by the market?**

We do not think that instances where a contract month other than prompt is primarily used as the "key benchmark contract" should cause particular problems. The key risk being addressed by limits is abusive squeezes occurring as the contract approaches expiry; spot month limits will

ultimately apply to all contract maturities as they approach expiry, regardless of whether some months are more traded than others; ESMA is also anticipating applying back month limits, which would govern all contract maturities outside of the spot month, which could apply to the "key benchmark contract" when spot month limits are not currently in effect.

**Q520: Do you agree that the baseline for the methodology of setting a position limit should be the deliverable supply? What concrete examples of issues do you foresee in obtaining or using the measure?**

As stated in our response to question 501:

Deliverable supply is the right metric for physically settled spot month contracts. For cash settled spot-month contracts, we believe that the metric should be the open interest.

We also believe that although they are expressed as percentage of open interest, limits on cash-settled spot month contracts should be as aligned as possible with limits applied to physically-settled spot month contracts.

In relation to the use of open interests for limits on physical and cash settled non-spot month contracts, as the MiFID II regime applies to a broader range of commodity derivatives than just futures and will include economically equivalent OTC contracts, it will be necessary to adjust the open interests (given is a futures related metric) to add the notional volumes of swaps relating to the relevant on-venue contract. It is also the case that certain commodities may not have a related futures contract and competent authorities will need to estimate the open interests based on notional amounts of swaps.

We also call ESMA to provide further detail on how they intend to determine the overall market size for securities contracts with a commodity underlying.

**Q521: If you consider that a more appropriate measure exists to form the baseline of the methodology, please explain the measure and why it is more appropriate. Consideration should be given to the reliability and availability of such a measure in order to provide certainty to market participants.**

In determining its methodology for the setting of position limits for physically delivered contracts ESMA should consider not only the defining of deliverable supply, but equally importantly the capacity for determination of deliverable supply.

Whether a trading venue or other related body is identified as the responsible calculation party, the ability for any one body to determine deliverable supply is limited by the scope of information available. For example, for medium to long term supply calculations, industry and government sponsored organisations (such as the International Energy Agency or, for oil, the OPEC reports) may have well established processes for determining structural supply and demand data, but for shorter term calculations it would most likely be the market participants that would be the key data providers for deliverable supply calculation.

In recommending a trading venue be responsible for determination of deliverable supply it is critical to provide a framework that enables the venue to access all relevant data and participants. In considering a more suitable calculation agent ESMA must consider the same availability and transparency of data. In support of the trading venue being the calculation agent, the availability of trading data across that particular venue may enable it to direct its focus to those participants most active in the relevant product most immediately and more effectively.

It should be noted by ESMA that commodity markets can exhibit very rapid changes in supply and demand balances given the global nature of those markets (where product may move in and out of region frequently given supply/demand/pricing arbitrage, and production volumes in some commodities can change very rapidly). As a result the deliverable supply, particularly where a defined set of criteria is used to determine that supply, can change dramatically and very rapidly. Shorter term supply calculations could, and would likely, exhibit a level of volatility that can disrupt the efficient functioning of the market if this short term supply volatility is manifested in rapidly changing position limits based on deliverable supply.

**Q522: Do you agree with this approach for the proposed methodology? If you do not agree, what alternative methodology do you propose, considering the full scope of the requirements of Article 57 MiFID II?**

We support the expression of the limits as percentage of open interests (for cash-settled contracts and non-spot month physically-settled contracts,) or deliverable supply (for physically settled spot month contracts). We note that open interest will need to be adjusted to take into account the notional value of swaps given open interest for the relevant contract will be applied to OTC equivalents.

**Q523: Do you have any views on the level at which the baseline (if relevant, for each different asset class) should be set, and the size of the adjustment numbers for each separate factor that ESMA must consider in the methodology defined by Article 57 MiFID II?**

We think that position limits should be sufficiently high until the regulators are able to assess the data. Downwards adjustments may be made afterwards.

Also, we foresee significant issues with adjusting and absolute baseline figures on the basis of deliverable supply, volatility and number and size of market participants. In addition we do not understand the basis for ESMA's maximum adjustment calibration of 15% of the baseline figure nor is it clear how this will be applied i.e. if the total limit 25% $\pm$ 15% how will this be applied to the spot and other months?

**Q524: Does the approach to asset classes have the right level of granularity to take into account market characteristics? Are the key characteristics the right ones to take into account? Are the conclusions by asset class appropriate?**

The characteristics for each class outlined by ESMA relate to the relevant exchange contract not necessarily the OTC and physical markets and these differences will need to be recognised when applying a limit e.g. a monthly OTC metals contract to a daily LME regime. However, in

general we think the granularity of the taxonomy is acceptable e.g. oil and oil products class should allow for the hedging of oil products without exchange contracts via ICE's Brent Contact.

**Q525: What trading venues or jurisdictions should ESMA take into consideration in defining its position limits methodology? What particular aspects of these experiences should be included within ESMA's work?**

We believe that all venues should be taken into account. We think that in addition to consulting with the relevant trading venues, ESMA should continue working closely with the CFTC on harmonising their approaches.

The key consideration in defining the EU position limits methodology is harmonisation. We also strongly believe that alignment of position limits regimes will improve results and provide a powerful data set for regulators to develop accurate and more useful tools to achieve their objectives. Inconsistencies across regimes will make systems harder to build and implement across global trading businesses.

**Q526: Do you agree that the RTS should accommodate the flexibility to express position limits in the units appropriate to the individual market? Are there any other alternative measures or mechanisms by which position limits could be expressed?**

Expression of limits as percentage of open interest or deliverable supply is the most appropriate way. But as long as the measure of the physical underlying market is taken into consideration, flexibility may make sense in some limited cases

See our response to question 502:

We agree that amending the position limit on a real-time basis is not only unnecessarily but unfeasible and that setting it for a fixed (excluding exceptional circumstances) period is preferable. With regard to the period itself, we propose that position limits on a contract are fixed for an initial period of two years and with annual reviews thereafter with amendments to the limits only where necessary.

We also believe that spot month limits generally should not be determined at the time a contract month becomes the spot month. Determining a position limit for the spot month contract on the first day that such contract is available for trade is impractical as it would require notice of a limit to be provided when that contract has already commenced trading (open interest calculations are usually published after trading has begun each day) and when parties may already be holding positions that are in breach of that new position limit. Requiring parties to trade out of positions to comply with the new position limits may lead to artificial volatility and a disorderly market.

For instance, the LME have daily Prompt date contracts and thus have daily settlements. The LME already impose a pseudo position limit when the contract is coming up to prompt (settlement) in that it has a rule that stipulates that if the accumulated net long positions of a particular participant or member, two days before settlement, exceeds 50% of LME warranted stock, the long position holder(s) has to reduce the positions to below 50% of LME stock at a

pre-determined set premium (price). It is possible to have a forward position that adds up to more than 100% of LME warranted stock. It is then up to the position holder to manage his positions over the two day period before settlement to ensure it is holding less than 50% of LME stock. LME stock figures are published each day at 09:00 UK time. We believe this is the method enshrined in the LME Lending Guidance rules that LME has been operating since 1998 is an effective tool in ensuring orderly markets and in effect imposes a pseudo position limit on LME contracts that are physically settled on the exchange. An explanation of the Lending Guidance can be found here: [http://www.lme.com/~media/Files/Notices/2011/2011\\_10/11\\_293\\_A286\\_R008\\_Explanation\\_of\\_Metal\\_Lending\\_Guidance.pdf](http://www.lme.com/~media/Files/Notices/2011/2011_10/11_293_A286_R008_Explanation_of_Metal_Lending_Guidance.pdf)

The implementation of a position limits regime will significantly affect the functioning of the commodity markets and for this reason an initial two year period is necessary to ensure that orderly trading conditions are maintained during the transition.

The measure of the deliverable supply for a period of time is challenging and ESMA and national regulators should rely on data gathered by exchanges and on existing database aiming to ensure transparency in physical markets. A one-size fits all approach such as the "three months expiry cycle" as proposed by ESMA may not fit the fundamentals of certain commodity markets.

We also highlight that data used for the purpose of defining the deliverable supply period per commodity type should span over a period of a minimum of three years and should have a granular view on a monthly basis. When calculating the deliverable supply period per commodity type, different factors must be included, among which, a basic taxonomy (i.e.: storable versus non-storable), weather, supply chain optimization level, demand and offer curve, geographical location-distance, seasonality, growth, and market concentration, as well as the trading cycles per each commodity market. As there would be differences across commodities and that some factors are outside of the control of either of the parties to the physically-settled contract, a +/- margin should be added to the averaged/estimated delivery supply period. This +/- margin could be set at no less than 15% of the overall delivery supply period.

**Q527: How should the methodology for setting limits take account of a daily contract structure, where this exists?**

We believe that ESMA should **defer to the relevant markets here. However, care needs to be taken not to ‘jam’ OTC/physical trades into inappropriate daily limits.**

**Q528: Do you agree that limits for option positions should be set on the basis of delta equivalent values? What processes should be put in place to avoid manipulation of the process?**

Yes. During the lifetime of the option, in order to minimise risk, the hedge for the option will replicate the change in delta (as opposed to the absolute value of the option). Therefore, in setting limits for options position limits should track the option delta. Regarding anti-manipulation, calculation methodology can be subject to retrospective audit from the relevant national regulator, upon request. Also, in the event options are used to hedge futures it is critical

that option deltas are able to be netted with futures positions delta in order to accurately reflect commodity risk levels.

**Q529: Do you agree that the preferred methodology for the calculation of delta-equivalent futures positions is the use of the delta value that is published by trading venues? If you do not, please explain what methodology you prefer, and the reasons in favour of it?**

As market participants will have different internal calculation methodology for calculating delta futures equivalent values, to ensure consistency with internal risk systems they should be allowed the flexibility to use their own calculations rather than those delta value published by trading venues (subject to being able to justify the calculation).

**Q530: Do you agree that the description of the approach outlined above, combined with the publication of limits under Article 57(9), would fulfil the requirement to be transparent and non-discriminatory?**

Yes, we fully agree with this approach.

**Q531: What challenges are posed by transition and what areas of guidance should be provided on implementation? What transitional arrangements would be considered to be appropriate?**

Unfortunately, the level 1 MiFID II text does not allow a phased-in approach. However, at a minimum, the grandfathering of existing positions at the time of implementation of the new regime, along with setting of "high limits" which can be calibrated over time, is required in order to avoid market disruption and mismatched hedging.

## Section 7.3 - Position Reporting

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**Q532: Do you agree that, in the interest of efficient reporting, the data requirements for position reporting required by Article 58 should contain elements to enable competent authorities and ESMA to monitor effectively position limits? If you do not agree, what alternative approach do you propose for the collection of information in order to efficiently and with the minimum of duplication meet the requirements of Article 57?**

### EXECUTIVE SUMMARY

**ISDA members question the appropriateness of setting up a Position Reporting for commodities. We do not understand why this specific position reporting is to be put in parallel to EMIR reporting, where the same information is supposed to end up anyway. They consequently do not see the additional value of this specific reporting.**

**We believe that ESMA could simply filter the information collected by Trade Repositories for purposes of monitoring their position limits regime.**

**Setting up a separate reporting regime for MiFID not only adds complexity, it is also prone to error if the relevant data and fields are not taken over from EMIR. Market participants would like to avoid a separate reporting chain, as this is just costly duplicity.**

We agree with ESMA's approach on the purpose of the position reporting requirements.

We particularly support the expressed will to standardise the data definitions and the format of the reporting information required by MiFID with other existing legislative texts to the greatest extent possible in order to reduce the quantity of duplicative reporting. In our view, wherever possible, we also think that ESMA should establish reporting requirements and data standards that are equivalent to, or at least compatible with, analogous requirements imposed (or proposed) by other jurisdictions. For instance, we believe that an appropriate comparison for regulators would be CFTC form 102 and 204, and the data required to be reported pursuant to Parts 15 through 20 of the CFTC's rules. In case the US and EU standards were not compatible, this would result in significant additional costs on the industry, and increase the risk of market disruption and fragmentation.

Lastly, we agree that the data fields included within position reports should include an indicator of whether a position is risk reducing for commercial purpose or not (and therefore eligible to the hedging exemption to position limits). However, we call for clarifications on the following points: a) do the requirements for members of trading venues to provide their clients' positions in on-venue contracts pertain only to that which the member holds on behalf of their client (rather than their counterparty's positions under principal transactions)?; b) if a market participant has to report positions all the way down to the "end client", how can this market participant establish whether or not the end client's position is a hedging position? c) Would the market participant be liable if the end client misinformed it (which would not be acceptable)?

**Q533: Do you agree with ESMA’s definition of a “position” for the purpose of Article 58? Do you agree that the same definition of position should be used for the purpose of Article 57? If you do not agree with either proposition, please provide details of a viable alternative definition.**

Yes, we agree that the definition of 'position' under article 58 should be aligned with the definition under article 57 since the position reporting requirements aim to support the position limit regime. The position reporting requirements should therefore apply to contracts traded on a trading venue and economically equivalent OTC contracts. We also agree that the definition of position, alternatively called 'open interest', should embrace the net accumulation of buy and sell transactions in a particular commodity derivative, emission allowance or derivative on an emission allowance at a specific point in time.

**Q534: Do you agree with ESMA’s approach to the reporting of spread and other strategy trades? If you do not agree, what approach can be practically implemented for the definition and reporting of these trades?**

Article 58 only requires that positions that are risk reducing transactions (i.e. netting applies to the calculation of the overall position of the market participant for the calculation of the limits but not to reporting) should be reported gross.

Any additional reporting is duplicative and unnecessary given that Investment Firms will already be reporting transactions. Looking at a gross position does not provide any regulatory useful information nor is it the way that exchanges currently receive position reports. Those positions that are not used for the purposes of ‘risk reducing’ should be reported net.

Any requirement to report spread and other complex trades on a disaggregated basis should be consistent with the reporting requirements imposed by other jurisdictions. For example, in certain circumstances, market participants should be permitted to report positions based on a diversified commodity index on a consolidated basis (e.g., where the index is commonly known and the weightings of individual components are publically available).

**Q535: Do you agree with ESMA’s proposed approach to use reporting protocols used by other market and regulatory initiatives, in particular, those being considered for transaction reporting under MiFID II?**

Yes, we agree with ESMA's approach to use reporting protocols used for other transactions reporting under MiFID II but not as stated above; position reporting should be on a net position basis.

**Q536: Do you have any specific comments on the proposed identification of legal persons and/or natural persons? Do you consider there are any practical challenges to ESMA’s proposals? If yes, please explain them and propose solutions to resolve them.**

ESMA's proposal to use LEI, BIC, National code waterfall logic will mean existing EMIR reporting methodology can be leveraged minimising new builds and facilitating implementation.

**Q537: What are your views on these three alternative approaches for reporting the positions of an end client where there are multiple parties involved in the transaction chain? Do you have a preferred solution from the three alternatives that are described?**

ISDA members have two major concerns regarding the reporting of the positions of an end-client:

- The protection of client confidentiality, i.e. the end-client's identity is not disclosed to the intermediaries involved in the transaction chain;
- The simplicity and cost-neutrality of the reporting system, i.e. the approach should not involve complex data fields setting that would imply onerous implementation for market participants.

With these two concerns in mind, ISDA members feel that none of the three approaches are entirely satisfactory.

They strongly believe that option 1 is definitely not suitable because of aforementioned reasons of client confidentiality. In particular, it would not be appropriate to require reporting parties to obtain potentially commercially sensitive information from their counterparties. For example, counterparties may not be willing to provide reporting parties with details of their other OTC swap positions with third parties because providing this information could place them at a competitive disadvantage.

Between options 2 and 3, ISDA members have tried to assess the advantages and disadvantages of each and may have different views.

Some members, mostly representing the sell-side, support option 3 whereby the position report provided by the investment firm to the trading venue or to the relevant competent authority may include the identification of its own immediate client and an indicator on whether that client is itself an investment firm. In this scenario the reporting firm would also be required to provide a position report to the trading venue or competent authority, giving the positions that it holds and on whose behalf. This process would have to be repeated until the investment firm that holds the ultimate end-client account is reached. They also feel that option 2 adds complexity.

Some other members, mostly representing the buy-side, believe that option 2 is the only one that truly protects client confidentiality and that while this option would imply additional set-up costs, ongoing maintenance costs would not be material.

The general feeling is that:

- If ESMA opts for option 2, they have to limit the set-up costs and therefore limit the additional data fields in the report;
- If ESMA opts for option 3, they have to ensure end-client confidentiality.

In addition, ESMA should ensure that any information published by ESMA, the competent authorities, or individual trading venues does not reveal the positions of individual market participants. This is a particular concern in physical commodity markets where contracts based on specific delivery points may be used by a small number of market participants. Even though position information for such contracts may be nominally anonymous, the identity of individual traders may still be discernible in markets with low volume or liquidity. Without adequate safeguards, reporting parties will be forced to share position information in a way that could reduce competition and frustrate beneficial risk management activities.

**Q538: What alternative structures or solutions are possible to meet the obligations under Article 58 to identify the positions of end clients? What are the advantages or disadvantages of these structures?**

One possible solution would be to adopt the CFTC approach where an investment firm will identify its client, and the relevant competent authority will require that client (or its underlying client) to provide the relevant report. This would allow competent authorities to receive the information they require without the intermediation of the investment firm, although there may be cases in which the client or its underlying client is unable to provide the necessary information.

However, regardless of the way in which ESMA seeks to obtain information on clients and their underlying clients, investment firms should not be prohibited from dealing with clients who are unable to provide the required information (either in relation to themselves or in relation to their underlying clients), as this is likely to result in significant barriers to market access for end clients.

