ISDA® Safe, Efficient Markets

FIA

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ESMA's Consultation Report on non-equity transparency and derivatives trading obligation

ISDA-FIA response

ISDA and FIA (together "the Associations") welcome the opportunity to respond to ESMA's consultation on the MiFID II/R review report on the transparency regime for non-equity instruments and the trading obligation for derivatives.

The response focuses on derivatives and does not address securities markets. The Associations noted that certain questions impose to make a distinction between exchange traded derivatives (ETD) and Over-the-counter (OTC) derivatives.

The Associations would have liked to be able to support their positions by a thorough data analysis, but it was not possible during the timeframe of this consultation. Due to all challenges associated with the Covid-19 crisis, it was not possible to run such analysis within the short timeframe that coincided with the peak of the crisis. However, we are keen to run an analysis and to contribute to the upcoming debate on the MiFID Review in the next few months.

By way of summary, please note the following:

Executive summary

- The Associations exclusively focus on derivatives markets and do appreciate that the conclusions on pre- and post-trade transparency may be different from those reached for securities markets.
- From the perspective of the Associations' members, it appears that the MiFID 2/ MiFIR framework lead to a significant amount of additional data being made available to the market and to trading counterparties. However, for OTC derivatives, the data does not always provide meaningful transparency or add benefits to end-users that justify the complexity and associated costs. Harmonisation of formats should be considered where benefits for the end-users exceed the costs and complexity for the industry.
- The Associations support a refit-style approach to MiFID that would clarify remaining uncertainties and ensure meaningful level of pre- and post-trade transparency. This could essentially be done through a re-calibration of ESMA RTS 2 rather than through changes of core concepts of the level 1 legislation. It would be premature to make significant changes to the transparency rules, which entail a phase-in approach.
- The Associations particularly support a comprehensive review of the methodology used to determine the liquidity and thresholds applied to commodity derivatives under RTS 2.

- If the focus should be more on changes to level, we however propose that the hedging exemption available in MiFIR Article 8(1) is extended via level 1 change to cover all commodity derivatives market participants managing risks arising from activity in the physical market, including financial counterparties.
- We also highlight the lack of accessibility and readability of the data, especially for OTC derivatives. Pre-trade and post-trade information is fragmented and reported by APAs and venues in a non-standardised format. It is therefore extremely difficult for market participants to access the information reported; the standards and their deployment are sometimes unclear, e.g. reference data taxonomy, ISIN, etc.
- Uncertainties and inconsistencies in the areas of financial instruments' scope (non-ToTV products, which notably affects the accuracy and effectiveness of the reference data system).
- Clients are not using pre-trade transparency for OTC derivatives as they use other sources for streamed data and calibration of pre-trade transparency for certain asset classes (notably equity derivatives) is not appropriate. Transparency has been designed based on concepts relevant for transferable securities but failed to achieve the same appropriate outcome for derivatives.
- Discretions granted to National Competent Authorities (NCAs) for post-trade transparency deferrals do not allow for consistent access to post-trade data.
- The opportunity should be taken to clarify that the scope of transactions subject to the Derivatives Trading Obligation should be a subset of transactions subject to the Clearing Obligation under EMIR.
- Furthermore, the Associations support the creation of a standalone Derivatives Trading Obligation (DTO) suspension mechanism.

Specific answers

Pre-trade transparency requirements

Q1: What benefits or impacts would you see in increased pre-trade transparency in the different non-equity markets? How could the benefits/impacts of such pre-trade transparency be achieved/be mitigated via changes of the Level 1 text?

We are fully committed to the policy objectives of MiFIR, including to provide more transparency in non-equity markets, with the aim to achieve deeper and more efficient EU financial markets. We agree that price formation is an essential part of the regulated markets' business model. However, only an appropriately calibrated transparency regime can achieve that objective.

The Associations consider that the purpose of pre-trade transparency is to give investors current orders and executable quotes before the trade is executed, in order to facilitate price formation and to help investment firms/ banks provide best execution. This is a central concept for liquid and fungible instruments, e.g. equities.

Pre-trade transparency to OTC derivatives is often a different nature because a majority of OTC derivatives markets do not operate with a direct interaction between buying and selling orders. In addition, many OTC derivatives instruments are not liquid. Therefore, the general benefits of pre-trade transparency in these markets is lessened compared to much more liquid markets such as equities. The Associations' members note that while accuracy and quality of post-trade transparency data has been an issue since the full application of MIFID 2, OTC derivatives end-users have not asked for increased pre-trade transparency.

To this end, it should be noted that non-equity markets are fundamentally different from equity markets. Furthermore, there are significant differences across derivatives asset classes. We therefore consider that transparency requirements must be balanced to avoid damaging liquidity or undermining price discovery processes.

For instruments traded on a trading venue, including derivatives, we note that article 8 of MIFIR has introduced a harmonised pre-trade transparency regime. This provision specifies that trading venues should publish information about current bid and offer prices and the depth of trading interests at those prices advertised through their systems. Article 9 of MiFIR rightly recognises that certain exemptions from the general requirement to publish pre-trade transparency data are necessary, to preserve an orderly price discovery process and to allow nascent and niche markets to develop. These exemptions are respectively implemented through pre-trade transparency waivers for:

- Orders above a certain volume threshold (Large in Scale waiver or 'LIS');
- Indications of interest in request-for-quote (RFQ) and voice trading systems above a size specific to the instrument (SSTI);
- Derivatives not subject to the trading obligation and instruments classified as illiquid, regardless of their volumes (Illiquid Instrument waiver or 'IL').

For ETD products, we consider that this set of principles under articles 8 and 9 of MiFIR is sensible but recognise that changes to the level 1 legislation concerning the SSTI waiver could be an appropriate way to simplify the regime and to meet the objectives of the pre-trade transparency. However, a flawed methodology for the IL and LIS waivers should be addressed in Level 2, particularly on commodity derivatives markets but not exclusively. In addition, we are of the view that LIS thresholds should also be recalibrated for some ETDs.