**Q539: Do you agree with ESMA's proposal that only volumes traded on-exchange should be used to determine the central competent authority to which reports are made? If you do not agree, what alternative structure may be used to determine the destination of position reports?**

We agree with ESMA's proposal that the determination of the central competent authority to which position reports are made should be decided solely by the volume of activity undertaken on exchanges but note that it does not take into account that the level of activity is likely to change from time to time, meaning that the relevant competent authority will also change. Firms may want some assurances that they will not be sanctioned for reporting to the wrong competent authority if there is a change.

ESMA may consider publishing a list of the relevant competent authorities, which firms could rely on for a period of time (e.g. one or two years) and which would be updated by ESMA. ESMA will also need to consider situations where a significant portion of the market is off exchange, i.e. OTC swap market.

**Q540: Do you agree that position reporting requirements should seek to use reporting formats from other market or regulatory initiatives? If not mentioned above, what formats and initiatives should ESMA consider?**

Yes, we agree that position reporting should seek to use reporting formats for other regulations and in particular those that are in place or being considered for EMIR trade reporting or for transaction reporting under MiFID.

We further recommend that any reporting requirements and data standards that are adopted be compatible with analogous requirements imposed by other jurisdictions. Differing data standards will require market participants to develop duplicative systems. This would be costly and inefficient. Moreover, inconsistent data standards increase the risk that regulators will receive and make policy decisions based on inconsistent market information. We therefore call, amongst other things, for consideration of the formats used for position reporting in other jurisdictions in order to facilitate both implementation and accuracy of reporting.

**Q541: Do you agree that ESMA should require reference data from trading venues and investment firms on commodity derivatives, emission allowances, and derivatives thereof in order to increase the efficiency of trade reporting?**

Yes, we agree that to support the position reporting of investment firms, trading venues should be required to provide reference data on on-venue and economically equivalent OTC contracts. We recognise the product identification under EMIR may not be granular enough in the specific context of position reporting of commodity derivatives for the purpose of position limits under MiFID II. We also recognise that product identification under EMIR does not incorporate the concept of linking position in on-venue contracts with 'economically equivalent OTC contracts'.

**Q542: What is your view on the use of existing elements of the market infrastructure for position reporting of both on-venue and economically equivalent OTC contracts? If you have any comments on how firms and trading venues may efficiently create a reporting infrastructure, please give details in your explanation.**

We believe that CCPs are best placed to report position data on OTC cleared trades however currently some data fields such as the client identifier will be missing. Trading venues should be able to report positions either to NCAs or Trade Repositories for on-exchange contracts.

**Q543: For what reasons may it be appropriate to require the reporting of option positions on a delta-equivalent basis? If an additional requirement to report delta-equivalent positions is established, how should the relevant delta value be determined?**

Reporting of delta equivalent positions is established, and then consistent with question 529, the conversion to delta would need to be based on market participants' models and not be restricted by pre-defined numbers published by trading venues.

We do not think that the preferred methodology for calculation of delta-equivalent futures position should require use of the delta value published by trading venues. Instead we think participants should be able to use their own internal models / delta calculations to ensure

consistency with internal records and risk systems (subject to being able to justify the calculation).

**Q544: Does the proposed set of data fields capture all necessary information to meet the requirements of Article 58(1)(b) MiFID II? If not, do you have any proposals for amendments, deletions or additional data fields to add the list above?**

Gap analysis should be conducted against existing reporting formats applicable to market participants. In particular, we recommend consideration of EMIR reporting formats and the CFTC's position reports, and new ownership and control reporting rules. This will ensure consistency and therefore reduction in differences in further formats.

**Q545: Are there any other fields that should be included in the Commitment of Traders Report published each week by trading venues other than those shown above?**

While recognising the need for the reporting fields to be specifically applicable to, and take account of, the idiosyncrasies of the European market framework and regulatory regime, both market participants and market infrastructures strongly support alignment with CFTC standards (including Commitment of Trader reports) wherever possible so as to promote consistency of reporting for all market participants with operations outside the EU (and, in particular, those active in the US).

## Section 8 - Market data reporting

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### Section 8.1 - Obligation to report transactions

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**Q546: Do you agree with ESMA's proposal for what constitutes a 'transaction' and 'execution of a transaction' for the purposes of Article 26 of MiFIR? If not, please provide reasons.**

There are two guiding principles behind ISDA's comments on the MiFIR transaction reporting regime:

1. As discussed in the Discussion Paper, the purpose of transaction reporting under Article 26 MiFIR is to detect and investigate potential instances of market abuse and to monitor the fair and orderly functioning of markets and firm activities. ISDA considers that transaction reporting under Article 26 MiFIR should not go beyond what is necessary to achieve these objectives, with respect to (i) the products and events that are in scope, and (ii) the information required to be included in the transaction report.
2. Transaction reporting under Article 26 MiFIR should be harmonised where possible with other European reporting regimes (e.g. EMIR, REMIT) as this will aid the smooth expansion of transaction reporting to further products. Therefore, definitions of 'transaction' and 'execution of a transaction' should be aligned with the equivalent events which affect the positions of investment firms and their clients in the other reporting regimes to allow for the efficient use of data and technology by investment firms. The need for clarity on the definitions here is paramount as any ambiguity around what is a transaction and execution of a transaction will have an impact which will manifest itself as over and under reporting.

In relation to the proposals set out in the Discussion Paper, ISDA has the following specific comments:

ISDA notes that many of the events that would trigger transaction reporting for transferrable securities (e.g. subscription) are not relevant for derivatives. Therefore, ISDA would recommend considering separately what events should trigger transaction reporting requirements for (a) transferrable securities; and (b) derivatives. In each case, a clear list of triggers should be specified.

In the case of derivatives, ISDA recommends that the definition of transaction and execution of a transaction should be aligned with the triggers for reporting under EMIR, as ISDA considers that the triggers established for EMIR reporting purposes are also appropriate and capture the relevant events which would need to be monitored for MiFIR transaction reporting purpose of preventing market abuse.

Repos, reverse repos and other securities financing transactions should not be included in the definition of transaction for the purposes of transaction reporting under MiFIR/MiFID II, as ISDA feels that:

- Such transactions are not readily subject to market abuse; and
- Such transactions will be dealt with under the European Commission's proposals on transparency of securities financing transaction and shadow banking.

Intra-group transactions should also be excluded from the definition of "transaction" for the purposes of transaction reporting, as ISDA does not consider that such transactions are relevant to detecting market abuse.

**Q547: Do you anticipate any difficulties in identifying when your investment firm has executed a transaction in accordance with the above principles?**

Any ambiguity regarding the scope of transaction reporting in terms of both the instruments in scope and activity (which takes place on such instruments) in scope will lead to problems for investment firms in knowing they have executed a transaction. In the absence of a central source of instruments with sufficient related information for each instrument about what activity constitutes a transaction or execution of a transaction, problems at investment firms in identification of an execution of a transaction can be expected.

In particular, investment firms will face challenges when trading a new instrument with a systematic internaliser to know whether the instrument is admitted to trading or traded on a trading venue or a request for admission to trading on a trading venue has been made but not yet granted, as this information may not be readily available to the investment firm. In the absence of any central source of information, the only way to be sure that an instrument is in scope would be to trade instruments on a trading venue, which may have an unforeseen adverse commercial impact on markets in the instrument. ISDA wants to avoid a situation where firms report transactions in all financial instruments because they are uncertain as to whether a transaction in a particular financial instrument is reportable or not.

Therefore, ISDA members would welcome the creation of a central source listing all instruments which are traded or admitted to trading or traded on a trading venue or for which a request for admission to trading has been made, which also lists activities associated with each instrument which constitute a transaction or execution of a transaction, which they would be entitled to rely upon for the purpose of transaction reporting.

**Q548: Is there any other activity that should not be reportable under Article 26 of MiFIR?**

In addition to the list proposed in the Discussion Paper, the following activities should not be reportable:

- Change to the composition of a basket
- Corporate Actions - any position change due to a corporate action
- Cash flow/settlement related transactions
- Expiry as a result of contractual terms

- Resets on Interest Rate Swaps
- Swaption expiry
- Coupon payment, trigger event or knockout/knockin detailed clearly in original contractual terms
- Transactions that cannot impact on a price benchmark and therefore are not susceptible to market abuse (e.g. TAS, EFS, EFP and block trades)
- Transactions resulting from compression and netting activity

As a general principle, ISDA considers that all post trade events which do not require positive action on the part of a decision maker should be out of scope. For example, ISDA considers that give-ups or give-ins should not be reportable under Article 26 MiFIR.

ISDA also considers that the automatic exercise of options on a pre-agreed trigger should not be within scope of transaction reporting, as the exercise would happen without any intervention from a decision maker. This is to be contrasted with manual exercise of options which would require intervention by a decision maker and therefore should be reportable under Article 26 MiFIR. However, ISDA considers that manual exercises of options should be reported as an 'event' rather than a 'buy' or 'sell' (addition of an activity field in the transaction report to allow reporting of activity which should not be classified as 'buy' or 'sell' would assist).

**Q549: Do you foresee any difficulties with the suggested approach? Please elaborate.**

Attributes to describe even non-complex product orders and definition of what information is sufficient for transmission of an order will vary greatly across products and asset classes. Is it the intention of ESMA re the proposed written agreements designating terms for order transmission for these agreements to be exhaustive in detail or to merely agree that order transmission is allowed between client and firm? More clarity around this proposed new more formal procedure will be needed. The logistical and bureaucratic effort to agree formats of and procedures for signing and exchanging such documents will be extremely onerous on investment firms. Definition of the sufficient information to describe an order of each reportable instrument to meet the order transmission will be required at a central source along with other instrument reference data as mentioned previously (such as its admitted to trade status of the instrument).

Whatever procedure is finally adopted, sufficient flexibility should be retained in order to ensure that such procedure is appropriate for the wide range of financial instruments in scope. Therefore, ISDA considers that as much flexibility as possible should be retained for investment firms to decide whether or not sufficient information has been provided by the party transmitting the order, in order to discharge its obligation to report.

In addition, ISDA would welcome clarity around report matching in the situation where the party transmitting an order does not provide sufficient information, and so is required to submit a transaction report itself. ISDA understands that there is a field for including a report matching

number, so that it is clear that the multiple reports submitted in fact relate to a single transaction. However, it is not clear how the report matching number would be obtained in time for each party in the chain to include such reference on the transaction report before the relevant entity is required to submit the report.

**Q550: 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.**

### **General comments**

Sufficient flexibility should be built into the reporting fields to allow reporting for the full range of financial instruments in scope. In this respect, ISDA notes that a number of fields appear to have been designed with transferrable securities in mind and so would be 'not applicable' for derivatives transactions. ISDA would welcome clear guidance as to which fields should apply in relation to which products and whether any fields would be mandatory for all products. Considerable thought should be given to mandating values for any field and flexibility to allow for realities of market evolution be catered for in any decisions. Endorsement by ESMA of ISDA best practices and ISDA taxonomies will aid clarity for ISDA members in populating fields consistently so that comparison of data sets is meaningful.

ISDA also notes that for certain types of tradeflows, firms may not have all of the information about counterparties that appears to be required by the proposed transaction reporting fields. For example, for anonymous trading scenarios (such as SEF anonymous flows), the counterparty details are never known pre-clearing so certain counterparty data attributes are not able to be populated. Similarly, for OTC prime brokered trades, the executing broker does not capture information detailing the ultimate end beneficiary of the trade as the trade is executed with the requirement that the prime broker accepts the trade for settlement and so the executing broker only captures information relating to the prime broker that accepts the trade. As a result, ISDA would welcome confirmation from ESMA that such fields can be left blank where this information is not known to the investment firm at the time of transaction reporting.

ISDA considers that a key principle for deciding which data fields are required is economy of information reporting. Therefore, firms should not have to report on the transaction report any redundant data which can be referenced using a relevant identifier from a 'golden source' of information. For example:

- If an LEI is used to identify a counterparty, then other information about the counterparty should not need to be reported to the extent that ESMA and NCAs can source this information from the 'golden source' of information held about that counterparty.
- ESMA will hold instrument reference data for each financial instrument which has been given an instrument identifier. Therefore, only the instrument identifier should be required on the transaction report as all other reference data can be sourced from the 'golden source' at ESMA.

- For identification of individuals (for example using the Trader ID), associated personal information should be held elsewhere and should not be transmitted on the transaction report because it can be looked up from another source.

While ISDA understands the motives of different EU reporting regimes are different (with MiFID/MiFIR focussed on transaction information for the purposes of market surveillance) ISDA does note and welcome ESMA's efforts to align these reporting data fields where possible with other reporting data fields (such as those required to make EMIR trade reporting submissions), as is anticipated in the Level 1 text. ISDA accepts that new and different fields may be required to complete the required data set but feel it is important to stress that the starting point for any data provided will be the same systems from which data is sourced for other reporting requirements (such as EMIR and REMIT reporting). In addition, where the same information field is used for reporting under EMIR, REMIT etc., in order for investment firms to derive the intended benefit from this overlap, guidance about how such field should be completed should be consistent across all reporting requirements.

Finally, ISDA considers that proliferation of non-essential fields should be avoided, as it increases the risk of errors being made in reports and places a disproportionate additional burden on firms.

ISDA and its members would welcome publication of the RTS including the transaction reporting fields in good time before the deadline for compliance to facilitate the planning and design of the necessary infrastructure changes to meet the transaction reporting requirement. Therefore ISDA asks that ESMA and others involved in publication of the RTS and further consultative process are particularly mindful of the impact of delays to this clarity being provided.

### **Comments on specific fields**

- Submitting entity identification code (field 2)

ISDA would welcome clarification from ESMA that this field should identify the last entity in the chain submitting the transaction report to the relevant competent authority.

- Branch of the reporting firm (fields 3 and 4)

Where there is no branch involved in the transaction, ISDA would welcome confirmation from ESMA that these fields should be left blank.

- Trading time (field 7)

ISDA would welcome clarification from ESMA as to what time post-trade events should be stamped with. ISDA suggests the timestamp should be aligned with EMIR Execution Timestamp where possible.

- Buy/Sell indicator (field 8)

The fields as proposed do not allow representation of transactions which are of a different form to the sale or purchase of a security, such as a notional increase or entering into a swap transaction. Therefore, the inclusion of an activity field in addition to the 'buy' or 'sell' field would be helpful as a first field to allow the identification of such transactions. ISDA would ask ESMA to note the EMIR reporting regime for derivatives where there are fields such as Counterparty Side (field 13), Action Type (field 58) and Details of Action Type (field 59) which provide the necessary functionality which is lacking with only a "buy" or "sell" field provided.

- Quantity and quantity notation (fields 10 and 11)

Using a single "Quantity" field to hold both quantity and notional value does not align with EMIR designations for Notional Price and related fields, where both quantity and notional fields are provided. ISDA considers that these fields should be aligned with the equivalent fields for EMIR reporting. ISDA notes that to the extent changes are made to these fields, the equivalent fields for post-trade transparency would also need to be changed accordingly.

ISDA understands that the instruments reference data should detail how these fields should be populated but would welcome clarification from ESMA that this understanding is correct.

- Price (field 12)

ISDA notes that the price for a derivative or basket can be undefined. Therefore, there should be an option to leave this field blank.

- Price notation and currency (fields 13, 14 and 15)

ISDA requests that these fields are aligned with the equivalent EMIR reporting fields for price notation and notional currency. In particular, ISDA notes that the price notation field for EMIR reporting purposes provides that if '100' is entered then the price is expressed as a rate and if a currency code is entered then the price is expressed as a monetary value. ISDA requests that the same convention is applied to the equivalent transaction reporting fields.

- Consideration (field 17)

It is not clear how this field would apply to derivatives. Whilst it could be interpreted as a duplicate of the notional amount, ISDA considers that this field would not be applicable to derivatives and so there should be an option to leave this field blank.

- Information about natural persons (fields 21 to 17, 30 to 36, 40 to 46, 49 to 55, 71 to 73 and 76 to 79)

ISDA considers that these fields should be deleted and the transaction report should contain only a numeric ID to represent individuals. This is because ISDA considers that the data protection risk of including full personal details in transaction reports outweighs the potential benefit of including such information. In addition, requiring more than a unique ID to represent such individuals will require investment firms to undertake additional IT build unnecessarily, as information associated with an individual should be able to be looked up from another source using the unique ID.

- Decision maker for the counterparty (fields 28 to 30)

ISDA considers that information about the decision maker for the counterparty should only be required where an investment firm has agreed to submit a transaction report on behalf of its counterparty.

- Instrument identification and classification (fields 56 to 61)

ISDA would welcome endorsement by ESMA of the use of instrument identifiers such as a UPI or an instrument reference number for OTC derivatives. ISDA recommends that any such endorsement should encompass the ISDA taxonomy, to avoid unnecessary changes to market practice. ISDA also considers that this would help better align the concept of 'financial instrument' for transaction reporting purposes under MiFIR with the concept of 'product/underlying' for EMIR reporting purposes.

In relation to fields 60 and 61, ISDA considers that where the financial instrument in question is traded or admitted to trading on a trading venue, or an application for admission has been made (including for OTCs transaction in such financial instrument), it should not be necessary to provide information about the underlying, as this information can be obtained from a central source using the instrument reference number.

- Information on derivatives (fields 62 to 66)

These fields will not be relevant for all types of derivatives. For example, fields 62, 63 and 66 will only be relevant for options. Where a field is not relevant, ISDA would welcome confirmation from ESMA that it should be left blank.

ISDA also notes that the option style (field 66) will be tied to the instrument reference data. Therefore, this field is redundant and so should be deleted.

- OTC post-trade identifier flag (field 84)

ISDA considers that post-trade activities relating to OTC trades (such as give-ups and give-ins) should not be considered execution of a transaction for the purposes of transaction reporting. Therefore, this flag would not be required.

- Compression (field 86)

ISDA considers that compressions should not fall within the scope of transaction reporting, as they arise as a result of a risk mitigation process. Therefore, this flag would not be required.

- Option exercise (field 87)

ISDA considers that where there is a reportable exercise of an option, then this should be captured by an expanded 'activity' field as noted in the comments on the 'buy/sell indicator' field above. Therefore this flag would not be required.

- Repo flag (field 88)

ISDA considers that repos should not fall within the scope of transaction reporting, as repos are not readily subject to market abuse. Therefore, this flag would not be required.

- Order transmitter (field 90)

ISDA would welcome confirmation from ESMA that investment firms are only required to identify in this field the firm which directly transmitted the order to it, and investment firms will not be required to source or provide information about every firm in an order/routing chain.

- Report matching number (field 91)

ISDA is concerned that the requirement to have a Report Matching Number for Transaction Reporting will introduce unnecessary complexity to the Transaction Reporting regime and lead to major problems for firms in the implementation of the Transaction Reporting for new instruments and markets. The challenges of agreeing and disseminating UTI for EMIR reporting purposes is a case study in what is likely to happen with this proposed field in the absence of clear guidance from ESMA on who is responsible for generation and transmission of the report matching number, particularly for more complicated counterparty order and execution flows and relationships seen in OTC derivative markets.

If ESMA does envisage that the report matching number be a requirement then ISDA would welcome clarity that investment firms would not be expected to pass report matching numbers down an order routing chain to firms who have transmitted orders as ISDA is concerned that passing this number through the chain of firms transmitting and routing orders in time for inclusion on the transaction report will be very difficult, particularly for OTC transactions.

ISDA also considers that a clear framework of IDs for transactions and how they relate to UTI and IDs for other reporting regimes would be required. This ID could be seen as a 'child ID' of UTI as many transactions would make up a position which would have a UTI.

- Transaction reference number (field 92)

ISDA would welcome confirmation from ESMA that this is merely an internally generated number which does not need to be shared beyond the reporting party.

- Report status (field 93)

ISDA would welcome clarification from ESMA as to whether this field relates to the status of the report or the status of the transaction. It appears that this field supposed to allow for amendment and cancellation of reports. If so, ISDA suggests that 'new', 'amend' and 'cancel' would be appropriate statuses for this field.

Please also see ISDA's responses to the other questions on section 8.1 of the Discussion Paper.

**Q551: Do you have any comments on the designation to identify the client and the client information and details that are to be included in transaction reports?**

ISDA welcomes the use of LEI as a client designation for legal persons. ISDA would like clarification in relation to the scenario where a legal person does not have an LEI, but may be eligible to obtain one. ISDA's view is that there should be no requirement on investment firms to restrict trading in any way due to their client's lack of an LEI. Any requirement on investment firms to trade only with clients who have an LEI will have a major commercial impact to firms and cause considerable market fragmentation. ISDA notes that due to existing requirements relating to LEIs under EMIR, this issue would arise only in circumstances where EMIR does not apply. Nevertheless, a clear statement from ESMA that this is the case would be welcomed.

ISDA is of the view that the extra information which must be available to firms regarding the beneficial owner of the transaction so that they can transaction report introduces some complexities on which our members would welcome clear guidance from ESMA. For example, would investment firms be expected to complete full Know Your Client (KYC) procedures on the beneficial owner, who under previous transaction reporting regimes may have been unknown to the investment firm? This extra KYC step is indirectly achieved today with the client to a transaction having responsibility for KYC of the beneficial owner. By way of illustration, where an investment firm enters into a transaction with an investment manager, currently the investment manager carries out KYC on its underlying clients and the investment firm may not be aware of the identity of such underlying clients. However, under the transaction reporting regime, the investment firm will become aware of the identity of such underlying clients. ISDA would welcome clarity from ESMA as to whether the investment firm would therefore be expected to conduct KYC on such underlying clients. In answering this question, ISDA asks ESMA to consider whether this extra layer of KYC provides further benefit when compared to the duplication of cost.

In relation to clients who are natural persons, data protection of personal details is a key consideration. This applies to identification of both traders and clients who are natural persons. Requiring the inclusion of the individual's name, address and date of birth on a systematic basis increases the risk of identity theft in cases where such information is not transferred or retained in a secure manner. ISDA considers that the data protection risk of including full personal

details in transaction reports outweighs the potential benefit of including such information. In addition, requiring more than a unique ID to represent such individuals will require investment firms to undertake additional IT build unnecessarily. Therefore, ISDA's preference would be to include only a numeric ID to represent such individual (per ESMA's description in paragraph 38 of the DP) on transaction reports.

In addition, since individuals' addresses change from time to time, the requirement to maintain and update address information in a database used for transaction reporting would be disproportionately burdensome.

**Q552: What are your views on the general approach to determining the relevant trader to be identified?**

ISDA would like ESMA to clarify the scenario where multiple traders are working on an order, but not as part of a formal committee. Should the Trader ID of the primary trader who worked on the trade be the one reported?

ISDA also notes that Article 26(3) MiFIR provides that transaction reports shall include a "designation to identify the persons...within the investment firm responsible for the investment decision and the execution of the transaction". Therefore, whilst firms will be required to provide this information for their own traders, there is no Level 1 requirement to provide information about traders at counterparties. ISDA considers that it is usually not practical for firms to obtain trader information from the counterparty in time for a T+1 report. This is because the traders involved may change from transaction to transaction and this information cannot therefore be provided upfront, unlike the requirement to provide the LEI of the counterparty (which can be provided upfront and does not change from transaction to transaction). Therefore, ISDA considers that an investment firm should only be required to include information about the trader executing the trade at the counterparty where the investment firm has agreed to submit a transaction report on behalf of its counterparty.

In addition, ISDA would welcome confirmation from ESMA that for transaction flows such as blind/masked execution and electronic trades where the transaction is executed on platform, the relevant trader to be identified would still be a trader within the investment firm submitting the transaction report. Where the transaction is executed on platform, ISDA understands that an investment firm would not be required to find out the identity of any individual at the platform involved in executing the trade, but would only need to identify the relevant individual in the investment firm itself.

ISDA would welcome confirmation from ESMA that, when provided with a Trader ID for inclusion on a transaction report, investment firms would not also be required to verify the identity and authorisation of the trader in question.

ISDA does not support ESMA's proposal to have the Trader ID identified based on the same process as for natural persons (i.e. unique national ID). ISDA would suggest allowing firms to identify their traders with a code internal to the firm, which would be unique, consistent and persistent within the firm. Currently, such identification codes are already in use within firms to

identify individual traders. Allowing investment firms to use their own internal codes will avoid having investment firms rebuilding their systems to accommodate national ID numbers and will limit IT costs. Nevertheless, the additional necessary information competent authorities require will still be available to competent authorities to carry out their market surveillance mandate on traders' activities.

Finally, ISDA considers that the transaction report should include the relevant individual's Trader ID only. This is because ISDA considers that the data protection risk of including full personal details in transaction reports outweighs the potential benefit of including such information. In addition, requiring more than a unique ID to represent such individuals will require investment firms to undertake additional IT build unnecessarily, as information associated with a trader should be able to be looked up from another source using the Trader ID.

**Q553: In particular, do you agree with ESMA's proposed approach to assigning a trader ID designation for committee decisions? If not, what do you think is the best way for NCAs to obtain accurate information about committee decisions?**

ISDA: No comments

**Q554: Do you have any views on how to identify the relevant trader in the cases of Direct Market Access and Sponsored Access?**

ISDA will welcome additional guidance on this proposal. Consideration of how direct market access accounts are used by clients would be appreciated. Some clients may allow many employees to use the same direct market access account.

**Q555: Do you believe that the approach outlined above is appropriate for identifying the 'computer algorithm within the investment firm responsible for the investment decision and the execution of the transaction'? If not, what difficulties do you see with the approach and what do you believe should be an alternative approach?**

As with ISDA's comments on the Trader ID, ISDA seeks clarification from ESMA as to which Algo ID should be reported, where chains of algorithms are in use. For example, should the last algorithm used in the execution process be identified 'algorithm responsible for execution' cell?

Whilst ISDA welcomes guidance on this question, ISDA considers that the relevant firm will be best placed to determine which algorithm is primarily responsible for (a) the investment decision; and (b) execution, and therefore, the firm should retain discretion to make this determination in accordance with its internal policies and procedures.

**Q556: 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, the storage of any extra information which is required at the time of execution will have a major impact on investment firms as they will need to change every order and execution system to handle these as yet unknown and undefined flags and designations of waivers. The cost and technological challenge this represents should be taken into account by ESMA in any decisions around the designation and requirement of flags to indicate use of these waivers. Therefore,

ISDA requests that ESMA limits any requirements to include information about waivers under which trades took place to the minimum required by Article 26(3) MiFIR.

**Q557: Do you agree with ESMA's proposed approach to adopt a simple short sale flagging approach for transaction reports? If not, what other approaches do you believe ESMA should consider and why?**

In respect of whether the flagging regime should distinguish between partial short sales and full short sales, ISDA agrees that a simple approach is more appropriate, and therefore agrees ESMA's suggestions in paragraphs 94 and 95.

Secondly, ISDA notes that ESMA suggests in paragraph 96 that investment firms acting under a market making or primary dealer exemption should flag that fact, as well as whether any given sale was a short sale. ISDA considers that firms executing a sale under a Short Selling Regulation ("SSR") exemption should not be required to flag that fact at all. Such an approach would be consistent with the SSR, pursuant to which market makers and primary dealers are not subject to the SSR cover or disclosure requirements. ISDA considers such an approach is supported by the reference to the SSR market making or primary dealer exemption within Article 26(3) of MiFIR. This subsection requires flagging of short sales in respect of any shares and sovereign debt "within the scope of Articles 12, 13 and 17" of the SSR. ISDA considers that the reference to Article 17 here should be read as indicating that exempt sales should not be flagged at all. As such, the Market Making Exemption flag should be removed from the proposed list of fields for transaction reporting and there should be no requirement on market makers and primary market operators to flag short sales.

Thirdly, in relation to the short sale flagging obligation more broadly, ISDA would be grateful for interpretive guidance from ESMA that individual transactions may be flagged from the perspective of the relevant trader, desk or decision making unit within the selling entity, rather than from the perspective of the entity as a whole. If two trading desks within the same legal entity trade the same (in-scope) share, there will likely be times where one such desk (Desk A) is conducting what it considers a short sale when in fact the entity does in fact own such shares by virtue of the other desk's (Desk B's) holdings. It would be easier for ISDA members to build a transaction reporting flagging logic which would in such circumstances flag Desk A's sale as a short sale. ISDA also imagines that competent authorities may find it more helpful to understand where a particular decision making unit within an entity has been short selling, rather than receive such information at an entity level.

**Q558: Which option do you believe is most appropriate for flagging short sales? Alternatively, what other approaches do you think ESMA should consider and why?**

Option 1 is the most appropriate. The infrastructural and commercial problems which would be introduced in option 2 where investment firms would have to calculate the holdings of their clients to determine if the transaction which is being reported represents a short sale would outweigh any suggested benefits. As acknowledged in paragraph 101 of the Discussion Paper, an investment firm will rarely (if ever) know or have visibility over whether any given client holds relevant shares/sovereign debt in a custody account with a third party, and so an

investment firm will never be in a position to accurately flag whether any given sale by such a client is a short sale or not.

Investment firms should simply be required to flag a client sale in accordance with information provided by the client to such an investment firm. If no information is provided in response to a request from an investment firm, then such investment firm should not flag the order as a short sale.

**Q559: What are your views regarding the two options above?**

Option 1 is the most appropriate. As ESMA indicates in paragraph 105, it would be consistent with the principle that investment firms should report transactions executed on a principal basis from its own perspective, and will prevent confusing double-reporting in case an investment firm's counterparty is another investment firm.

**Q560: Do you agree with ESMA's proposed approach in relation to reporting aggregated transactions? If not, what other alternative approaches do you think ESMA should consider and why?**

ISDA agrees with ESMA's proposed approach in relation to reporting aggregated transactions. For the market side leg, the designation of the short sale flag should be as if the investment firm is trading as principal while for the client side leg, the designation of the transaction as a short sale should be as indicated by the client.

**Q561: Are there any other particular issues or trading scenarios that ESMA should consider in light of the short selling flag?**

ISDA considers that the flagging of short sales applies to transactions in shares and sovereign debt only. It does not apply to derivative transactions or to instruments other than shares and sovereign debt. ISDA would welcome a restating of this position by ESMA.

**Q562: Do you agree with ESMA's proposed approach for reporting financial instruments over baskets? If not, what other approaches do you believe ESMA should consider and why?**

While the requirement that a transaction is reportable because it is over a basket containing reportable instruments is capable of being implemented, ISDA considers that it is a major global issue for the industry to provide details of the constituents of the basket. A common public identifier which links to reference data for the basket including its constituents is ISDA's preferred solution.

ISDA notes that from experience with EMIR reporting requirement, it is particularly difficult to provide information on the composition of a basket or formula for indexed energy trades, as there are no UPIs for the underlyings and no detailed taxonomy has been put in place. Ideally each basket, or at least each underlying, should have a UPI (or other relevant identifier) and this should be in place before the reporting requirement comes into force for that contract. The fact

that units of measure (e.g. barrels, tonnes, gallons) can be different for each constituent of the basket is also problematic for reporting.

In addition, it will be a particular challenge to provide details of the constituents of a basket where firms create baskets tailored to client needs, such as in the case of portfolio swaps and other OTC products where there is lot of activity on each basket with bespoke baskets being created and adjusted at a high frequency every day.

A global solution for representation of baskets is crucial. ISDA notes that the approach of other reporting regimes where the underlying on basket trades is just reported with the value "basket" does not provide sufficient information to understand activity taking place. ISDA and its members would welcome the opportunity to work with ESMA to find a workable solution which is both simple to implement and gives ESMA and authorities the information at the level of detail they need.

ISDA considers it would be appropriate to give a time concession to allow this to happen. Whilst ISDA acknowledges that the transaction reporting requirement cannot be delayed generally, ISDA considers that a phased-in approach would be appropriate, for example by allowing firms to indicate that the transaction is over a 'bespoke basket' but not requiring more detailed information about the constituents of the basket during an introductory period.

**Q563: Which option is preferable for reporting financial instruments over indices? Would you have any difficulty in applying any of the three approaches, such as determining the weighting of the index or determining whether the index is the underlying in another financial instrument? Alternatively, are there any other approaches which you believe ESMA should consider?**

ISDA suggests that approach iii. is the most suitable approach for indices but as with other reportable financial instruments, ISDA would welcome the creation and maintenance of a central source of reportable financial instruments, to ensure all investment firms treat a transaction on the same index as reportable.

**Q564: Do you think the current MiFID approach to branch reporting should be maintained?**

ISDA would welcome clarity around the obligations of branches to report to correct any ambiguity (including under the current MiFID 1) which leads to duplicate reporting, over reporting or under reporting.

**Q565: Do you anticipate any difficulties in implementing the branch reporting requirement proposed above?**

ISDA would echo ESMA's stated desire for the requirements to be as simple as possible. The proposal for a branch's head office to report to solely the home NCA seems an appropriately succinct solution.

**Q566: Is the proposed list of criteria sufficient, or should ESMA consider other/extra criteria?**

In relation to criterion i. (most liquid market of instrument), ISDA notes that the concept of liquidity of an instrument is not well defined yet and will be decided in another facet of MiFIR/MiFID II. Therefore having a criterion which is contingent on as yet undefined feature is of concern.

ISDA also would welcome confirmation from ESMA that only NCAs are required to apply these criteria and correctly route the transaction reports, and so there will be no obligation on trading venues, systematic internalisers or investment firms to determine where transaction reports should be routed.

**Q567: Which format, not limited to the ones above, do you think is most suitable for the purposes of transaction reporting under Article 26 of MiFIR? Please provide a detailed explanation including cost-benefit considerations.**

FPML where FPML is the market standard, such as in the reporting of OTC derivatives, and XML where that is the market standard for the messaging format of financial information. The option to report via .csv file should also be available where investment firms' infrastructure is not capable of messaging in formats mentioned above.

## **Section 8.2 Obligation to supply financial instrument reference data**

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**Q568: Do you anticipate any difficulties in providing, at least daily, a delta file which only includes updates?**

Regarding the choice of file submission, ISDA notes that there are advantages and disadvantages to providing both delta files and full files. In addition to those identified in the Discussion Paper, there is a risk when providing a full file of erasing the previous file completely. Systematic internalisers building a solution for reporting instrument reference data will typically have functionality to do either full file and delta file. ISDA's preference would be for a solution that allows either full or delta files to be submitted but not the third suggested option where the use of delta and full files is mandated in a complicated sequence. This may introduce complexity which may have an adverse impact on reference data submissions.

ISDA welcomes an affirmative statement from ESMA confirming that the obligation to supply the instrument reference data is on trading venues and systematic internalisers and is not in any way on investment firms. ISDA would also welcome clarification from ESMA that systematic internalisers are only required to supply instrument reference data for instruments for which they are a systematic internaliser where this is not being provided by a trading venue under the first paragraph of Article 27(1) MiFIR. If so, then ISDA notes that a golden source of information would be needed in order to allow systematic internalisers to check whether they need to provide instrument reference data or whether up-to-date information has already been provided by a trading venue. Otherwise, systematic internalisers will not know which instrument reference data

they need to provide and which instrument reference data has already been provided by trading venues. This would likely lead to duplicative reporting by systematic internalisers.