As for Level 1, we propose that the hedging exemption available in MiFIR Article 8(1) is extended to cover all commodity derivatives market participants managing risks arising from activity in the physical market, including financial counterparties. Such a solution would allow for more order book liquidity without jeopardising the ability of commodity derivatives markets to fulfil their function. In addition, it would better take into account the important risk management function of commodity derivatives trading.

We recommend a cautious approach with respect to commodity derivatives. These instruments are regularly used by real economy businesses to manage their commercial as well as financial risks. And whilst some products, such as the ICE Futures Europe Brent Crude Futures, have developed into global benchmarks, most commodity derivatives markets remain relatively illiquid. An appropriately designed Block Trading Policy is essential for their further development.

In the opinion of the Associations, the current MiFIR pre-trade transparency regime does not sufficiently take into account the above considerations. In addition to the proposed change on Level 1, the methodology for calculation of thresholds setting boundaries of the pre-trade transparency regime, including Illiquid Instrument and Large In Scale (LIS), should be improved. It results in a number of illiquid derivative contracts being wrongly classified as liquid and being subject to very high LIS thresholds. The consequences of the above are particularly visible in commodity derivatives markets, thereby forcing larger volumes to be executed in bilateral transactions.

We support relevant amendments to Level 2 legislation in order to remove the current factors leading to inappropriate thresholds (e.g. using notional values, which are highly reliant on market prices).

Beyond commodity derivatives, we also observed that for specific ETD derivatives, the thresholds have affected the liquidity of these products.

Q2: What proposals do you have for improving the level of pre-trade transparency available? Do you believe that the simplification of the regime for pre-trade transparency waivers would contribute to the improvement of the level of pre-trade transparency available?

Rather than the framework itself, the Associations' members consider that the calibration of the current threshold for application of the waivers is questionable. In our view, the current non-satisfactory level of pre-trade transparency in derivatives markets is caused by inappropriately calculated Illiquid Instrument and Large in Scale thresholds, rather than an excessive number of available waivers. This is the case for commodity derivatives markets in particular.

In order to improve pre-trade transparency in commodities markets, an urgent revision is needed of the threshold calculation. Furthermore, we propose that the hedging exemption envisaged by MiFIR Article 8(1) is extended to financial counterparties for pre-trade transparency purposes.

As per paragraph 18 in this consultation paper and as per MiFIR Article 9 (1) (b), MiFIR recognises the role and existence of RFQ and voice trading systems and defines the SSTI waiver to protect liquidity providers from undue risks. Similarly, for trading with systematic internalisers, MiFIR Article 18 (10) limits the quote transparency requirement when dealing in sizes above SSTI, itself referring to MiFIR Article 9 (5) (d), to protect liquidity providers from undue risks. The Associations consider that this principle is sensible and guarantees the provision and access to liquidity.

Beyond commodity derivatives markets, we consider that the ESMA RTS 2 would deserve re-calibration, in particular for some ETD products and sub-asset classes. RTS 2 sets out the methodology for calculating LIS thresholds and determining illiquid instruments. The Associations' members have consistently reported that the transparency regime is not calibrated appropriately to match the economic characteristics of certain products that are actually traded and that this could significantly impair liquidity in those markets. In general, particularly for equity derivatives (but not only) instruments, a 'crude' taxonomy applies to a heterogeneous asset class, characterised by low liquidity, such that this asset class is treated as homogeneous and deemed liquid. We would therefore encourage ESMA to conduct liquidity assessment based on selling and buying interest rather than the current static determination.

For specific exchange traded equity derivative products, it would be sensible to assess whether temporarily lower LIS thresholds could be established, taking into consideration that on-venue trading accounts for only a minimal share of overall trading volumes in these specific products.

For ETDs, we agree that whether the SSTI thresholds should be reconsidered is a relevant question and that simplification of the waiver regime may be considered.

Q3: Are you supportive of ESMA's proposal to delete the pre-trade SSTI-waiver? Would you compensate for this by lowering the pre-trade LIS-thresholds across all asset classes or only for selected asset classes? What would be the appropriate level for such adjusted LIS-thresholds? If you do not support ESMA's proposal to delete the pre-trade SSTI-waiver, what should be the way forward on the SSTI-waiver in your view?

The Associations are not supportive of deleting the pre-trade SSTI waiver for trading venues in all circumstances.

As stated in response to question 2, we believe that the MiFIR principle to protect liquidity providers from undue risk is sensible and guarantees the provision and access to liquidity. In paragraph 18 of the consultation report, ESMA states that MiFIR recognises the role and existence of RFQ and voice trading systems and defines the SSTI waiver to protect liquidity providers from undue risks. Similarly, for trading with systematic internalisers, MiFIR Article 18 (10) limits the quote transparency requirement when dealing in sizes above SSTI, itself referring to MiFIR Article 9 (5) (d), to protect liquidity providers from undue risks.

For ETD products, we agree that whether the SSTI thresholds should be reconsidered is a relevant question and that simplification of the waiver regime may be considered.

Moreover, as ESMA rightly points out (in paragraph 67 of the consultation report), "*for non-equity instruments other than bonds, the first regular transparency calculations will only be published in May 2020. Hence, the first regular transparency calculations may result in a higher share of liquid instruments, since the transitional transparency calculations (TTC) were performed at the time APAs were not operating, thus the results reflected more on-venue trading, under the assumption of the use of good quality data. Indeed, there remain a number of issues for data of non-equity instruments that, at times, might undermine the quality and validity of the results*".

We generally note that it is too early to properly assess the usefulness of the SSTI waiver for most asset classes. Since the full application of MIFID II in January 2018, many new trading venue operators have started operating and many APAs have been established to collect data. It is premature to assume that the SSTI should be removed. As stated in response to question 2, the calibration of the various thresholds requires further attention rather than the existence of the thresholds.

In addition, while we understand that the overall underlying rationale of ESMA proposals in this field is to simplify the whole waiver regime, we nevertheless call ESMA to consider that every change to the regulatory framework is likely to affect the ability of intermediaries to provide essential liquidity.

The Associations' members consider that there is no evidence that the level of pre-trade transparency is insufficient. MIFID II considers a phase-in approach where the level of pre-trade SSTI will be increased with time and, therefore, the level of transparency is meant to increase as market participants move down the phases. The Associations are keen to make practical suggestions, based on fact and data analysis, as to how the threshold could be recalibrated to optimise objectives of the Level 1 legislation.

However, some members note that for exchange traded commodity derivatives, the SSTI waiver is not used in practice and that for these contracts the deletion of this threshold could be considered if at the same time the LIS threshold is lowered. These members also highlight that the LIS calculation is revised to remove factors leading to counterintuitive result, namely less liquid instruments receiving very high LIS thresholds.

Generally, when looking at ETD products, even if the thresholds have affected the liquidity, the Associations agree with the current methodology for the determination of LIS thresholds.

We therefore do not support at this stage the general deletion of the SSTI-waiver but that it could be considered for certain sub-asset classes, e.g. exchange traded commodity derivatives.

Q4: What are your views on the use of the SSTI for the SI-quoting obligations. Should it remain (Option 1) or be replaced by linking the quoting obligation to another threshold (e.g. a certain percentage of the LIS-threshold) (Option 2)? Please explain.

As stated in response to Question 3, members do not support the deletion of the pre-trade SSTI concept for both trading venues and SIs, as there is no evidence that it negatively affects pre-trade transparency.

With specific reference to SIs, we strongly disagree with Option 2 as it does not seem consistent with the stance taken by ESMA in the Consultation Paper "MiFIR report on Systematic Internalisers in non-equity instruments". In this report, ESMA reached the conclusion that there was no need to change the legal framework regarding SIs. We agreed with this conclusion.

We also do not agree with ESMA's proposal that the SSTI waiver should be deleted and replaced by the LIS waiver. We believe that SSTI and LIS are not perfect substitutes. It is also questionable whether a methodology based on a percentage of the LIS threshold would effectively simplify the waivers regime.

Q5: Would you support turning the hedging exemption into a limited negotiated trade waiver? If so, would you support Option 1 or Option 2? If not, please explain why.

Although we are supportive of a dedicated negotiated trade waiver for commodity markets, as we argue in our response to Q31, we do not see any merit in replacing the current hedging exemption by such waiver with the exact same scope. This would increase paperwork and procedural obligations for market participants, outweighing potential benefits a waiver could bring.

If this is not possible, we would instead recommend extending the hedging exemption to financial counterparties. This would already allow for more crucial pre-negotiated trades in nascent and illiquid contracts to be brought to an exchange for central clearing, hence addressing the specific market reality of commodity markets.

Q6: Do you agree with ESMA's observations on the emergence of new trading systems and the proposed way forward requiring a Level 1 change and ESMA to issue an Opinion for each new trading system defining its characteristics and the transparency requirements? Would you have suggestions for the timeline and process of such Opinions? Please explain.

We agree that the current catalogue of trading systems in Annex 1 of RTS 2 may not fully capture all available trading systems. However, having an opinion issued by ESMA for every new system might result in very extensive acknowledgement processes and likely result in undue stress on ESMA's resources. Any backlog in such an approval process (as it has been observed with the approval process for waiver applications) bears the risk to delay innovation and will result in longer periods of trading in less regulated environments. Moreover, a case-by-case approach – like the one proposed by ESMA based on Opinions – risks to make the regulatory treatment of the trading systems increasingly fragmented in the long run.

Instead, we believe that a more efficient way forward is to extend the existing definitions of trading systems. We propose to amend the definitions of Annex 1 in such a way that they cover variations of the initial system types, which might share main characteristics but are also partly innovative. The transparency requirement for such innovative systems should, however, be sufficiently amended, reflecting the fact that it might prove difficult to provide the same level of transparency. Such an amendment would additionally pose a change on Level 2 as opposed to Level 1, offering the possibility of a quicker amendment process.

We could see merit in the proposed ESMA opinions on new trading systems as a complementary solution, where they cover system types which are in no way variations of the definitions listed in Annex 1 and instead completely innovative. This way, ESMA resources would only be used in exceptional cases where there is indeed a distinct need for analysis and requirements suitable for the respective market conditions. To not obstruct market innovation, trading venues should be allowed to operate these new systems under provisional requirements agreed with their respective regulators, while the opinion is pending. However, we would like to stress that such opinions must be issued as soon as practically possible and within less than six weeks.

Q7: Do you agree with the proposal for the definition of hybrid system? Are there in your view trading systems currently not or not appropriately covered in RTS 2 on which ESMA should provide further guidance? Please explain.

We consider hybrid systems as those formed of more than one component. Our proposal in our answer to Question 6 would bring its definition back to its originally intended use-case of only covering combinations, instead leaving variations to be covered by extended definitions and complete innovations by ESMA opinions, respectively.

Since the definition of hybrid system is based on the first five rows of Annex I of RTS 2, we would deem even more appropriate to assess the review of this definition in the broader context of a systematic and comprehensive review, rather than solely as part of reviewing Annex I of RTS 2.

Q8: Do you agree with ESMA's proposal to require SIs to make available data free of charge 15 minutes after publication? Please explain.

We understand that ESMA's suggestion to require SIs to make pre-trade transparency data (i.e. quotes) available free of charge after 15 minutes aims at ensuring a level playing field between SIs and trading venues and APAs.

ESMA highlights that trading venues and SIs are required to make real-time pre-trade data available on a reasonable commercial basis and that 15 minutes after publication trading venues are required to make the information available free of charge.

ESMA points out that in practice a number of trading venues and APAs are not complying with the requirement to make pre-trade data available for free 15 minutes after publication, and it seems to suggest that the reason for lacking compliance relates to SIs are not being subject to the same requirement.

The Associations' members note that the scope of application of the SI regime should be clarified in the first place. The level playing field between SIs and trading venues is a legitimate policy objective as long as the products subject to the transparency rules are traded on both trading venues and SIs. Therefore, the transparency rules applied to trading venues should not apply to instruments traded on SIs that are not traded on trading venues (non-ToTV products).

Members have consistently reported the problems associated with the potential application of the SI regime to non-ToTV products (inappropriate generation of ISINs for non-ToTV products, inaccuracies in FIRDS because only non-ToTV products traded on SIs are reported under RTS 23).