**Q569: Do you anticipate any difficulties in providing, at least daily, a full file containing all the financial instruments?**

Regarding the choice of file submission, ISDA notes that there are advantages and disadvantages to providing both delta files and full files. In addition to those identified in the Discussion Paper, there is a risk when providing a full file of erasing the previous file completely. Systematic internalisers building a solution for reporting instrument reference data will typically have functionality to do either full file and delta file. ISDA's preference would be for a solution that allows either full or delta files to be submitted but not the third suggested option where the use of delta and full files is mandated in a complicated sequence. This may introduce complexity which may have an adverse impact on reference data submissions.

ISDA welcomes an affirmative statement from ESMA confirming that the obligation to supply the instrument reference data is on trading venues and systematic internalisers and is not in any way on investment firms. ISDA would also welcome clarification from ESMA that systematic internalisers are only required to supply instrument reference data for instruments for which they are a systematic internaliser where this is not being provided by a trading venue under the first paragraph of Article 27(1) MiFIR. If so, then ISDA notes that a golden source of information would be needed in order to allow systematic internalisers to check whether they need to provide instrument reference data or whether up-to-date information has already been provided by a trading venue. Otherwise, systematic internalisers will not know which instrument reference data they need to provide and which instrument reference data has already been provided by trading venues. This would likely lead to duplicative reporting by systematic internalisers.

**Q570: Do you anticipate any difficulties in providing a combination of delta files and full files?**

Regarding the choice of file submission, ISDA notes that there are advantages and disadvantages to providing both delta files and full files. In addition to those identified in the Discussion Paper, there is a risk when providing a full file of erasing the previous file completely. Systematic internalisers building a solution for reporting instrument reference data will typically have functionality to do either full file and delta file. ISDA's preference would be for a solution that allows either full or delta files to be submitted but not the third suggested option where the use of delta and full files is mandated in a complicated sequence. This may introduce complexity which may have an adverse impact on reference data submissions.

ISDA welcomes an affirmative statement from ESMA confirming that the obligation to supply the instrument reference data is on trading venues and systematic internalisers and is not in any way on investment firms. ISDA would also welcome clarification from ESMA that systematic internalisers are only required to supply instrument reference data for instruments for which they are a systematic internaliser where this is not being provided by a trading venue under the first paragraph of Article 27(1) MiFIR. If so, then ISDA notes that a golden source of information

would be needed in order to allow systematic internalisers to check whether they need to provide instrument reference data or whether up-to-date information has already been provided by a trading venue. Otherwise, systematic internalisers will not know which instrument reference data they need to provide and which instrument reference data has already been provided by trading venues. This would likely lead to duplicative reporting by systematic internalisers.

**Q571: Do you anticipate any difficulties in providing details of financial instruments twice per day?**

No. However, ISDA notes that information provided in the morning is unlikely to be different from the information provided at close of business the previous day. Therefore, the benefit of reporting twice a day (rather than once a day) is not apparent.

**Q572: What other aspects should ESMA consider when determining a suitable solution for the timeframes of the notifications? Please include in your response any foreseen technical limitations.**

ISDA notes the intention to have a frequency of twice per day but would welcome flexibility to allow time for the reference data in relation to OTC derivatives and more complex bespoke instruments to be gathered and decided. Consideration of the future landscape of markets in financial instruments will be important here particularly taking into account instruments which are traded OTC or traded over non-security underlyers. ISDA considers that ESMA should endorse the use of instrument identifiers such as a UPI or an instrument reference number.

ISDA notes that where the relevant instrument identifier is applied for as trading commences on a trading venue, the instrument identifier may not be available immediately upon commencement of trading and therefore could not be included in notifications required to be submitted before the instrument identifier is available. In this case, notifications may need to be delayed. Otherwise, an appropriate identifier would need to be allocated to an instrument before commencement of trading in that instrument on a trading venue.

**Q573: Do you agree with the proposed fields? Do trading venues and investment firms have access to the specified reference data elements in order to populate the proposed fields?**

Where an instrument identifier is designated for an instrument this identifier should have all the relevant reference information stored with it on many public data providers (e.g. with an ISIN the Issuer Country, Issuer Name etc can easily be referenced on a data provider such as Bloomberg). To provide any of this information in reference data reports from trading venues and systematic internalisers would be redundant and so should not be required, as it would place a disproportionate burden on firms to fill in such redundant information, and increases the risk of error.

**Q574: Are you aware of any available industry classification standards you would consider appropriate?**

ISDA considers that ISDA taxonomy would be most appropriate for OTC derivatives. ISDA and its members would be happy to work with ESMA to provide information on work done with ISDA taxonomy for derivatives. This is because ISIN or aii codes are not currently used for OTC derivatives and considerable changes to procedures for creating derivative instruments might be required, should the instrument identifiers be mandated to use a narrow class of identifiers.

Further details around use of the "Other" classification will be required, as at present is it not clear where derivative products fit into the proposed classification. For example, the "Futures" and "Options" sections seem to have been created with listed derivatives in mind and so it appears that non-listed or OTC derivatives would all fall within the "Other" category. ESMA should consider clearly stating that the Futures and Options classifications are for exchange traded Futures and Options (for example by designating them "ETD-Futures" & "ETD-Options") so it is clear that OTC derivatives should not be classified under these classifications. ESMA should further consider an OTC derivative classification with the ISDA taxonomy providing further classification granularity under this classification.

**Q575: For both MiFID and MAR (OTC) derivatives based on indexes are in scope. Therefore it could be helpful to publish a list of relevant indexes. Do you foresee any difficulties in providing reference data for indexes listed on your trading venue? Furthermore, what reference data could you provide on indexes?**

Details of reference data for indices should be available at public data providers. Where this is the case trading venues and systematic internalisers should not need to provide this instrument reference data. ISDA considers that providing the correct identification code which can be used to source the reference data from another data provider should be sufficient.

**Q576: Do you agree with ESMA's intention to maintain the current RCA determination rules?**

ISDA considers that where the current determination works well our members feel it should continue.

**Q577: What criteria would you consider appropriate to establish the RCA for instruments that are currently not covered by the RCA rule?**

ISDA understands that the responsibility to determine the RCA and route the transaction reports rests solely with the NCAs. ISDA notes that this understanding is consistent with the fact that there is no proposed field for the RCA to be indicated for Instrument Reference Data and therefore believes that its understanding is in line with ESMA's. However, ISDA should be grateful for confirmation of this from ESMA.

ISDA notes that it will be a considerable challenge to determine the RCA for financial instruments with non-security underlyers. For instance, which is the RCA for an FX derivative (where neither currency may be an EU currency) or derivative on a specific oil contract?

### **Section 8.3 - Obligation to maintain records of orders**

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**Q578: In your view, which option (and, where relevant, methodology) is more appropriate for implementation? Please elaborate.**

ISDA understands that ESMA is mandated to specify the order data required to be maintained by operators of trading venues under Article 25(2) MiFIR only (and not the order data required to be maintained by investment firms under Article 25(1) MiFIR). ISDA would welcome confirmation from ESMA that this is the case and that investment firms will therefore have discretion as to how they comply with Article 25(1) MiFIR.

Option 1 is ISDA's preferred approach (i.e. ESMA determines the list of data elements required but not the format in which they are maintained).

**Q579: In your view, what are the data elements that cannot be harmonised? Please elaborate.**

Most of the characteristics of orders are not standardised for derivatives.

**Q580: For those elements that would have to be harmonised under Option 2 or under Option 3, do you think industry standards/protocols could be utilised? Please elaborate.**

ISDA considers that an ESMA-endorsed industry standard or taxonomy will be needed for this approach to work.

**Q581: Do you foresee any difficulties with the proposed approach for the use of LEI?**

In ISDA's view, when maintaining records of orders, recording internal counterparty IDs should suffice. These can then be mapped to the LEI (if the counterparty has one) at a later time on request, via a lookup of static data provided with order data.

It should also be noted that for block orders, the LEI of the counterparty may not be known at all until allocation.

One other related difficulty is where participants do not have an LEI. ISDA considers that firms should not be prevented from trading with a counterparty that does not have an LEI (even if the counterparty is eligible for an LEI). Otherwise, this would put firms in the position of requiring their clients to obtain an LEI and may be a barrier to trading with the counterparty. ISDA would welcome confirmation from ESMA that, as for transaction reporting, where a counterparty does

not have an LEI, a BIC may be used instead, and where the counterparty has neither an LEI nor a BIC, a national code may be used.

## Section 8.5 - Synchronisation of business clocks

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**Q602: Would you prefer a synchronisation at a national or at a pan-European level? Please elaborate. If you would prefer synchronisation to a single source, please indicate which would be the reference clock for those purposes.**

ISDA believes that a better approach is for the regulation to refer to a typical maximum divergence from UTC rather than proscribing the technology (see A604). However, ISDA recommends that divergence is expressed by reference to the international stratum levels (ANSI/T1.101-1987) definitions of accuracy since this determines the accuracy of clocks.

These stratum/tiers recognise the practical (operational, technical, implementation, cost) barriers of distribution and synchronisation of time as it fans out from the reference clocks. The highest stratum/tier of accuracy would be applied to events occurring in higher volume execution trading venues (where proximity of a GPS synchronised reference clock would be most practical) whereas the lower tiers of accuracy would be appropriate for events occurring further within individual market participants infrastructure where the primary reference clock may have been further disseminated through lower strata (i.e. by defining different minimum strata for roles such as execution or post-trade processing).

It should be recognised that NTP is the only widely available cross-platform protocol for synchronisation.

To avoid barriers to entry, in terms of synchronising the primary internal reference clock of market participants, this should also be tiered with larger market participants (e.g. with access to dedicated data centres) meeting a higher standard of accuracy (e.g. such as provided by GPS) whereas smaller participants may set the primary clock through more readily available but less accurate means (e.g. NTP over the internet).

**Q603: Do you agree with the requirement to synchronise clocks to the microsecond level?**

ISDA disagrees with a requirement to synchronise all clocks to the microsecond level - a tiered/stratum approach should be used instead. For lower tiers of process it should be acceptable to allow for the tolerance expected from widely available NTP for common operating platforms (including windows) which could be much wider - potentially +-10s of milliseconds over Internet, +-1s of milliseconds over LAN in ideal conditions and perhaps errors as wide as +-100 milliseconds in the face of asymmetric routes and network congestion ([http://en.wikipedia.org/wiki/Network\\_Time\\_Protocol](http://en.wikipedia.org/wiki/Network_Time_Protocol)).

PTP is not a widely used protocol and while capable of greater accuracy also has dependency on ideal network conditions and potentially costly network reconfiguration; whilst it could be used in a targeted manner for crucial sensitive areas (e.g. trading venue execution) it will not be practical (or useful) to employ widely.

Consideration needs to be given to the granularity of timestamps generated within the infrastructure separately from the accuracy of the clock being referenced. ISDA disagrees that time should always be reported at the microsecond level. Both modern and legacy software platforms and environments running across market venues and within market participants infrastructure (java, .net, sql, etc) are highly diverse and, by default, typically only provide access to timestamp granularity at a millisecond granularity ([http://en.wikipedia.org/wiki/System\\_time](http://en.wikipedia.org/wiki/System_time)).

It will be technologically impractical to upgrade all software environments to support a finer granularity of time. Even extending timestamp data formats to have sufficient decimal places to hold microseconds would be a massive and costly exercise and in practice no advantage will be gained if the underlying software platform does not provide sufficient granularity of the clock to provide any significant figures past the millisecond level (i.e. always having 000 in the 4th to 6th significant figures). Moreover, where there is language/OS support, the clock itself has to be read by any running program which is itself a process that will have widely varying latency depending upon whether process is running on physical or virtual server, specific operating system, CPU specification, programming language, load on the server, etc. which could itself add inaccuracies measured in 10s of microseconds to the timestamp read.

It is important therefore to target the granularity requirement to those 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. Considering all the above, ISDA disagrees that there should be a blanket tolerance of 1ms and recommend higher and/or tiered tolerances.

**Q604: Which would be the maximum divergence that should be permitted with respect to the reference clock? How often should any divergence be corrected?**

ISDA notes that whilst firms setting their primary internal reference clock via GPS will be able to adhere to a fairly tight divergence, this is unlikely to be the case for smaller participants unable to leverage GPS for setting their internal reference clock. For participants who use NTP to set their internal reference clock, the protocol will check and correct recognised divergences but it will not be possible to practically measure or control the fundamental divergence introduced by virtue of NTP's dependence on ideal network conditions for accuracy.

In respect of divergence between a firm's primary internal reference clock and its internal server clocks, the same limitations relating to use of NTP (or another protocol) and the difficulty to measure/control divergences will also generally apply, even if the firm is bringing in GPS to a central point.

However, outside of those specific cases where the accuracy of the reference clocks are critical to support the required granularity of timestamping (e.g. high volume electronic automated executions) these divergences would not be a practical issue due to timestamping limitations.

ISDA considers that divergence should be checked and corrected at least every 30 minutes, although in practice, it is likely that many firms' protocols will go into a cycle of more frequent checking when a divergence is recognised.

## Section 9 - Post-trading issues

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### Section 9.1 - Obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing (STP)

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**Q605: What are your views generally on (1) the systems, procedures, arrangements supporting the flow of information to the CCP, (2) the operational process that should be in place to perform the transfer of margins, (3) the relevant parties involved these processes and the time required for each of the steps?**

For the avoidance of doubt, unless otherwise stated, our responses relate to OTC derivatives only. By way of general comments, we would note the following:

1. It is imperative that the regulatory and market frameworks ensure that all parties involved throughout the derivatives clearing chain have as much **certainty of clearing at execution** as is reasonably achievable in order to reduce participants' credit and counterparty risk.

As discussed below, such risks can be mitigated by pre-execution limit checks and use of a 'soft' kill switch. Ultimately, to ensure absolute certainty of clearing at execution it would be necessary to check (prior to execution) that: (i) (where the counterparty is not clearing on its own behalf) the client's limits with its nominated clearing broker ("**CB**") are not exceeded and (ii) the CB remains in good standing at the CCP. In the short term, leveraging the work conducted in the US to ensure compliance with the US rules on STP, it would be possible to develop a system of pre-execution credit checks which would operate to assess and confirm whether the executing party's nominated CB (where relevant) is willing to accept the resulting trade.

Members are broadly supportive of the principle of pre-execution credit checks which would operate at the CB level (i.e. to assess the CB's credit limits at the relevant CCP). Such checks may increase the certainty of clearing at execution by reducing the number of trades which are rejected by a CCP because the relevant CB has insufficient margin. However, developing a workable system imposes a number of challenges and at present there is no consensus on a way forward. Accordingly, we would encourage ESMA to ask CCPs to work with the industry to identify potential solutions.

2. Parties clearing OTC derivatives transactions also need **absolute product certainty prior to execution**. Whilst, product requirements are to a large extent covered by the relevant venue and CCP rules there are rare occasions on which ineligible transactions are submitted to a CCP. In our view it is important that the clearing obligation is applied with sufficient granularity to give certainty to the market, with the determination in respect of the application of the clearing obligation to an individual transaction possible by reference to a definitive list maintained and published by ESMA.
3. The treatment of **rejected OTC derivative transactions** will depend on whether they are executed on or off of a Trading Venue.

- a. When trading off venue, industry participants should have agreements in place that address trades that are intended to clear if they are rejected by the CCP, such agreements should include a robust resubmission process.
  - b. When executed on a Trading Venue, the rules of the Trading Venue should govern their treatment. However, in our view such rules should include as the first fall-back a robust resubmission process. Where a trade fails the resubmission process, for whatever reason, we would recommend that the venue provides clarity on its mechanisms for remediation which may include rules for calculation of breakage amounts or rules for nullification of the trade. In our view, ESMA should not be prescriptive in this regard and should:
    - i. allow Trading Venues to determine the hierarchy of remediation rules for their venue; and
    - ii. in respect of name disclosed Trading Venues, allow parties to supplement the remediation rules of a Trading Venue with a bilateral agreement provided that (i) such bilateral arrangements do not supersede or override the rules of the Trading Venue and (ii) the arrangements do not seek to, and are not used to, impose conditions in relation to whom the parties can trade with on the relevant Trading Venue.
4. There are significant problems with the introduction of rules which treat as invalid from the outset trades which fail to clear, without preserving the economic impact of subsequent price movements (referred to in this response as "**Trade Nullification Rules**") As noted in point 3 above, it is imperative that, in such instances, the industry is afforded sufficient time to rectify and resubmit the trade. As noted above if resubmission is unsuccessful then nullification should be permitted as a means of remediation alongside other mechanisms that would preserve the economic interest through a compensation arrangement but these mechanisms and their hierarchy should be set out clearly in the rulebooks of the Trading Venues and/or the applicable bilateral arrangements; and
  5. Where possible and appropriate it will be important, in the context of the global OTC derivatives market and given that a significant number of market participants have constructed, and are using, the execution and clearing architecture necessary to comply with the CFTC rules, to establish a sufficiently flexible market framework which **follows the precedent set in the US for OTC derivatives**. In our view, consistency should be a core aim and unnecessary divergence between the US and European regulatory regimes (unless justified, as is the case in respect of the treatment of trades that fail to clear and other areas highlighted in our response) will result in conflicts of law that will reduce liquidity and access to global markets for end users

**Q606: In particular, who are currently responsible, in the ETD and OTC context, for obtaining the information required for clearing and for submitting the transaction to a CCP for clearing? Do you consider that anything should be changed in this respect? What are the current timeframes, in the ETD and OTC context, between the conclusion of the contract and the exchange of information required for clearing on one hand and on the other hand between the exchange of information and the submission of the transaction to the CPP?**

For the avoidance of doubt, unless otherwise stated, our responses relate to OTC derivatives only.