We would therefore support ESMA's proposal to require SIs to make available data free of charge 15 minutes after publication if this requirement is limited to ToTV instruments. However, as highlighted in our response to the ESMA 'MiFIR report on systematic internalisers in non-equity instruments', SIs are reporting that clients almost never request information in relation to quotes. Therefore, any requirements with respect to the publication of quotes should not further contribute to the overall costs of market data. The Associations supports that ESMA aims to mitigate the problem of rising market data costs, as acknowledged in 'ESMA's report on MiFID II/MiFIR Review Report No. 1'.

Q9: Would you see value in further standardising the pre-trade transparency information to increase the usability and comparability of the information? Please explain.

The content of the information to be made public for the pre-trade transparency purposes is clearly defined in Annex I of RTS 2, for each different trading system, and we do not see value in introducing further details.

We believe that the costs of changing the format of pre-trade transparency data – to both the trading venues that generate this data and to data users that already consume this data in its existing formats – is likely to exceed any benefits. Therefore, we do not support further standardisation of pre-trade transparency information.

The reasons for this are as follows:

- The vast quantity of data that needs to be published. It should be noted that the file formats are restricted in the quantity of data that can be displayed. Furthermore, applications that are

available to non-professional users will have their own built-in features that restrict the display of millions of data entries.

- The high number of publication sites since each venue must publish data in the public domain. This is a very costly source for users to collect data. Professional users will have to connect to multiple sites to collate all data they require, restructuring multiple formats and filtering the required content. This requires a lot of time and effort.

- The lack of demand for such information.

Post-trade transparency requirements

Q10: Do you agree with ESMA's assessment of the level of post-trade transparency and with the need of a more streamlined and uniform post-trade regime which does not include options at the discretion of the different jurisdictions? If not, please explain why and, where available, support your assessment with data.

While the MiFID II/ MiFIR framework has significantly increased the amount of additional data which is available to the market and to trading counterparties, the data is not in all cases providing meaningful transparency or adding benefit to end users that justify the associated costs. This is due, in particular, to the lack of accessibility/readability of the data and the lack of harmonisation of post-trade transparency deferrals.

There is currently a lack of harmonization of post-trade deferrals across EU member states. The post-trade transparency requirements for non-equity allow NCAs to choose between various options on extended deferrals for large trades in bonds and derivatives.

Post-trade deferrals have been introduced under MiFID II to protect transactions in more illiquid instruments and large in scale transactions to ensure that markets in the derivatives space remain efficient.

The Associations strongly believe that a reduction or a deletion of the post-trade deferrals would lead to a decrease in market liquidity and higher costs to end-users. Although certain transactions (illiquid instruments and large in scale) benefit from deferrals, ultimately all derivatives transactions are fully reported and made transparent to the public. The post-trade transparency regime should remain carefully calibrated and no changes should be made without a robust cost and benefit analysis. We would question who will really benefit from a reduction of post-trade deferrals for illiquid and large transactions. Usually these transactions are undertaken by institutional investors and allow markets to function more efficiently by ensuring lower funding costs for European corporates, including SMEs, and sovereigns, and higher liquidity in markets for the benefit of European investors.

The core of the issue is that discretions granted to NCAs regarding post-trade deferrals have led to a non-harmonised application of deferrals. It is important to remove the NCA's discretions and to set out a harmonised deferrals regime per asset class, so that all investment firms can benefit from the same deferrals across all EU countries. It is also important that the harmonised deferral regime must be appropriately calibrated and continue to ensure market participants are not exposed to undue risk. A consultation on deferrals per asset class would be required.

Another issue is that aggregated data streams are costly to obtain from providers. Members would welcome mandating the use of an open common industry standard such as the Financial Information Exchange protocol (FIX). This would result in cheaper data transmission and better data quality. Lack of harmonisation of APAs post-trade data formats has been an issue and it is crucial that the information is reported in a consistent way.

In addition, data must be appropriate for the relevant asset class, and should not create a situation whereby trading in certain instruments creates undue risk. There is a need to work on data quality of OTC derivative instruments.

Q11: Do you agree with this proposal? What would be the appropriate level of such a revised LIS-threshold in your view?

As stated in response to Question 3 on pre-trade transparency waivers, we consider that it is too early to properly assess the usefulness of the SSTI waiver and therefore it is premature to assume that the SSTI should be removed for OTC non-equity instruments.

Rather than changes to Level 1 legislation, calibration of threshold set out in RTS 2 should be prioritised in particular for OTC derivatives.

We therefore do not support at this stage the deletion of the concept of SSTI for the post-trade deferral regime for OTC products.

For ETD products, we agree that whether the SSTI thresholds should be reconsidered is a relevant question and that simplification of the waiver regime may be considered.

Q12: In your view, should the real time publication of volume masking transactions apply to transactions in illiquid instruments and above LIS waiver (Option 1) or to transactions above LIS only (Option 2 and Option 3). Please elaborate. If you support another alternative, please explain which one and why.

We do not support any of the options put forward by ESMA in their consultation paper. We believe that before any significant changes are considered on the post-trade regime, policymakers should focus on improving the current issues, which are accessibility/ readability of the data, data quality and the scope.

As mentioned in our response to Question 10, the Associations strongly believe that a reduction or a deletion of the post-trade deferrals would lead to a decrease in market liquidity and higher costs to end-users. Although certain transactions (illiquid instruments and large in scale) benefit from deferrals, ultimately all derivatives transactions are fully reported and made transparent to the public. The post-trade transparency regime should remain carefully calibrated and no changes should be made without a robust cost and benefit analysis. We would question who will really benefit from a reduction of post-trade deferrals for illiquid and large transactions. Usually these transactions are undertaken by institutional investors and allow markets to function more efficiently by ensuring lower funding costs for European corporates, including SMEs, and sovereigns, and higher liquidity for the benefit of European investors.