*Existing OTC Clearing Process in Europe*

The existing clearing process for OTC derivatives can be summarised as follows (and is represented diagrammatically in Figure A, "**Existing OTC Clearing Model**" below). In our example we set out a scenario in which a voice trade is executed between a self-clearing market participant ("**Dealer**") and a counterparty ("**C/p**") that clears through a CB:

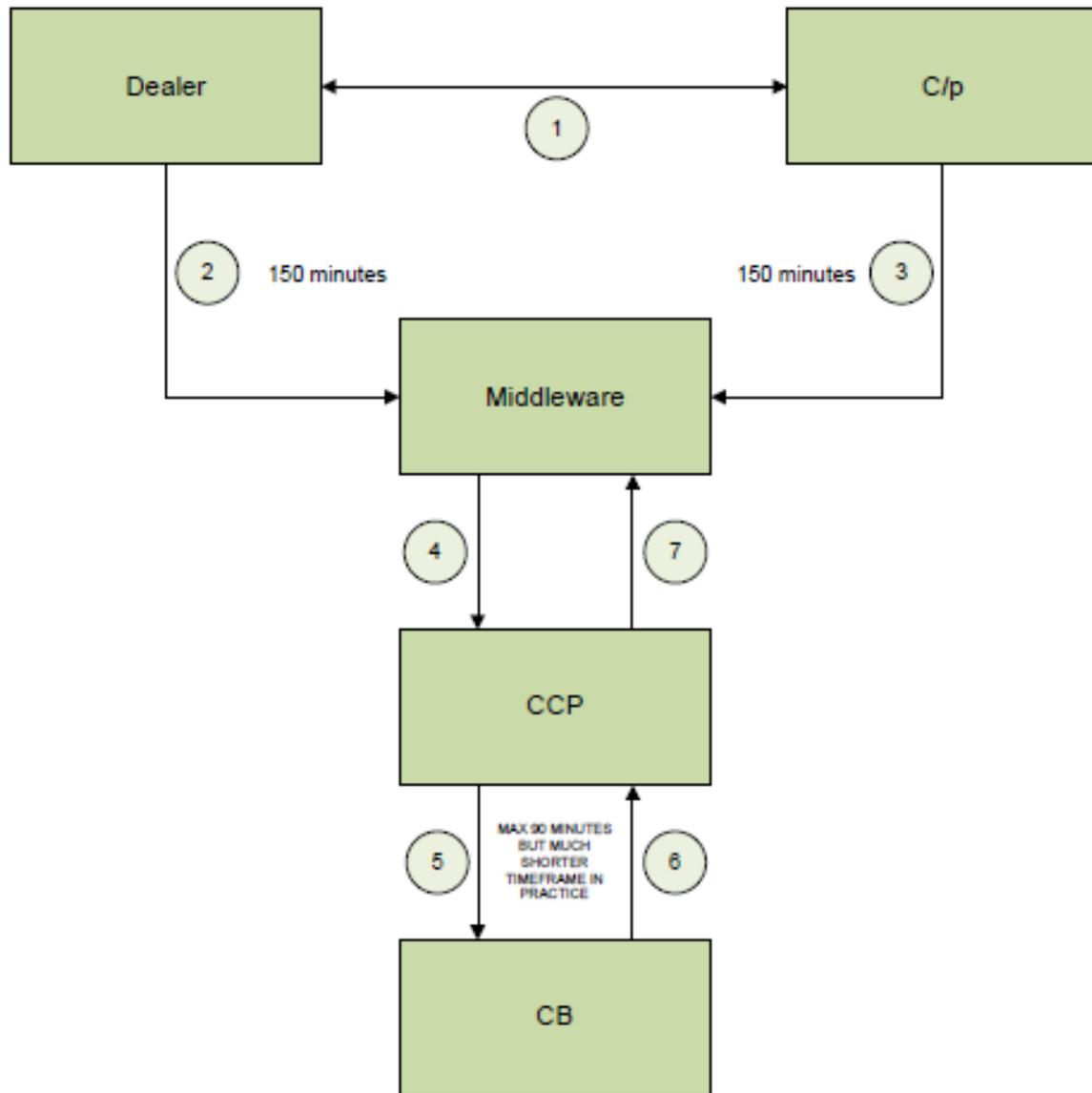
1. **Step 1** - C/p and Dealer bilaterally execute an OTC derivative transaction, which they intend to clear.
2. **Steps 2 and 3** - C/p and/or Dealer submit the details of that OTC derivative transaction to the agreed CCP (together with details regarding CB) via an appropriate trade source system ("**Middleware**"). The trade details need to match in the Middleware before they are sent on to the CCP. Any mismatched trades will remain in the Middleware until the mismatch is resolved.
3. **Step 4** – On receipt of the message from the relevant Middleware, the CCP performs (i) a counterparty risk check to validate whether the relevant CBs are within their established risk limits and (ii) product validation to ensure that the relevant transaction meets the relevant product eligibility criteria.
4. **Step 5** – The CCP sends a request to clear the OTC derivative transaction to CB via the request / consent flow system.
5. **Step 6** - CB will check that the trade falls within C/p’s credit limits and will accept or reject the OTC derivative transaction for clearing on that basis.
6. **Step 7** – Once it has received an acceptance back from CB, and assuming its own checks on Dealer and CB in Step 4 were positive, the CCP will accept the trade for clearing. Subject to satisfaction of the requirements in the relevant CCP’s rulebook, upon acceptance the CCP will register two contracts: one between CB and the CCP on behalf of C/p, the other between the CCP and Dealer. Under the clearing agreement between CB and C/p, a back-to-back transaction is deemed to come into existence between CB and C/p.

Under the existing process, there are no regulatory timing requirements with respect to OTC derivative clearing; therefore, in theory (subject to the timing requirements set out in the relevant CCP's rulebook e.g. some CCPs stipulate that trades can only be submitted for clearing up to close of business on T+1 after execution) a trade could remain un-cleared indefinitely if, for instance, the Middleware trade submissions do not match or the trade is not accepted or rejected by CB. However, whilst there are no regulatory timing requirements, best practice guidelines indicate a time period of 4 hours from the point of execution to clearing. In addition, counterparties may agree to impose contractual time-frames. In this respect, we note that the market standard execution agreement mandates the following timeframes:

1. 150 minutes from the execution of the transaction for C/p and Dealer to complete steps 2 and 3;
2. 90 minutes after the submission of the transaction to CB for rejection/acceptance of trade (step 6) with an absolute longstop date of 10:30 am on the business day immediately following the day on which the transaction was executed. Although, we would note that some participants have infrastructure in place to ensure that this step is conducted on a much quicker timescale (i.e. within a matter of minutes).

We should note that, in a variation to the model described above, some CBs communicate their clients' limits to the CCP and allow the CCP to perform the relevant C/p credit limit check on their behalf.

Figure A – Existing OTC Clearing Model where an execution agreement is in place



1. C/p executes a trade with Dealer
2. Dealer submits trade to the Middleware
3. C/p makes allocations and affirms trade in Middleware
4. Middleware messages the CCP with the individual allocations alleged for clearing
5. CCP sends the trades proposed for clearing to CB
6. CB accepts/rejects trade and then confirms trade acceptance back to the CCP
7. CCP sends confirmation that the trades have cleared back to the Middleware/C/p

*Proposed improvements to clearing process for OTC derivative transactions*

"Off venue" transactions (those transactions which are subject to the clearing obligation but are not subject to the trading obligation) necessarily involve manual processing. Whilst, we recognise that the timeframe for steps 5 and 6 in Figure A should become more closely aligned with the equivalent steps for trades executed on venue, it will take time for market infrastructure to be developed to support this. Accordingly, the workflow set out above continues to be the only viable workflow for "off venue" derivative transactions.

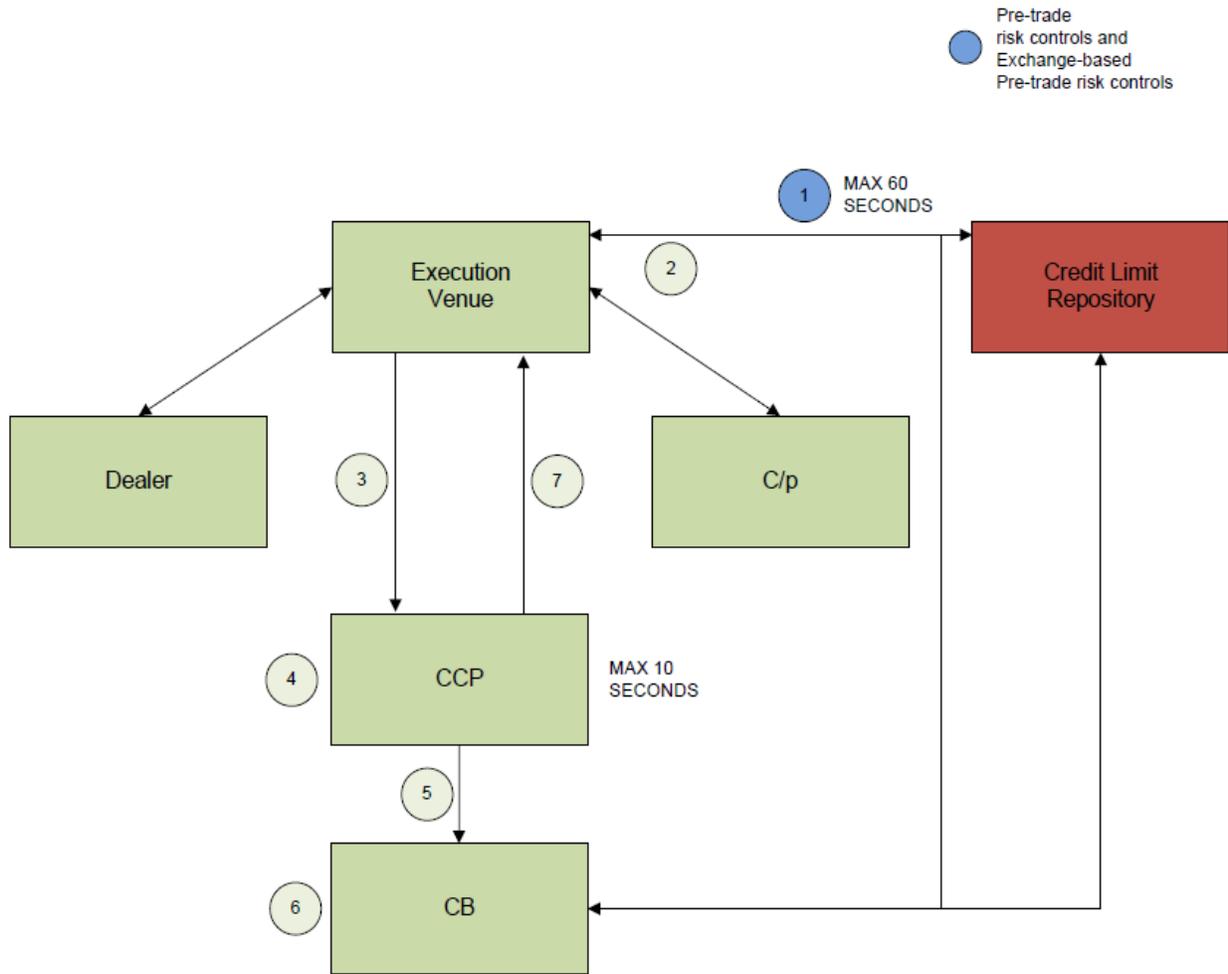
As we move increasingly towards venue-based execution however there are a number of amendments (in particular the implementation of a pre-execution C/p credit check) that should be made to the existing workflow for on venue trades in order to provide a robust market infrastructure for all parties.

In this regard, it is necessary to distinguish between:

- (i) screen-based/electronic Trading Venues which are fully automated; and
- (ii) voice Trading Venues which continue to involve an element of manual process.

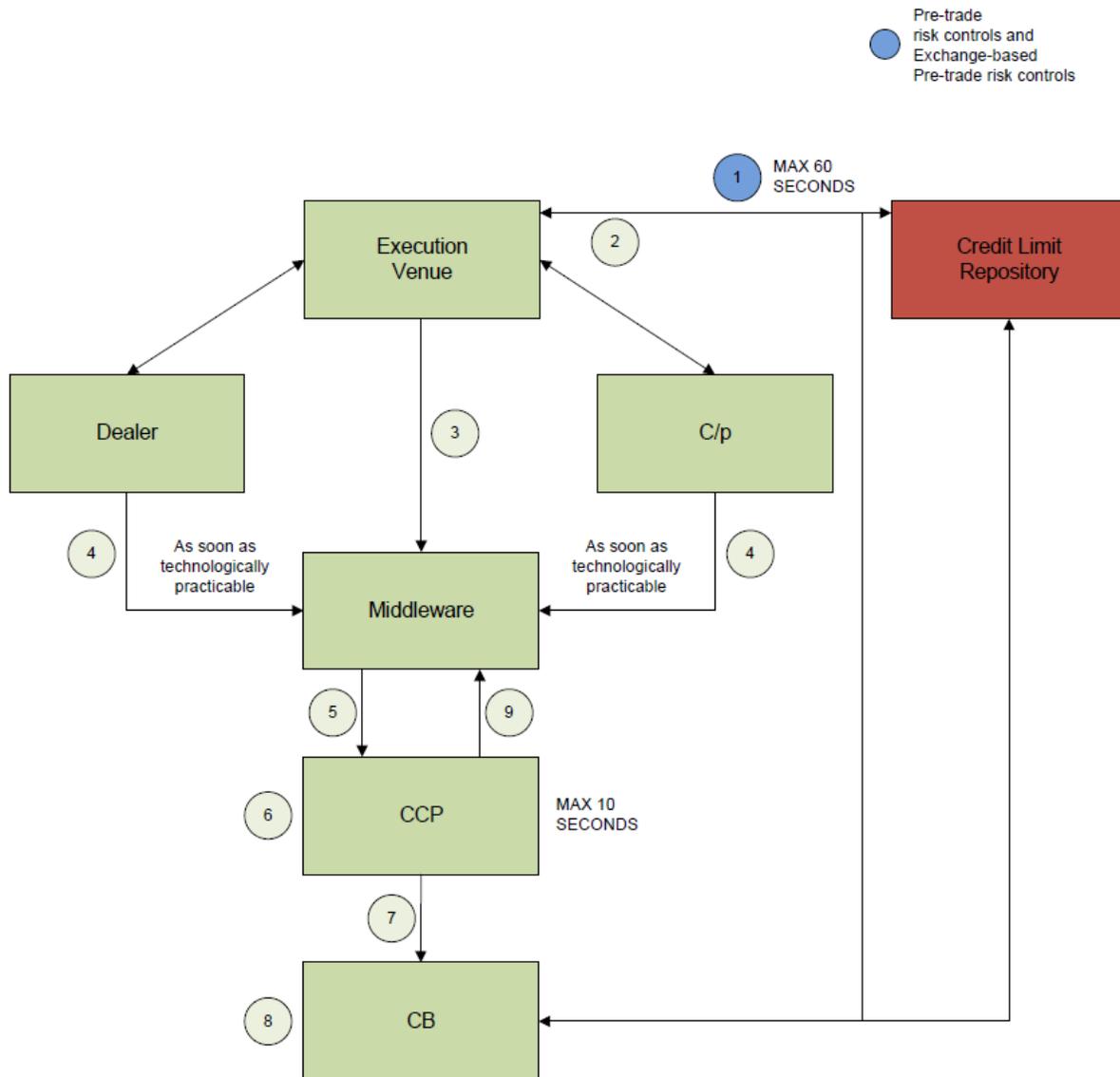
The revised process flow for both scenarios are set out in Figure B (Screen-Based/Electronic Venue Workflow with Pre-Execution Check) and Figure C (Voice Venue Workflow with Pre-Execution Check). The proposed improvements are discussed in further detail below.

Figure B – Screen-Based/Electronic Venue Workflow with Pre-Execution Check



- ① C/p obtains a pre-execution credit check and product eligibility check (i.e. validates that the product is clearable) on an Execution Venue, either via a credit limit repository (i.e. Credit Hub) or directly at Execution Venue as provided by CB
- ② Credit limit repository or Execution Venue assigns a credit approval for client side of the trade
- ③ Trade is executed and Execution Venue submits trade to CCP
- ④ CCP performs the following checks prior to clearing;
  - a. CCP product check
  - b. risk check for creditworthiness of Dealer and CB
- ⑤ Trade sent to clearing bypassing any CB request/consent workflow
- ⑥ CB books trade into risk system no client level credit check required as trade cleared and pre-execution checked
- ⑦ CCP sends confirmation that the trades have cleared back to Execution Venue

Figure C – Voice Venue Workflow with Pre-Execution Check



- ① C/p obtains a pre-execution credit check and product eligibility check (i.e. validates that the product is clearable) on an Execution Venue, either via a credit limit repository (i.e. Credit Hub) or directly at Execution Venue as provided by CB
- ② Credit limit repository or Execution Venue assigns a credit approval for client side of the trade
- ③ Trade is executed and Execution Venue submits trade to CCP via Middleware
- ④ C/p and Dealer affirm trade in Middleware
- ⑤ Middleware messages CCP
- ⑥ CCP performs the following checks prior to clearing;
  - a. CCP product check
  - b. risk check for creditworthiness of Dealer and CB
- ⑦ Trade sent to clearing bypassing any CB request/consent workflow
- ⑧ CB books trade into risk system no client level credit check required as trade cleared and pre-execution checked
- ⑨ CCP sends confirmation that the trades have cleared back to Middleware

A. Proposed requirements for Trading Venues:

In our view, the current arrangements would be improved if Trading Venues were required to perform the following functions/carry out the following tasks (as applicable).

1. Ensure a **pre trade credit and product eligibility check** is performed on all orders submitted to the Trading Venue so that transacting parties know that all orders have been pre-approved by any relevant CBs. While pre-trade credit check infrastructure exists in the US and in time could be developed for implementation in Europe, in order to incorporate a pre-execution product eligibility check, the market would need to develop new forms of infrastructure. Notwithstanding, we agree that the industry should aspire to move these product checks to as close to the point of execution as possible. Accordingly, ESMA should engage with the industry in this respect, noting that any requirements in this regard would need to be subject to phase-in periods which have been agreed with the industry and all market participants.
2. Send all **trade status messages in real time** to the CB (directly or via a credit limit repository). Trade status messages should include:
  - a. new orders for credit screening;
  - b. execution/partial execution of pre-approved orders;
  - c. (where a C/p elects to cancel an open order it has placed on a Trading Venue) expiration/cancellation of unexecuted pre-approved orders;
  - d. cancellation of open orders pursuant to operation of a kill switch;
  - e. partial cancellations of pre-approved orders (i.e. client reduces notional, only partial fill occurred); and
  - f. notice of trades rejected for clearing by the CCP.
3. Provide CBs with the option to execute (directly or via a credit limit repository) a **kill switch** enabling the CB to cancel open orders. This is a ‘last resort’ option for a CB to deal with the extreme cases where it urgently needs to cut all exposure to a client, including with respect to pre-approved orders that remain unexecuted.
4. To the fullest extent possible, ensure **direct delivery of executed trades to the CCP** for clearing immediately after execution. In our view, the trade record delivered to the CCP must include (inter alia) details of all parties to the transaction. A screen-based Trading Venue will have, with respect to an executed trade, all the information required for the submission to clearing and there will be no requirement for an affirmation step prior to submission. A direct or "hands-free" submission from the venue to the CCP will be far

quicker than one that relies on affirmation. Thus this approach to submission should be encouraged.

5. In the voice context, affirmation is an important concept because the parties need to agree on the trade that they executed prior to submission to the CCP. The affirmation step implies a certain amount of latency but parties should be encouraged to process their responsibilities relating to submission as promptly as possible. Thus we would encourage controls and procedures to be implemented to ensure that all parties are alerted when **CCP affirmation messages** are not received on a timely basis.
6. Put in place controls and procedures to facilitate **trade resubmission** in those circumstances where it is permitted. In particular, Trading Venues should:
  - a. receive clearing status messages from the CCP;
  - b. ensure that any CCP rejection messages they receive are relayed immediately to the appropriate parties;
  - c. support (though not mandate) the optionality set out in the market standard execution agreement for dealing with problems in clearing a trade;
  - d. where appropriate, facilitate a process to enable the parties to resolve any problems with a rejected trade and, if agreed, resubmit the trade for clearing; and
  - e. ensure action takes place within 30 minutes.
7. When offering **bunch order allocation** tools on their platform, the Trading Venue should generate a link identifier between bunched orders, decrements and ultimate allocations and ensure that the economic details of allocations and decrements match the original bunched order.
8. Where third parties are involved in providing messaging services between the Trading Venue and CCP, the Trading Venues should be responsible for **ensuring** such **third parties comply** with the relevant regulatory and/or best practice requirements (i.e., middleware/affirmation platforms should not interfere with the requirement that cleared derivatives are "submitted and accepted for clearing as quickly as technologically practicable using automated systems" (as required by Article 29(2) of MiFIR)).

Trading Venues in the US have adopted various means of facilitating pre-execution screening of trades against CB risk-based limits. Given that there are a variety of potential approaches to pre-screening, we do not believe that the technical standards should be prescriptive as to the form such screening functionality must take. Rather, Trading Venues and hubs should be afforded flexibility on the precise types of credit screening/limit checking they offer and be free to compete with each other in offering functionality that will attract CBs to their platforms. A CB may also elect to require a Trading Venue to "ping" the CB (or a limits hub) for a credit screen/approval (which should be processed consistent with STP standards (e.g., within 60

seconds)) if the CB prefers not to "push" limits or otherwise use a Trading Venue's limit screening functionality.

B. Proposed requirements for CCPs:

In our view, the current arrangements would be improved if CCPs were required to perform the following functions/carry out the following tasks (as applicable).

1. Amend its rules to **remove Clearing Members ("CM")' "last look" provisions** (i.e., request/consent messaging from the CB) for any trades that had passed a pre-execution credit check.
2. **Report clearing status** of a trade to both the Trading Venue and the CBs immediately. In our view this should include obligations to (i) inform the Trading Venue and CBs if a trade has been rejected for clearing immediately with a rejection reason applied to the messaging and (ii) notify CBs of trade executions in real time.
3. CCPs must have controls in place for the **bunch order process**. This includes:
  - i. Verification of the existence of a bunched order I.D. to eliminate over allocation and under allocation (i.e. ultimate allocations bunch and decrement should all share an identifier).
  - ii. The ability to properly label transactions in the bunch account as "New Bunch" and "Decrement".
4. Require all trade sources systems (Middleware providers) and Trading Venues to meet **consistent standards**. In particular CCP should required trades source systems and Trading Venues to use consistent data fields and to pass on execution IDs.
5. CCPs should be required to accept/reject trades within a very short timeframe – 10 seconds is the standard in the US and in our view such timelines are achievable.
6. Put in place policies and procedures on the cure process for **erroneous trades**.

In our view, ESMA should engage with CCPs to assess the feasibility of introducing a pre-trade credit check on each CB order.

**Q607: What are your views on the balance of these risks against the benefits of STP for the derivatives market and on the manner to mitigate such risks at the different levels of the clearing chain?**

In our view, the benefits of STP far outweigh the risks associated with it and that STP provides benefits to the parties at different levels of the clearing chain.

*Executing Party*

The executing parties are exposed to counterparty risk under the OTC derivative transaction prior to it being cleared. Therefore clearing certainty prior to or at the time of execution is critical and the transaction should be cleared as soon as technologically practicable. By reducing the likelihood of rejections from clearing (using pre-trade credit checks) and by compressing the timeframe for clearing (by applying STP), in our view the risks to executing parties will be reduced.

### *Clearing Broker*

The CB faces credit risk management challenges. However as we described above in response to question 606 we are of the view that these risks can be mitigated via pre-execution credit limit checks and use of a 'soft' kill switch.

### *CCP*

We do not believe that ESMA should prescribe pre-funding of a clearing arrangement between a client and their clearing member or a clearing member with a CCP. It should be the responsibility of the CCPs and Clearing Members, as extenders of interim credit, to be able to analyse the credit worthiness of their clients and establish credit limits as appropriate. Where a CCP extends credit, it should have sufficient capital, plus suitable control systems in place to ensure such credit risks are managed and the default of a member to whom credit has been extended does not impact other members in unexpected ways. Alternatively a CCP might offer an effective credit facility through mutualisation of such a risk by members to account for the temporary extension of credit, such mutualisation amounts being in excess of the Default Fund requirement for the CCP.

### *CFTC lessons*

Our members have recently updated their systems and procedures in order to comply with the STP requirements in the US and we would reiterate our desire (where appropriate and proportionate) for a consistent cross-border approach. Our Members are supportive of the following features of the US regime for STP, each of which reduces the risks inherent in the clearing process:

1. CFTC prescribes pre-trade credit checks for all orders submitted to a venue.
2. CFTC permits trades above specified notional amounts ("**Block trades**") to be executed off-venue and subject to more relaxed protocols.
3. CFTC mandates that trades need to be submitted for clearing as soon as technologically practicable and in any event by close of business of the trade date which prevents trades rolling over to the next business day.
4. CFTC mandates that the pre-approval of a trade by a CB cannot be revoked.

5. CFTC mandates that trades must be routed by SEFs to CCPs as quickly as would be technologically practicable if fully automated systems were used.
6. CFTC mandates that CBs have no more than 60 seconds to accept/reject a trade.
7. CFTC mandates that CCPs have no more than 10 seconds to accept/reject a trade.

For the avoidance of doubt, our responses relate to OTC derivatives only.

**Q608: When does the CM assume the responsibility of the transactions? At the time when the CCP accepts the transaction or at a different moment in time?**

For OTC derivative transactions that are executed on or subject to the rules of a Trading Venue, where a pre-execution credit check has occurred, the CB commits to accepting the trade (subject to the operation of the kill switch) at the time of the pre-execution credit check is passed. However, the counterparty risk will not actually transfer until trade is executed and accepted for clearing by the CCP, in accordance with the relevant Trading Venue's and CCP's rulebook.

For OTC derivative transactions that are not executed on or subject to the rules of a Trading Venue, the CB assumes responsibility for the trade at the time when the post-execution credit check is passed and the CB accepts the trade.

For the avoidance of doubt, our response relates to OTC derivatives only.

**Q609: What are your views on how practicable it would be for CM to validate the transaction before their submission to the CCP? What would the CM require for this purpose and the timeframe required? How would this validation process fit with STP?**

In the context of transaction validation, it is necessary to distinguish between (i) credit validation and (ii) product validation and (x) transactions executed off-venue and (y) transactions executed on venue.

In respect of transactions executed off venue it is not possible to conduct a pre-trade credit check or product validation before the transaction is submitted to the CCP.

In respect of on venue transactions it is possible to facilitate a pre-execution credit check prior to execution and in our view if appropriate product controls and procedures are in place between CBs, CCPs and Trading Venues to manage a pre-CCP submission, product validation by a CB is not necessary.

While pre-trade credit check infrastructure exists in the US and in time could be developed for implementation in Europe, in order to incorporate a pre-execution product eligibility check, the market would need to develop new forms of infrastructure. Notwithstanding, we agree that the industry should aspire to move these product checks to as close to the point of execution as possible. Accordingly, ESMA should engage with the industry in this respect, noting that any

requirements in this regard would need to be subject to phase-in periods which have been agreed with the industry and all market participants.

For the avoidance of doubt, our response relates to OTC derivatives only.

**Q610: What are your views on the manner to determine the timeframe for (1) the exchange of information required for clearing, (2) the submission of a transaction to the CCP, and the constraints and requirements to consider for parties involved in both the ETD and OTC contexts?**

We have set out our proposed changes to the cleared OTC derivative transaction flow in our response to Q606 (which we have copied below). As discussed, we believe these timeframes work well in the context of the US STP rules and we see no reason to deviate from these timeframes.

For the avoidance of doubt, unless otherwise stated, our responses relate to OTC derivatives only.

*Existing OTC Clearing Process in Europe*

The existing clearing process for OTC derivatives can be summarised as follows (and is represented diagrammatically in Figure A, "**Existing OTC Clearing Model**" below). In our example we set out a scenario in which a voice trade is executed between a self-clearing market participant ("**Dealer**") and a counterparty ("**C/p**") that clears through a CB:

1. **Step 1** - C/p and Dealer bilaterally execute an OTC derivative transaction, which they intend to clear.
2. **Steps 2 and 3** - C/p and/or Dealer submit the details of that OTC derivative transaction to the agreed CCP (together with details regarding CB) via an appropriate trade source system ("**Middleware**"). The trade details need to match in the Middleware before they are sent on to the CCP. Any mismatched trades will remain in the Middleware until the mismatch is resolved.
3. **Step 4** – On receipt of the message from the relevant Middleware, the CCP performs (i) a counterparty risk check to validate whether the relevant CBs are within their established risk limits and (ii) product validation to ensure that the relevant transaction meets the relevant product eligibility criteria.
4. **Step 5** – The CCP sends a request to clear the OTC derivative transaction to CB via the request / consent flow system.
5. **Step 6** - CB will check that the trade falls within C/p's credit limits and will accept or reject the OTC derivative transaction for clearing on that basis.

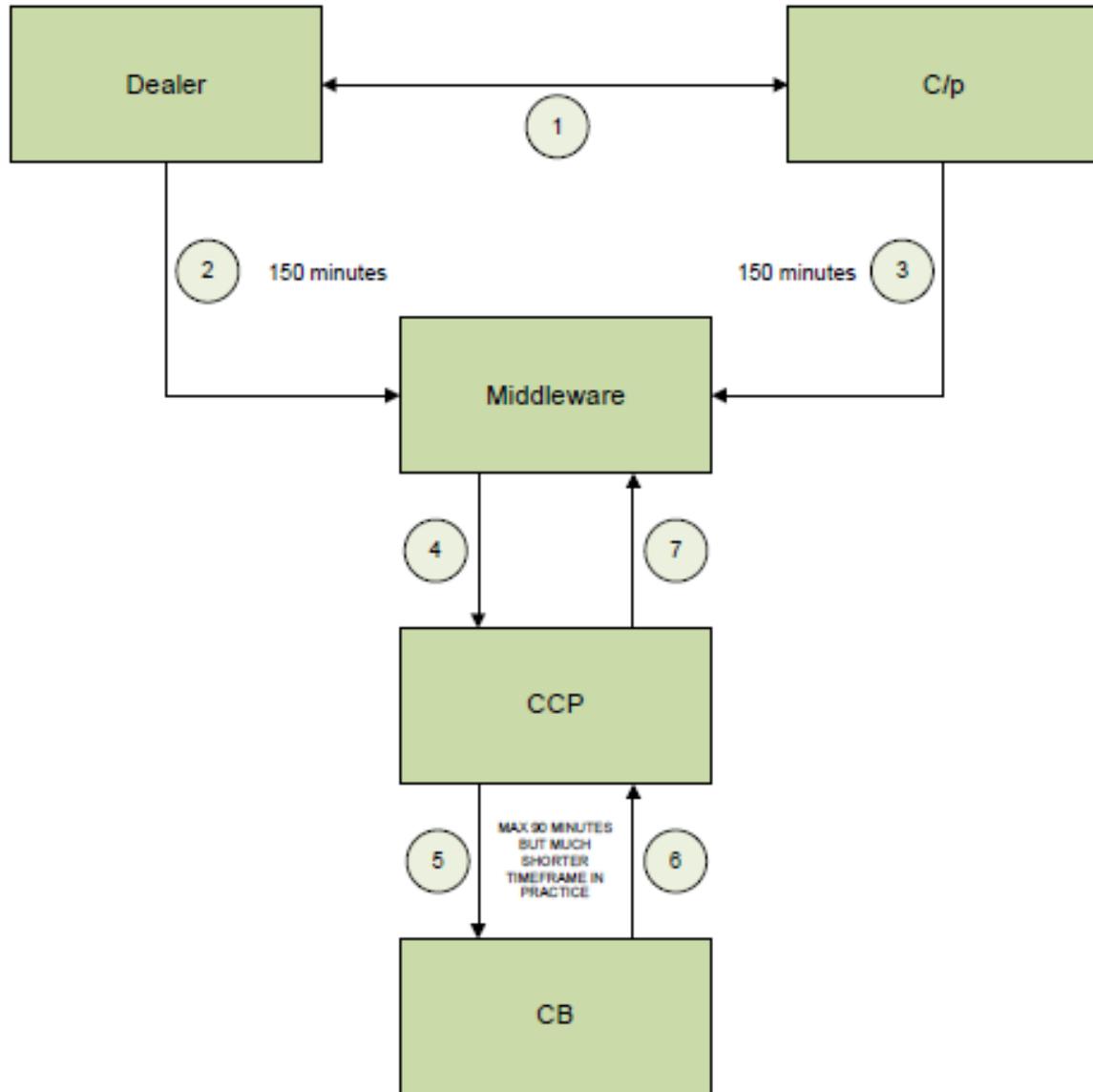
6. **Step 7** – Once it has received an acceptance back from CB, and assuming its own checks on Dealer and CB in Step 4 were positive, the CCP will accept the trade for clearing. Subject to satisfaction of the requirements in the relevant CCP’s rulebook, upon acceptance the CCP will register two contracts: one between CB and the CCP on behalf of C/p, the other between the CCP and Dealer. Under the clearing agreement between CB and C/p, a back-to-back transaction is deemed to come into existence between CB and C/p.

Under the existing process, there are no regulatory timing requirements with respect to OTC derivative clearing; therefore, in theory (subject to the timing requirements set out in the relevant CCP’s rulebook e.g. some CCPs stipulate that trades can only be submitted for clearing up to close of business on T+1 after execution) a trade could remain un-cleared indefinitely if, for instance, the Middleware trade submissions do not match or the trade is not accepted or rejected by CB. However, whilst there are no regulatory timing requirements, best practice guidelines indicate a time period of 4 hours from the point of execution to clearing. In addition, counterparties may agree to impose contractual time-frames. In this respect, we note that the market standard execution agreement mandates the following timeframes:

1. 150 minutes from the execution of the transaction for C/p and Dealer to complete steps 2 and 3;
2. 90 minutes after the submission of the transaction to CB for rejection/acceptance of trade (step 6) with an absolute longstop date of 10:30 am on the business day immediately following the day on which the transaction was executed. Although, we would note that some participants have infrastructure in place to ensure that this step is conducted on a much quicker timescale (i.e. within a matter of minutes).

We should note that, in a variation to the model described above, some CBs communicate their clients’ limits to the CCP and allow the CCP to perform the relevant C/p credit limit check on their behalf.