We therefore strongly support the current regime which allows for illiquid instruments to be able to benefit from a deferral. In addition, we believe that it is important to keep the four weeks volume omission and the supplementary deferrals for larger transactions and illiquid instruments. The four-week volume omission for these transactions, allow for some time for liquidity providers to hedge their risk. We note that all the options presented by ESMA in their consultation represent a significant change from the current regime which was only implemented two and a half years ago.

ESMA also seems to argue that their proposed options would allow the EU regime to be more aligned to the US regime. However, we would caution against blindly following a regime that could have negative consequences on the EU market. The EU post-trade transparency regime has a lot of qualities such as its dynamic nature and this should not be underestimated.

Q13: Do you agree with the publication of the price and volume of all transactions after a certain period of time, such as two calendar weeks (Option 1 and 2) or do you support the two-steps approach for LIS transactions (Option 3)? Please explain why and provide any alternative you would support. Which is the optimal option in case a consolidated tape would emerge in the future?

We do not support any of the options put forward by ESMA in their consultation paper. We believe that before any significant changes are considered on the post-trade regime, policymakers should focus on accessibility/ readability of the data, data quality and the scope.

Q14: Do you agree with ESMA's proposed way forward to issue further guidance and put a stronger focus on enforcement to improve the quality of post-trade data? Are there any other measures necessary at the legislative level to improve the quality of post-trade data? What changes to the transparency regime in Level 1 could lead to a substantial improvement of data quality?

Quality of data is of the upmost importance and it is right for regulators to put the emphasis on this.

Q15: What would be the optimal transparency regime to help with the potential creation of a CTP?

The Association's members consider that the primary reason why a consolidated tape has not emerged for derivatives is the lack of use cases. Clients and end-users of derivatives have never expressed the need to get a consolidated tape for derivatives instruments. The Associations' focus is on derivatives, but we appreciate that for equities and bonds there is a use case for a CTP.

Frequently traded derivatives, such as IRS and CDS, are predominantly used by sophisticated market participants for risk management purposes. Therefore, the use case for retail investors seeking to have a better view of market or finding "pockets of liquidity" is, unlike for equity and bonds, rather limited It is difficult to see how a CT for derivatives could benefit derivatives markets for the following reasons:

- A significant barrier has been the high number of trading venues and APAs that a consolidated tape provider would need to connect to. As rightly pointed by ESMA, 279 entities reported non-equity data to its reference data system in 2018.
- Aggregate data streams are costly to obtain from providers, some of whom charge.

We strongly believe that rather than the transparency regime itself, the pre-condition for a consolidated tape for derivative is high quality of data under the reasonable commercial basis. The Associations' members would welcome mandating the use of an open common industry standard such as the Financial Information Exchange protocol (FIX). This would result in cheaper data transmission, and better data quality.

Q16: Do you agree with ESMA's above assessment? If not, please explain.

Regulatory reporting and Transparency rules serve two different purposes.

Regulatory reporting aims to enable NCAs to supervise the trading behaviour of market participants and to improve the detection of possible market abuse or breach of conduct of business rules. It is legitimate that it covers a very broad scope of instruments.

Post-trade transparency aims to give investors information on orders/quotes (pre-trade transparency) or on trades after execution (post-trade execution), in order to help them make decisions on their future transactions.

It is therefore logical that their scope is different. For derivatives instruments, regulatory reporting applies to instruments that are traded on a trading venue (ToTV) and uToTV[1] instruments whereas post-trade transparency applies only to ToTV instruments.

Furthermore, as stated in response to question 1, pre-trade transparency to derivatives differs from transparency to securities by nature because a majority of derivatives markets do not operate with a direct interaction between buying and selling orders. In addition, many derivatives instruments are not liquid and there is no retail investors in derivatives markets.

Members are therefore opposed to the view that a lower level of transparency in derivatives markets compared to securities markets proves that transparency is insufficient. The calibration of transparency rules depends upon the assessment of liquidity of derivatives markets. The crude comparison between OTC derivatives, exchange traded derivatives and securities does not appear logical in this respect.

We also question ESMA's suggestion that the gap between ISINs being generated and FIRDs should be addressed by treating all OTC derivatives as TOTV. We do not believe that it can be concluded that OTC derivatives are not being adequately caught by transparency just because there is a gap between the number of ISINs that are generated and the number of instruments reported under FIRDS. There are a number of reasons for this gap. As ESMA notes in the consultation report, ISINs are often generated in anticipation of reporting but may not be used for reference data reporting (e.g. used for RTS 27 reporting).

More generally, the SI regime was created to assure a level level-playing field between trading venues and OTC / off-venues trades with investment firms. The SI regime is fundamentally linked to the to the concept of TOTV instruments. Therefore, we strongly believe that ISINs should only be used for TOTV instruments only, to allow comparison between "standardised" derivatives traded on- or off-venue. The usefulness of an ISIN appears where it is used for various trade executions of the same derivative instrument (via a trading venue or an SI). The ISIN would then prove useful in the transparency regime to compare the various trades executed on the same instrument.

But the creation of ISINs for non-TOTV instruments, which will be traded only once, does not serve any purpose. It only complexifies the reporting framework as an ISIN would need to be created with an external provider (ANNA DSB), reported to FIRDS, used in the transaction reporting of both counterparties of the transactions, meaning exchange of that ISIN and integration in both counterparties systems, after execution. This type of framework is very far from the origin of the ISIN for securities (i.e. a fungible instruments), where the ISIN is created before the instrument is listed on a trading venue and, at the moment of the execution, can easily flow in both counterparties systems.

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[1] uToTV means: a) financial instruments where the underlying is a financial instrument admitted to trading or traded on a trading venue or b) financial instruments where the underlying is an index or a basket composed of financial instruments admitted to trading or traded on a trading venue.

Q17: Are you of the view that the interpretation of TOTV should remained aligned for both transparency and transaction reporting? If not, please explain why.

The Associations' members strongly believe that a full alignment between the reporting and transparency scope is not appropriate, in particular for OTC products.

From our perspective, the ambiguity derives from the SI regime. SIs are not trading venues but can be used by clients to trade instruments that are traded on traded venue (Regulated Markets, MTFs or OTFs). It is legitimate to assure a level playing between SIs and trading venues for transparency rules, for instruments traded on both systems. However, it is not appropriate and may be confusing if transparency rules are applied to instruments traded on SIs that are not traded on trading venues.

We support the view that regulatory reporting applies to instruments that are traded on a trading venue (ToTV) and uToTV[2] instruments whereas transparency applies only to ToTV instruments.

We do not share ESMA's view that the definition of ToTV should be broader to increase the number of products reported into FIRDS with an ISIN.
Firstly, we do not see how a broader scope of ToTV would add value to NCAs in their supervisory role given that they already access all transactions via the EMIR reporting to trade repositories.

Secondly, making non-ToTV derivatives instruments subject to post-trade transparency would not be of added value to end-users .

For the industry, the generation of ISINs is still sub-optimal and members note that there are some ISINs used in FIRDS that are not available in ANNA DSB for the products that ANNA DSB own, meaning that some ISINs should in FIRDS can be incorrect in their construct. Members also note that some ISINs enter into FIRDS although they should be rejected, as they are ISINs from SIs for TOTV products, ISINs from SIs for non-TOTV/non-uTOTV products, etc.

We strongly believe that post-trade transparency scope should remain based on products traded on trading venues (Regulated Markets, MTFs, OTFs).

Q18: Which of the three options proposed, would you recommend (Option 1, Option 2 or Option 3)? In case you recommend an alternative way forward, please explain.

The Association support option 1.

We support the view that products that are traded on multilateral trading venues (Regulated markets, MTFs or OTFs) are subject to transparency when they are also traded outside of the multilateral trading venue. As MiFID defines three categories of trading venues – Regulated markets, MTFs, OTFs – it is logical to limit the concept of ToTV to products traded on these venues. The purpose of transparency rules is notably to create a level playing field between trading venues and off-venue trades on ToTV instruments. The application of transparency rules to non-ToTV instruments does not serve this purpose.

To the contrary, it would be counterintuitive to consider that a product that is traded only OTC or on an SI is ToTV. We therefore do not support options 2 and 3. We do not agree with the underlying

[2] uToTV means: a) financial instruments where the underlying is a financial instrument admitted to trading or traded on a trading venue or b) financial instruments where the underlying is an index or a basket composed of financial instruments admitted to trading or traded on a trading venue.

assumption of Option 2 that derivatives with the same physical underlying, traded on different trading venues, should somehow be considered the same or equivalent contracts. Such instruments are subject to different terms and conditions as well as settlement procedures and prices.

We also reiterate that there is no objective reason for aligning the scope of transparency with the scope of reporting because they serve two different purposes.

Furthermore, ESMA rightly states that under the US CFTC rules all swaps are generally subject to public dissemination (i.e., "real-time reporting") regardless if they are traded on a venue or not, we point out that there are exceptions for "block trades" or "large notional off facility trades" (equivalent concept to the EU "large in scale"). These trades are still reported to the public tape, but on a delayed basis (48 hours).

Q19: What is your view on the proposal to delete the possibility for temporarily suspending the transparency provisions? Please explain.

We do not believe that the powers to temporarily suspend the transparency provisions should be deleted. It seems premature to take such measure and delete such possibility, only based on the notion that the powers have never been used. We do not believe that it necessarily needs to be changed to an EU-wide mechanism at this stage because allowing individual NCAs to suspend could be a more responsive mechanism than creating an EU wide mechanism.

Notably, MiFID II/R has only been in place since January 2018 and the powers can be an important tool for NCAs to utilise in time of market stress and/or as we move to the next MiFID II phases in case any of the phases were to create undue risk or other unwelcome effects.

Derivatives Trading Obligation

Q20: Do you have any remarks on the assessment of Article 28 of MiFIR? Please explain

The Association broadly agree with ESMA's assessment of MiFIR Article 28.

- **Equivalence decisions**: Whilst we are aware that equivalence decisions are not within ESMA's remit, we would like to make ESMA aware that we continue to encourage the European Commission to accelerate the process of adopting equivalence decisions under MiFIR Article 28(4), in particular with respect to UK trading venues. The willingness to enable mutual equivalence decisions has also been expressed in the Political Declaration setting out the framework for the future relationship between the EU and the UK.[3]

- **Circumvention provisions**: We agree with ESMA's description with respect to Brexit implications regarding mutual EU and UK DTO compliance. ISDA is of the view that this situation should be prevented by adopting equivalence decisions for UK trading venues as described above.

- **Trading of derivatives subject to the DTO on a non- exclusive and non-discriminatory basis:** We agree that derivatives subject to the DTO should be traded or admitted to trading on a

[3] https://ec.europa.eu/commission/sites/beta-political/files/revised_political_declaration.pdf

trading venue on a non-exclusive and non-discriminatory basis and is also not aware of any issues in relation to MiFIR Article 28(3).

However, we would like to propose alignment of the CO and DTO based on *transactions* (rather than counterparties)

- **Link to the Clearing Obligation (CO):** the Associations agree that '*the introduction of CO is the precondition for the DTO'*, as expressed in Paragraph 227. Furthermore, we widely agree with the conclusions of ESMA's report in relation to the review on the alignment of MiFIR with the changes introduced by EMIR Refit, published in January 2020. As ESMA points out in Paragraph 31 of the final report, ESMA was mandated to assess CO and DTO alignment in relation to *entities*. However, in the context of this report, we would like to reiterate its view that the CO and DTO should be aligned based on *transaction* terms, i.e. transactions subject to the DTO should be a subset of transactions subject to the CO.