Figure A – Existing OTC Clearing Model where an execution agreement is in place



1. C/p executes a trade with Dealer
2. Dealer submits trade to the Middleware
3. C/p makes allocations and affirms trade in Middleware
4. Middleware messages the CCP with the individual allocations alleged for clearing
5. CCP sends the trades proposed for clearing to CB
6. CB accepts/rejects trade and then confirms trade acceptance back to the CCP
7. CCP sends confirmation that the trades have cleared back to the Middleware/C/p

*Proposed improvements to clearing process for OTC derivative transactions*

"Off venue" transactions (those transactions which are subject to the clearing obligation but are not subject to the trading obligation) necessarily involve manual processing. Whilst, we recognise that the timeframe for steps 5 and 6 in Figure A should become more closely aligned with the equivalent steps for trades executed on venue, it will take time for market infrastructure to be developed to support this. Accordingly, the workflow set out above continues to be the only viable workflow for "off venue" derivative transactions.

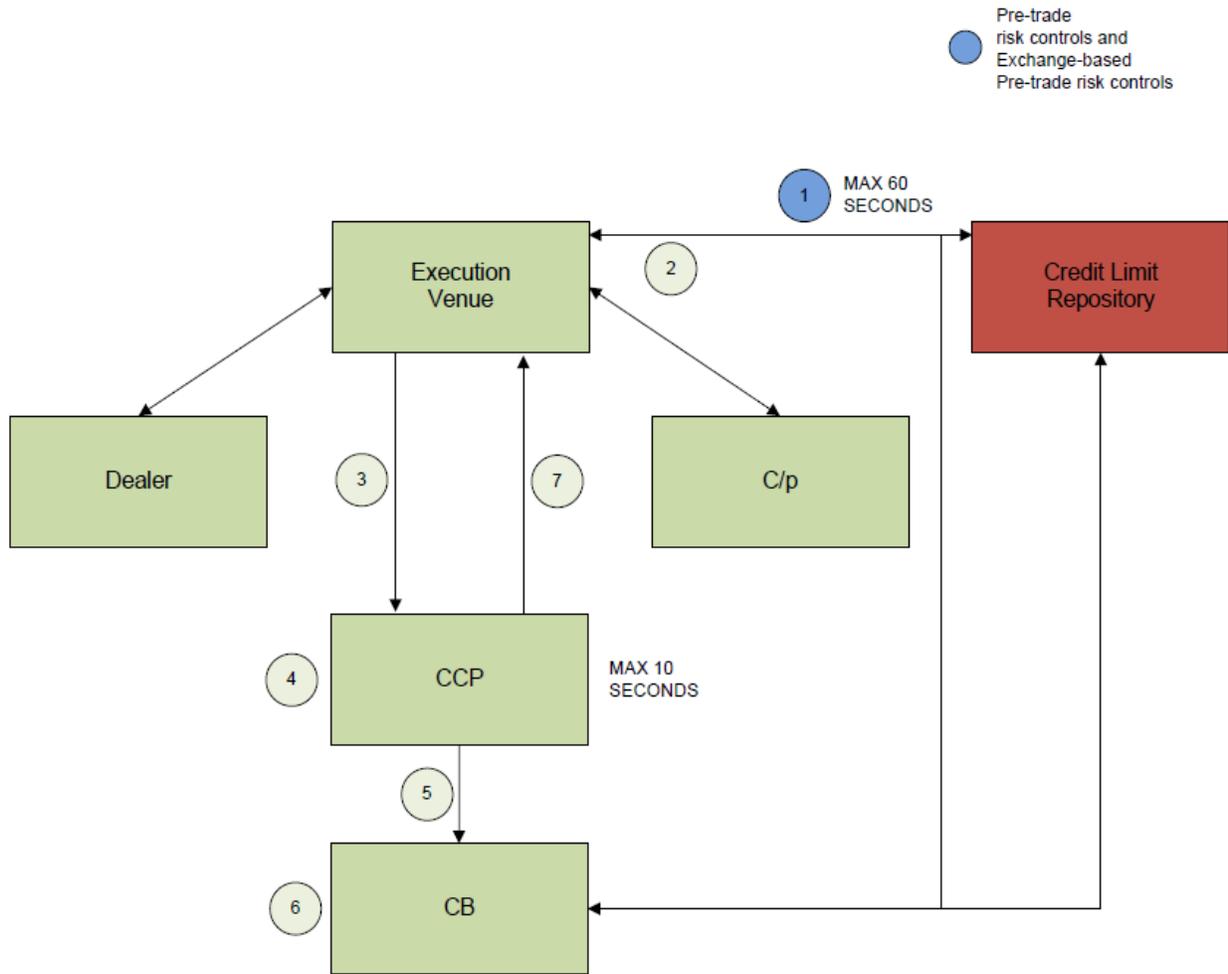
As we move increasingly towards venue-based execution however there are a number of amendments (in particular the implementation of a pre-execution C/p credit check) that should be made to the existing workflow for on venue trades in order to provide a robust market infrastructure for all parties.

In this regard, it is necessary to distinguish between:

- (i) screen-based/electronic Trading Venues which are fully automated
- (ii) voice Trading Venues which continue to involve an element of manual process

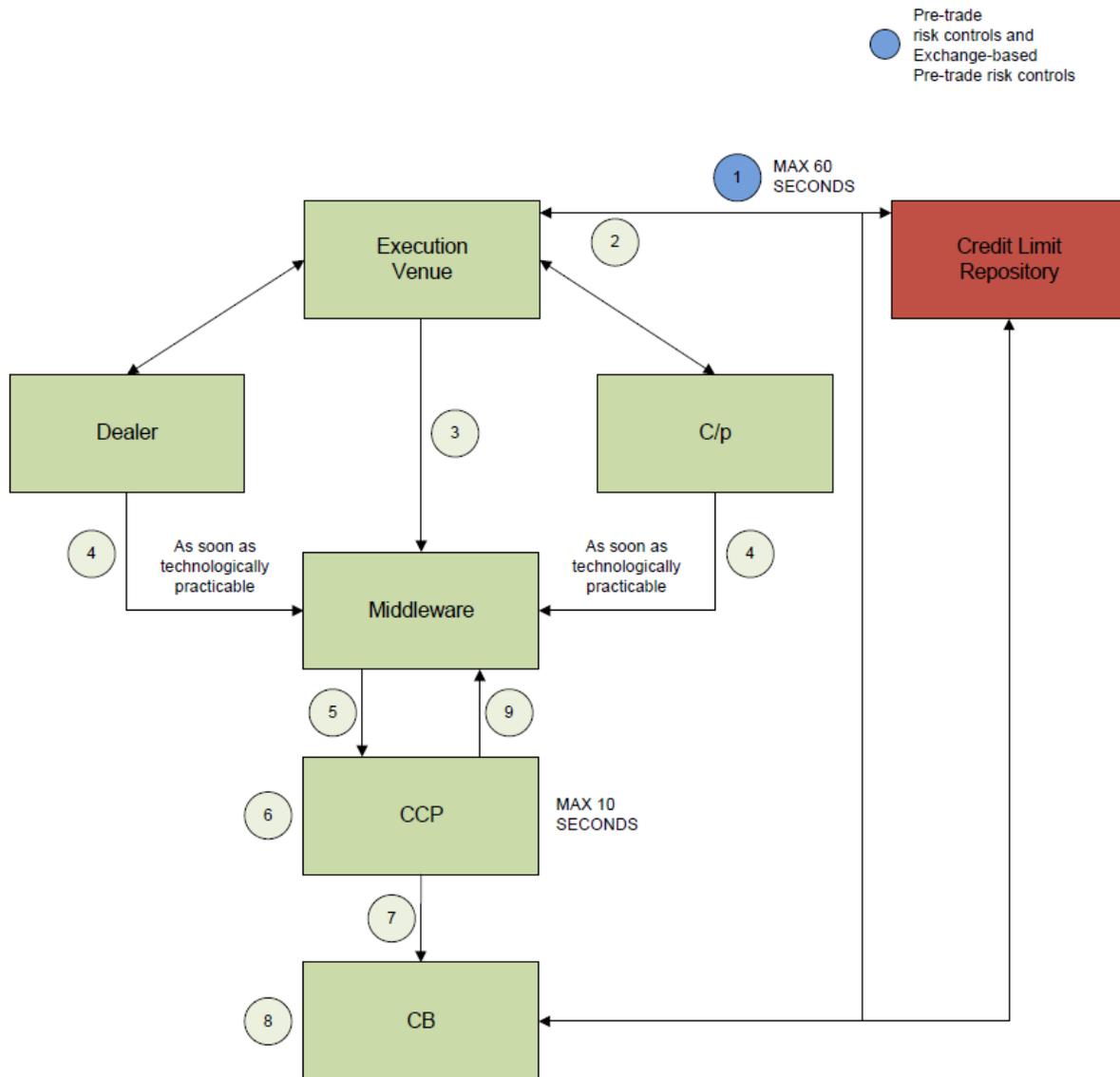
The revised process flow for both scenarios are set out in Figure B (Screen-Based/Electronic Venue Workflow with Pre-Execution Check) and Figure C (Voice Venue Workflow with Pre-Execution Check). The proposed improvements are discussed in further detail below.

Figure B – Screen-Based/Electronic Venue Workflow with Pre-Execution Check



- ① C/p obtains a pre-execution credit check and product eligibility check (i.e. validates that the product is clearable) on an Execution Venue, either via a credit limit repository (i.e. Credit Hub) or directly at Execution Venue as provided by CB
- ② Credit limit repository or Execution Venue assigns a credit approval for client side of the trade
- ③ Trade is executed and Execution Venue submits trade to CCP
- ④ CCP performs the following checks prior to clearing;
  - a. CCP product check
  - b. risk check for creditworthiness of Dealer and CB
- ⑤ Trade sent to clearing bypassing any CB request/consent workflow
- ⑥ CB books trade into risk system no client level credit check required as trade cleared and pre-execution checked
- ⑦ CCP sends confirmation that the trades have cleared back to Execution Venue

Figure C – Voice Venue Workflow with Pre-Execution Check



- ① C/p obtains a pre-execution credit check and product eligibility check (i.e. validates that the product is clearable) on an Execution Venue, either via a credit limit repository (i.e. Credit Hub) or directly at Execution Venue as provided by CB
- ② Credit limit repository or Execution Venue assigns a credit approval for client side of the trade
- ③ Trade is executed and Execution Venue submits trade to CCP via Middleware
- ④ C/p and Dealer affirm trade in Middleware
- ⑤ Middleware messages CCP
- ⑥ CCP performs the following checks prior to clearing;
  - a. CCP product check
  - b. risk check for creditworthiness of Dealer and CB
- ⑦ Trade sent to clearing bypassing any CB request/consent workflow
- ⑧ CB books trade into risk system no client level credit check required as trade cleared and pre-execution checked
- ⑨ CCP sends confirmation that the trades have cleared back to Middleware

A. Proposed requirements for Trading Venues:

In our view, the current arrangements would be improved if Trading Venues were required to perform the following functions/carry out the following tasks (as applicable).

1. Ensure a **pre trade credit and product eligibility check** is performed on all orders submitted to the Trading Venue so that transacting parties know that all orders have been pre-approved by any relevant CBs. While pre-trade credit check infrastructure exists in the US and in time could be developed for implementation in Europe, in order to incorporate a pre-execution product eligibility check, the market would need to develop new forms of infrastructure. Notwithstanding, we agree that the industry should aspire to move these product checks to as close to the point of execution as possible. Accordingly, ESMA should engage with the industry in this respect, noting that any requirements in this regard would need to be subject to phase-in periods which have been agreed with the industry and all market participants.
2. Send all **trade status messages in real time** to the CB (directly or via a credit limit repository). Trade status messages should include
  - a. New orders for credit screening
  - b. Execution/partial execution of pre-approved orders
  - c. (where a C/p elects to cancel an open order it has placed on a Trading Venue) expiration/cancellation of unexecuted pre-approved orders
  - d. cancellation of open orders pursuant to operation of a kill switch
  - e. Partial cancellations of pre-approved orders (i.e. client reduces notional, only partial fill occurred); and
  - f. Notice of trades rejected for clearing by the CCP
3. Provide CBs with the option to execute (directly or via a credit limit repository) a **kill switch** enabling the CB to cancel open orders. This is a ‘last resort’ option for a CB to deal with the extreme cases where it urgently needs to cut all exposure to a client, including with respect to pre-approved orders that remain unexecuted.
4. To the fullest extent possible, ensure **direct delivery of executed trades to the CCP** for clearing immediately after execution. In our view, the trade record delivered to the CCP must include (inter alia) details of all parties to the transaction. A screen-based Trading Venue will have, with respect to an executed trade, all the information required for the submission to clearing and there will be no requirement for an affirmation step prior to submission. A direct or "hands-free" submission from the venue to the CCP will be far

quicker than one that relies on affirmation. Thus this approach to submission should be encouraged.

5. In the voice context, affirmation is an important concept because the parties need to agree on the trade that they executed prior to submission to the CCP. The affirmation step implies a certain amount of latency but parties should be encouraged to process their responsibilities relating to submission as promptly as possible. Thus we would encourage controls and procedures to be implemented to ensure that all parties are alerted when **CCP affirmation messages** are not received on a timely basis.
6. Put in place controls and procedures to facilitate **trade resubmission** in those circumstances where it is permitted. In particular, Trading Venues should:
  - a. Receive clearing status messages from the CCP;
  - b. ensure that any CCP rejection messages they receive are relayed immediately to the appropriate parties;
  - c. support (though not mandate) the optionality set out in the market standard execution agreement for dealing with problems in clearing a trade;
  - d. where appropriate, facilitate a process to enable the parties to resolve any problems with a rejected trade and, if agreed, resubmit the trade for clearing;
  - e. ensure action takes place within 30 minutes.
7. When offering **bunch order allocation** tools on their platform, the Trading Venue should generate a link identifier between bunched orders, decrements and ultimate allocations and ensure that the economic details of allocations and decrements match the original bunched order.
8. Where third parties are involved in providing messaging services between the Trading Venue and CCP, the Trading Venues should be responsible for **ensuring** such **third parties comply** with the relevant regulatory and/or best practice requirements (i.e., middleware/affirmation platforms should not interfere with the requirement that cleared derivatives are "submitted and accepted for clearing as quickly as technologically practicable using automated systems" (as required by Article 29(2) of MiFIR)).

Trading Venues in the US have adopted various means of facilitating pre-execution screening of trades against CB risk-based limits. Given that there are a variety of potential approaches to pre-screening, we do not believe that the technical standards should be prescriptive as to the form such screening functionality must take. Rather, Trading Venues and hubs should be afforded flexibility on the precise types of credit screening/limit checking they offer and be free to compete with each other in offering functionality that will attract CBs to their platforms. A CB may also elect to require a Trading Venue to "ping" the CB (or a limits hub) for a credit screen/approval (which should be processed consistent with STP standards (e.g., within 60

seconds)) if the CB prefers not to "push" limits or otherwise use a Trading Venue's limit screening functionality.

B. Proposed requirements for CCPs:

In our view, the current arrangements would be improved if CCPs were required to perform the following functions/carry out the following tasks (as applicable).

1. Amend its rules to **remove Clearing Members ("CM")' "last look" provisions** (i.e., request/consent messaging from the CB) for any trades that had passed a pre-execution credit check.
2. **Report clearing status** of a trade to both the Trading Venue and the CBs immediately. In our view this should include obligations to (i) inform the Trading Venue and CBs if a trade has been rejected for clearing immediately with a rejection reason applied to the messaging and (ii) notify CBs of trade executions in real time.
3. CCPs must have controls in place for the **bunch order process**. This includes:
  - i. Verification of the existence of a bunched order I.D. to eliminate over allocation and under allocation (i.e. ultimate allocations bunch and decrement should all share an identifier).
  - ii. The ability to properly label transactions in the bunch account as "New Bunch" and "Decrement".
4. Require all trade sources systems (Middleware providers) and Trading Venues to meet **consistent standards**. In particular CCP should required trades source systems and Trading Venues to use consistent data fields and to pass on execution IDs.
5. CCPs should be required to accept/reject trades within a very short timeframe – 10 seconds is the standard in the US and in our view such timelines are achievable.
6. Put in place policies and procedures on the cure process for **erroneous trades**.

In our view, ESMA should engage with CCPs to assess the feasibility of introducing a pre-trade credit check on each CB order.

**Q611: What are your views on the systems, procedures, arrangements and timeframe for (1) the submission of a transaction to the CCP and (2) the acceptance or rejection of a transaction by the CCP in view of the operational process required for a strong product validation in the context of ETD and OTC? How should it compare with the current process and timeframe? Does the current practice envisage a product validation?**

Ultimately responsibility for assessing whether a product is eligible for clearing should fall on the Trading Venue. We would reiterate that while pre-trade credit check infrastructure exists in the US and in time could be developed for implementation in Europe, in order to incorporate a pre-execution product eligibility check, the market would need to develop new forms of infrastructure. Notwithstanding, we agree that the industry should aspire to move these product checks to as close to the point of execution as possible. Accordingly, ESMA should engage with the industry in this respect, noting that any requirements in this regard would need to be subject to phase-in periods which have been agreed with the industry and all market participants.

For the avoidance of doubt, our response relates to OTC derivatives only.

**Q612: What should be the degree of flexibility for CM, its timeframe, and the characteristics of the systems, procedures and arrangements required to supporting that flexibility? How should it compare to the current practices and timeframe?**

We do not see the time it takes to transfer margin as a specific obstacle to STP. As discussed above, under the current model the CMs and CCPs set ‘credit limits’ in respect of their counterparties. In the case of CBs these are trading limits for a counterparty based on the CBs credit determination of the client. Such limits are calculated by reference to the relevant available collateral balance that has been posted and the amount of daily uncollateralised exposure that CCPs and CMs (as applicable) are prepared to take as against the relevant counterparty. In our view it should be for the CM and/or CCP to determine whether it is sufficiently collateralised and we would therefore resist any requirement to pre-fund trades.