- **Dynamic alignment would 'future-proof' MiFIR:** The approach of alignment based on transaction would be dynamic and automatically reflect changes to the scope of the CO resulting from amendments to Article 4 or relevant Level 2 provisions, in MiFIR. Therefore, The Associations suggest that MiFIR Article 28 should be amended to clarify that the derivatives trading obligation in Article 28 MiFIR should be aligned in counterparty and transaction scope with the clearing obligation in EMIR and that, as a result, any changes made to the scope of the clearing obligation in EMIR (e.g., to exempt certain counterparty types or transaction types from the clearing obligation) should automatically be reflected in the scope of the derivatives trading obligation in MiFIR. Furthermore, Article 28 MiFIR already cross-refers to EMIR to a certain extent (e.g., for the definition of financial counterparty and non-financial counterparty and for the conditions in Article 10(1)(b) EMIR) but while intragroup transactions and transactions covered by the Article 89 transitional provisions are specifically mentioned it is unclear whether other exemptions under EMIR also apply to Article 28 (e.g., the exemption in relation to central banks). In addition, where EMIR is amended to provide for additional exemptions from the clearing obligation (e.g., the new exemption for small FCs) these do not automatically track through into Article 28 MiFIR and it would be necessary to amend MiFIR in order to align it with EMIR. In light of the above, it is important to note that transactions subject to the DTO should remain a *subset* of transactions to the CO under EMIR, i.e. not all transactions subject to the CO should automatically be subject to the DTO.

Q21: Do you have any views on the above-mentioned criteria and whether the criteria are sufficient and appropriate for assessing the liquidity of derivatives? Do you consider it necessary to include further criteria (e.g. currency)? Do you consider that ESMA should make use of the provision in Article 32(4) for asset classes currently not subject to the trading obligations? Please explain.

In line with Paragraph 250, members also did not identify any asset class which should be subject to the DTO in the absence of CCPs offering clearing of such products. In principle, we are of the view that asset classes should be – as a precondition- subject to the clearing obligation before ESMA carries out the mentioned venue and liquidity tests. Furthermore, we would like to recall that ESMA acknowledged in its Final Report 'Alignment of MiFIR with changes introduced by EMIR Refit' Paragraph 44: *However, some of the MTFs and OTFs which offer trading of derivatives subject to the DTO may require all counterparties (including those exempted from the CO) to centrally clear those contracts. As a result, a standalone DTO (without a CO) could lead certain counterparties to a forced CO if they transact through these MTFs or OTFs.*

Given that a) central trading of non-cleared products is not widely developed in the EU and b) we are also not aware of sufficient demand by market participants to conduct trades of uncleared products on venues, we would recommend that ESMA does not make use of the provisions of Article 32(4). Market participants shall have discretion in terms of trade execution for products not subject to the CO, i.e. decide on a case by case basis whether they would like to conduct such trades OTC or on venues (if a venue is willing to offer the service).

Whilst the Associations agree that the mentioned tests are generally appropriate, we would also like to highlight that, in particular future liquidity assessments, in the context of Brexit, may require changes to the DTO status for certain non-euro denominated derivatives products.

Q22: Do you agree that a procedure for the swift suspension of the trading obligation for derivatives is needed? Do you agree with the proposed procedure? Please explain.

We agree with the assessment that ESMA should have a standalone power to request the Commission to suspend the DTO, independent of whether or not the CO has been suspended. The Associations agree that the existing MiFIR DTO suspension mechanism, which requires amending RTS, would not allow ESMA or the European Commission to react swiftly to unforeseeable market disruption. However, in order to give market participants sufficient guidance in relation to the suspension power, the suspension of the DTO should be based on a pre-defined mechanism and pre-defined criteria, which could relate, for example, to a lack of liquidity in the market. The Associations generally believe that ESMA's suggested approach regarding the suspension mechanism, as outlined in Paragraph 259, seems sensible and is similar to the clearing obligation suspension mechanism under EMIR. It is important to note that the process must allow for an immediate suspension. Therefore, the time between ESMA's request for a suspension, the EC's final decision and the publication in the Official Journal of the European Union must be as short as possible to serve the purpose of a DTO suspension, i.e. to swiftly react to unexpected market disruptions.

In addition, in light of the lead time required to on-board clients to a new trading venue, a fourth condition for suspension may be considered: where a trading venue is likely to cease trading a specific class of derivatives and other available trading venues are unable to on-board all impacted clients without interruption. Finally, there should not be an assumption that only when the CO is suspended should suspension of the DTO be considered. In this regard, it is worth recalling that while application of the CO to classes of derivatives is a precondition to these being made subject to the DTO, in other respects, the criteria for application of the DTO differ from criteria for application of the CO.

Q23: Do you have a view on this or any other issues related to the application of the DTO?

Introduction of benchmarks fallback clauses under the EU Benchmarks Regulation

Regarding the introduction of benchmarks fallback clauses under the EU Benchmarks Regulation, Article 28(2) of the EU Benchmark Regulation requires EU supervised entities to have in place written plans setting out robust fallbacks relating to the discontinuance or material modification of a benchmark, including the nomination of a substitute index where feasible and appropriate. ISDA has published supplements to the relevant ISDA definitional booklets to address this requirement. On 5 December 2019, the ESAs published a statement on the introduction of fallbacks in OTC derivative contracts and the requirement to exchange collateral. The ESAs notably clarify that "Fall-backs introduced in OTC derivative contracts, reflect written plans which set out the actions that counterparties would take in the event that the benchmark used in these contracts materially changes

or ceases to be provided. The ESAs are of the view that amendments made to outstanding uncleared OTC derivative contracts (legacy contracts) for the sole purpose of introducing such fallbacks should not create new obligations on these legacy contracts."

The introduction of fallback clauses in legacy contracts should not, furthermore, trigger the derivatives trading obligation where these contracts are in classes subject to the derivatives trading obligation. Therefore, we would recommend amendments to MiFIR Article 33 to clarify that the a) replacement of interest rate benchmarks and b) the introduction of fallbacks in accordance with BMR Article 28(2) should not, for that reason, become subject to the derivatives trading obligation.

Scope of the Derivatives trading obligation

ISDA and FIA members highlight that the extra-territorial application of the Derivatives Trading Obligation is creating conflicts of rules for firms operating on a cross border basis (i.e. between the EU and other jurisdictions applying a DTO). In order to avoid such conflicts of rules, it is critical that the European Commission produces equivalence decisions under MiFIR art 28(4) in favour of third country trading venues with equivalent legal and supervisory frameworks with regard to the trading obligation. Equivalence decisions would mitigate the conflict of rules that could otherwise prevent clients accessing the services of investment firms on a cross border basis (e.g. non-EU clients using the services of an EU based firm).