Notwithstanding the above, we note that the current arrangements for the transfer of margin are currently deficient in the following respects.

1. The time required to transfer collateral to CCPs is currently approximately one hour (for cash) or longer (for securities) which greatly exceeds the timeline needed for STP and clearing certainty. The window for posting collateral is also not aligned with CCP opening hours, an issue which is primarily driven by the requirement for CCPs to re-invest cash collateral. In our view pre-funding should not be mandated. In addition to being inconsistent with the timing of STP, these factors incentivise CMs to conservatively over-fund collateral holdings at CCPs to increase the probability of trades clearing, creating an unnecessary drain on liquidity.
2. The flow of information is insufficiently transparent and is not currently reciprocal. The CCP needs to provide visibility as to the CM or clients’ utilisation of collateral pre-funding or credit lines in the context of an individually segregated account. This will allow all parties involved in the clearing process to better manage their ability to clear.
3. The transfer of margin from CM to CCP currently suffers a lack of standardisation and automation and relies heavily on manual intervention by CMs, CCPs, payment banks and concentration banks. These issues create bottlenecks in the movement of collateral,

requiring the pre-funding of margin and leading to unnecessary rejections of trades submitted for clearing.

For the avoidance of doubt, our response relates to OTC derivatives only.

**Q613: What are your views on the treatment of rejected transactions for transactions subject to the clearing requirement and those cleared on a voluntary basis? Do you agree that the framework should be set in advance?**

We agree that a framework for the treatment of rejected transactions should be set in advance. Even where pre-trade credit checks are conducted, trades still fail to clear on the initial submission for a variety of operational reasons.

The majority of failed trades fail due to operational rather than credit issues – OTC clearing infrastructure is still in development and as the industry moves towards direct/hands-free clearing, adds new functionality around credit checks and fully implements new product sets into the infrastructure (e.g. packages), the industry continues to encounter operational problems. This is to be expected as the nature of developing new infrastructure and we will continue to see rejections based on static data problems, IT glitches, and product ineligibility (as a result of different CCPs each supporting slightly different product sets, even where they clear the same class of derivatives, as a consequence of such classes being defined at a higher, less granular level). As we launch similar infrastructure over the coming years, we can expect to encounter these problems repeatedly.

As these issues arise on any given trade, they are generally resolvable via resubmission of the trade and do not warrant termination of the original trade and the crystallisation of a loss for one of the parties due to factors that are typically completely out of the parties' control. It is therefore essential to ensure that robust and understood procedures for resubmission are in place.

Notwithstanding our desire for robust resubmission procedures, in our view rather than being overly prescriptive, ESMA should establish a flexible best practice framework (in line with our suggestions below), which can be adapted by market participants according to particular CCPs, OTC derivative product types and client/broker relationships.

***Proposed framework for OTC derivative transactions which fail to clear:***

***Bilateral OTC Derivatives***

With respect to bilateral OTC derivatives not concluded on a Trading Venue but which will be submitted for clearing, market participants should be free to bilaterally negotiate the procedure to be followed where transactions fail to clear. We envisage the industry standard execution agreements providing the optimal solution for both EBs and clients in this regard. The standard execution agreements provide for:

- a. resolution of the problem and resubmission;

- b. the option to terminate the transaction with compensation payable to the out of the money party (i.e. the party that would need to pay a hedge counterparty to break any hedge), including calculation of an early termination amount designed to compensate one party for change in the value of the derivative between the initial agreement of the trade and the rejection from clearing; and
- c. where permissible under applicable law (i.e. this isn't an option for mandatorily clearable product), affirmation of the trade bilaterally between parties.

However, certain entities may take a different view depending on the particular client and/or product to be cleared, so the regulatory framework should incorporate flexibility and not seek to pre-empt such negotiations by setting out mandatory requirements.

*OTC derivative transactions concluded on venue*

In our view, with respect to OTC derivative transactions concluded on a Trading Venue, whether subject to a clearing obligation or cleared voluntarily, the following framework should apply to transactions that fail to clear:

- (i) the Trading Venues and CCP rules should include as the first fall-back a robust resubmission process; and
- (ii) where a trade fails the resubmission process, for whatever reason, a Trading Venue should include provisions within its rules in respect of the mechanisms for remediation which may include rules for calculation of breakage amounts or rules for nullification of the trade. In this regard, the Trading Venue should be free to determine the hierarchy of remediation rules for their venue.

In our view, for transactions concluded on venue there should be no requirement to enter into a bilateral arrangement with the relevant counterparty. However, in respect of a name disclosed trading venue, parties should be free to supplement the remediation rules of a Trading Venue with a bilateral agreement provided that (i) such bilateral arrangements do not supersede or override the rules of the Trading Venue and (ii) the arrangements do not seek to, and are not used to, impose conditions in relation to whom the parties can trade with on the relevant Trading Venue.

***Trade Nullification Rules:***

As stated above, we endorse the need for a mechanism in the rules to govern rejection of OTC derivatives trades for clearing. The introduction of rules which treat as invalid from the outset trades which fail to clear, without preserving the economic impact of subsequent price movements (referred to in this response as "**Trade Nullification Rules**") could have a detrimental effect on the market. Trade Nullification Rules, if applied across the board, could:

- (a) require the parties to re-execute a trade which failed to clear, rather than enabling the parties to resolve any operational or other problems that led to the rejection of the original trade and subsequently resubmitting that original trade; and
- (b) penalise the out of the money party unnecessarily and for events that are often out of their control if they need to unwind any hedge they executed at the time of the original trade.

Whilst evidence suggests that the majority of trades that are sent for clearing eventually clear, many trades encounter problems on the way to clearing and by mandating the nullification of such trades upon receipt of a CCP rejection we would be increasing the number of failures and unnecessarily crystallising losses for market participants.

In the typically rare circumstances where a trade cannot be cleared even after resubmission, it will sometimes be terminated. This will either be by preference of the counterparties, because the counterparties lack appropriate bilateral documentation, or because the derivative is subject to a clearing obligation and therefore cannot be affirmed bilaterally. In these cases, we see significant benefits for one counterparty being permitted to compensate the other for the change in the value of the derivative between the time of execution (and hedging) and the point at which the clearing rejection is notified to the parties (which can be a time period lasting minutes or several hours, particularly where resubmission to clearing is attempted). Counterparties manage their risk on the expectation that the trade will clear, and in the event that the trade has to be terminated, will experience economic consequences (gain or loss) of a market movement.

Clean payment of compensation, particularly where governed by bilateral agreement or venue rules (such as the early termination amount described above) mitigates against these economic consequences. Conversely, gain or loss without the ability for counterparties to compensate each other, which would be the effect of Trade Nullification Rules, acts as a significant deterrent to enter into transactions and to provision of liquidity by market makers. Furthermore, given the choice between trading on venue or trading bilaterally that will exist for many derivatives not subject to a clearing obligation, it is imperative that counterparties have flexible fallbacks available to them for trades executed on venues that fail to clear; their absence could pose a deterrent to adoption of trading of OTC derivatives on venues.

Notwithstanding the above, in our view it is not necessary for ESMA to explicitly prohibit use of Trade Nullification Rules. Accordingly venues should be free to incorporate them into their rules governing rejections by CCPs if they wish to do so.

For the avoidance of doubt, our response relates to OTC derivatives only.

## Section 9.2 - Indirect Clearing Arrangements

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**Q614: Is there any reason for ESMA to adopt a different approach (1) from the one under EMIR, (2) for OTC and ETD? If so, please explain your reasons.**

Yes

In summary, our responses are:

- (1) Yes. We believe that the EMIR approach, as currently understood, incorporates requirements for indirect clearing which fundamentally undermine its efficacy and objectives – i.e. increasing access on commercially reasonable terms embedding choice and transparency.

The discussion below of the challenges which the EMIR requirements give rise to is equally relevant for OTC cleared and ETD products. However, the impact is likely to be much more serious and immediate in the context of an existing, mature market for client clearing of exchange-traded derivatives.

- (2) We refer to our response to (1) above. We continue to have major concerns regarding the indirect clearing elements of EMIR and hope that these can be addressed for OTC client clearing in the context of the upcoming EMIR review.

### **Detailed response to Q614 (1)**

#### *Development of the EMIR Requirements*

Based on our engagement in the legislative process under EMIR, we believe that indirect clearing was included in the context of EMIR with the objectives of increasing flexibility of access to clearing on commercially reasonable terms, without diminution of client choice and embedding full transparency. This was in a context where various end-users of OTC derivatives would in due course be required to use CCP services for standardised derivatives business.

ISDA and its members engaged extensively with ESMA in original discussions to interpret the concept of indirect clearing as referred to in Article 4 of EMIR and the resulting EMIR RTS. We raised various concerns regarding the meaning of the conditions in Article 4 and the more detailed conditions which were eventually included in the EMIR RTS.

We welcomed the removal of the original proposal that all clearing members should be obliged to offer indirect clearing – we were concerned that requiring all clearing members to provide such a difficult offering would cause many clearing members to reconsider their ability to remain clearing members at all, and this was acknowledged by ESMA.

However, in relation to the requirements which remained for those who did choose to offer indirect clearing, we advocated at the time, and continue to maintain, that EMIR Level 1 allows sufficient flexibility to specify requirements for indirect clearing which are less problematic and therefore more likely to be implementable in practice than those which are in the EMIR RTS. As noted below, we believe that our views are borne out in recent EMIR guidance from the Commission and ESMA.

### ***Challenges in satisfying the EMIR Requirements in practice***

In considering these arrangements, it is important first to note two factual elements which are specific to indirect clearing arrangements:

- a) The nature of indirect clearing is one in which there may be, at least, two intermediate brokers in a chain of back-to-back principal relationships<sup>1</sup>, between the end client and the CCP. (As discussed below, in practice, this chain may necessarily be longer in the context of current ETD practices.) Any end-client protections therefore need to contemplate outcomes in the event of a default of (i) the clearing member, (ii) the indirect clearer, and (iii) the clearing member AND the indirect clearer at the same time.
- b) In this chain of entities, it is very likely in many cases that more than one jurisdiction is involved. Hence, any approach needs to take account of a multiplicity of national insolvency regimes.

The concept behind the EMIR RTS, in applying EMIR arrangements at the indirect client level, was described essentially as one in which the role of the CCP as contemplated in Title IV EMIR is "shifted down" a level, so that the clearing member is expected to deliver the same level of record-keeping, segregation, porting, as a CCP would for direct clients of a clearing member.

Whilst such an approach sounds logical:

- (1) CCPs have the benefit of various legislation, national and at EU level<sup>2</sup>, which protect their actions taken on a clearing member default from the risk of insolvency challenge.

Porting necessarily involved the transfer of positions and / or assets for the benefit of the end client where the interests of an intermediate entity in default (i.e. normally the clearing member) might give rise to insolvency-based challenges. Even in this environment, the delivery of robust and practical porting mechanisms in an international context is not straightforward.

No such similar protections would be available to clearing members when acting to port assets and positions in the event of a failure of their immediate client, the indirect clearer. We do not believe that the EMIR RTS has the effect of overriding national insolvency regimes in this regard.

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<sup>1</sup> We note that agency arrangements might also be utilised in certain cases, but riskless principal arrangements are prevalent in current EU clearing arrangements and should therefore be catered for in any market solution.

<sup>2</sup> Including EMIR itself, and the Settlement Finality Directive.

We note that certain EU jurisdictions have taken or are considering steps to recognise indirect clearing arrangements in their national insolvency regimes<sup>3</sup>. However, in our experience, these steps are unlikely to be sufficient in light of the range of circumstances they need to cater for and their likely cross-border nature (see below).

It is unreasonable to expect clearing members to take on such an unquantifiable insolvency risk. It presents commercial, risk and regulatory capital concerns that are likely to make such an offering non-viable.

- (2) CCPs assume no obligations to the clients of clearing members. In the event that a clearing member defaults and there is not another clearing member available to step into its shoes and cover the liability of the CCP in full, the CCP is not obliged to port positions and will simply liquidate positions in accordance with its default rules.

By contrast, clearing members under indirect clearing arrangements are required to provide "a credible mechanism for transferring the positions and assets to an alternative client or clearing member, subject to the agreement of the indirect clients affected."

As noted above, we would expect this to need to be present on a clearing member default or an indirect clearer default. Whilst a clearing member default is more straightforward, since the indirect clearer should be able to benefit from CCP-level provisions protecting it as a client of the clearing member so that the indirect clearer can transition the entire book of its indirect clients and supporting collateral to a transferee clearing member (assuming it has arranged one).

Upon an indirect clearer's default however, the clearing member immediately has uncovered risk for the open positions of entities whom it has not taken on as clients. If the indirect clearer were just an ordinary client of the clearing member, the clearing member would immediately liquidate the position to preserve its own risk position.

Any arrangement which anticipates that clearing members take on indirect client risk for any period of time, in order to facilitate porting, fundamentally undermines the clearing member's ability to protect itself (and its other clients). These are novel and material risks.<sup>4</sup>

- (3) CCPs are not obliged to do anything more than make one further sub-account available in which the positions of all indirect clients of a client are reflected, i.e. those indirect clients are reflected on an omnibus basis only on the books of the CCP. This requirement does not go to reducing the risks and concerns described above.
- (4) We understand that Article 4(2) EMIR RTS has been interpreted so that any indirect clearing offering must have a range of choices for the end client which include an ISA

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<sup>3</sup> By way of example, the UK's amendments to Part VII of the Companies Act 1989, which are a welcome, but not sufficient, step.

<sup>4</sup> It was suggested in original consultation on the EMIR requirements that clearing members hold indirect client positions open for a period of 30 days following an indirect clearer's failure. This proposal was strongly resisted by market participants on risk grounds and was dropped by ESMA.

lookalike and an OSA lookalike. The suggestion that the offering could be an "either/or" was dismissed.

In light of the challenges above, delivering an ISA-like protection at indirect client level presents legal and risk challenges that are extremely difficult. OSA-like protections should be more achievable but would still require clarification as to the nature of the "credible" porting mechanism that clearing members are required to make available in such circumstances (noting that porting in the context of direct omnibus client clearing itself presents real practical limitations).

ISDA and its members have spent extensive efforts looking to develop models which are (i) legally robust, particularly in a cross-border scenario and based on the more restrictive reading of the EMIR requirements and (ii) commercially viable – i.e. capable of being provided at a cost and with regard to the capital costs of clearing members. Despite those efforts, there continue to be material obstacles to designing a model which satisfies all of these elements.

ISDA and its members are also continuing to look at, and consider with CCPs and national regulators, other methods of increasing access utilising arrangements other than those which would fall within the description of indirect clearing, including possible reliance on agency-style elements and looking at CCP-based solutions for wider direct membership/participation which might deliver client porting protections (for those who want them) in a less complex and more robust manner. ISDA would welcome further discussion with ESMA on these topics.

### ***Interpretation in light of more recent guidance in EMIR***

We understand that the EMIR RTS requirements were, at least in part, drafted as they are because it was considered that the Level 1 requirement for "equivalent" protection to that under Articles 39 and 48 EMIR anticipated identical protections without the possibility for any flexibility (which is an interpretation with which we did not agree).

Recent Commission and ESMA guidance in interpretation of EMIR has demonstrated however that there is often more flexibility in the interpretation of these EMIR Level 1 requirements than originally anticipated. In particular, when looking at the protections contemplated under Articles 39 and 48 themselves (which are a fundamental underpinning to the definition of indirect clearing under EMIR, and are also therefore referenced in MiFIR Article 30):

- 1) In their recently issued guidance<sup>5</sup>, the Commission and ESMA have acknowledged that there may be circumstances in which the protections contemplated under Articles 39 and 48 may not be satisfied in a conventional manner and that, in such circumstances, provided that the client is given but refuses the option to contract with a different legal entity, the client may contract with an entity delivering clearing services which do not meet Articles 39 and 48.
- 2) Article 39 and 48 protections are not available to direct clients who use a recognised CCP to meet their clearing obligation. This is clearly not considered to be incompatible with

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<sup>5</sup> In the context of non-EU clearing members of EU CCPs –ESMA and EC citation to be included.

EMIR. Equally, if one were to read the EMIR Requirements for indirect clearing narrowly, this would imply that indirect clearing is simply not available for those wishing to satisfy their clearing obligation through a recognised CCP. We do not consider that this is the correct outcome.

This would suggest that there remains scope for interpreting EMIR requirements in a manner which is more sensitive to regulatory objectives and also to the legal and practical complexities of relevant markets.

### ***Solutions***

We offer no solution at this stage as to how one might meet MiFIR objectives in a manner which is sustainable for existing exchange-traded derivatives markets.

ISDA does however look forward to engaging further with the Commission and ESMA on this topic in the upcoming EMIR review and exploring solutions which address these challenges without undermining key principles which EMIR seeks to embody for client clearing.

### **Detailed response to Q614(2)**

We refer to our answer to Q614(1) above.

We do also look forward to engaging further with the Commission and ESMA on this topic in the upcoming EMIR review. Whilst client clearing in the context of OTC cleared derivatives is in its early stages and the current impact is therefore not comparable with the very real concerns in respect of exchange traded derivatives, we continue to have major concerns regarding the indirect clearing elements of EMIR and hope that these can be addressed for OTC client clearing as it develops.

### **Q615: In your view, how should it compare with current practice?**

We have no comment on this question.