If such equivalence decisions were not published, the European Commission would have to find another legal path to address the conflict of rules or to re-scope the EU DTO so that it avoids preventing the provision of services to clients across jurisdictions.

Q24: Do you have any views on the functioning of the register? Please explain.

The Associations are supportive of ESMA maintaining a register which includes the classes of derivatives subject to the DTO and the relevant EU and equivalent third country venues. It has proven useful to have the relevant information in one place and agrees with ESMA's suggestion in Paragraph 264, i.e. the presence of a register is still valid. Therefore, we encourage to continue the maintenance of the register.

Level 2 Review

Q25: Do you agree that the current quarterly liquidity calculation for bonds is appropriate or would you be of the view that the liquidity determination of bonds should be simplified and provide for more stable results? Please explain.

The Associations do not respond to questions relating to Bond markets.

Q26: Do you agree with ESMA proposal to move to stage 2 for the determination of the liquidity assessment of bonds? Please explain.

The Associations do not respond to questions relating to Bond markets.

Q27: Do you agree with ESMA proposal not to move to stage 2 for the determination of the pre-trade SSTI thresholds for all non-equity instruments except bonds? Please explain.

We agree with ESMA's proposal not to move to phase 2 for pre-trade SSTI for derivatives

Q28: Do you agree with ESMA proposal to move to stage 2 for the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs)? Please explain.

RTS 2 Review for Commodity derivatives

Q29: What is your view on the current calibration of the ADNA and ADNT for commodity derivatives? Are there specific sub-asset classes for which the current calibration is problematic? Please justify your views and proposals with quantitative elements where available.

The Associations' members are of the view that generally, the pre-trade transparency regime should better take into account the fact that derivatives markets are fundamentally different from securities markets, and that there are significant differences across the underlying non-equity markets themselves. It is, for example, important to understand that commodity markets have specific characteristics and hence often suffer from a one-size fits all regulatory approach to financial instruments.

Commodity instruments are often non-liquid. In order to achieve execution, trades are pre-negotiated outside the regulated venues according to the rules of a specific exchange, and concluded on the exchange with immediate clearing availability at the exchanges' respective central counterparty (CCP), rather than in a central order book where a satisfactory execution would be less likely. This ensures maximum transparency for these nascent markets.

Additionally, commodity markets are characterised by a wide range of different contract types, including former swaps, forwards, futures and options with various combinations of quality, location, delivery type, duration and size. These markets are used by professional investors to hedge risk connected to the production or consumption of an actual commodity, and thus often requires liaison to find a counter party, without incurring undue risk. This process of has been and still is a driver behind shifting volumes from OTC to on-venue trading in these markets.

Therefore, we believe that transparency requirements need to be balanced and could benefit from a more tailored approach to commodity markets.

We consider that the current calibration of Average Daily-Notional Amount (ADNA) and of Average Daily Number of Trades (ADNT) requires modifications.

Regarding the ADNT, we consider that there should be a sufficiently high daily number of trades for a market to be deemed liquid. Rather than 10 transaction per day (which is the current metric), we recommend that the threshold should be set at the median of 100 transactions per day. Considering that liquidity is the ability to find a counterparty in a relatively short period of time within a given trading day, a threshold of 100 trades per day has the practical implication that it represents an average of approximately 1 trade every 5 minutes on an 8-hour trading day. In contrast, a threshold of 10 trades represents just 1a trade every 48 minutes. For the same reason, a median is proposed as the minimum instead of a mean. The mean can simply be an alternate view of the sum count of trades per year.

Regarding the ADNA, we consider that trade frequency and standard size is are much better liquidity indicators than volume. Consider two instruments: Instrument 1 is traded on average once per day for 100,000 units and Instrument 2 is traded on average 10,000 times per day for 10 units. In both cases, the average notional amount will be the same. However, it would be very difficult to categorise Instrument 1 as liquid, whereas Instrument 2 can be considered to be relatively liquid. We therefore recommend that trade frequency and standard size, excluding unrelated vectors such as price and currency, are both measured in order to determine liquidity.

With regards to commodity derivatives especially, we are of the view that the pre-trade transparency regime in its present form is not fit for purpose without compromising their vital role in supporting the hedging activity of commercial market participants and in mitigating wider systemic risks.

Finally, commodity trading venues and market participants are challenged by the fact that they are set in Euros instead of lots. Prices do not determine liquidity of a market and notional values do not reflect trading practice. Notional values include a significant amount of 'noise' to an analysis of market liquidity. Moreover, market participants typically hedge their production and consumption in trading in lots and not in notional value. Thus, we recommend that liquidity analysis is normalised to a base quantity unit that is native to the asset class. For commodities, this will typically be a specific unit of measure.
Specifically, we consider the current pre-trade transparency calculation methodology introduced by RTS 2 to be flawed and thus leading to inappropriately calibrated thresholds.

We are of the view that the methodology should be amended in line with the following recommendations.

1) Exclusion of price factor from the calculation of IL and LIS thresholds
The inclusion of price in the calculation of LIS and IL threshold values can lead to misinterpretations and indeed confusion when measuring liquidity in instruments that are not natively defined in notional value.

This can result in situations like the following:

a. Price movements occurring in the same direction as changes in liquidity exaggerate the liquidity changes;
b. Price movements which occur in the opposite direction mute the change in liquidity; and
c. Price movements without a change in liquidity make liquidity appear more volatile than it actually is. Liquidity should therefore not be measured by using the notional value of transactions.

Applying notional value as per, for example, the ADNA (Average Daily Notional Amount) across all asset classes is likely to introduce a significant amount of 'noise' to an analysis of market liquidity. Moreover, market players typically hedge their production and consumption in trading in lots and not in notional value. Thus, we recommend that any liquidity analysis is normalised to a base quantity unit that is native to the asset class. For commodities, this will typically be a specific unit of measure (e.g. barrels, tons, MW, etc.).

2) Sufficiently high daily number of trades for a market to be liquid

For a market to be considered liquid, a sufficiently high number of trades should be executed on each trading day. We recommend that the threshold should be set at the median of 100 transactions per day instead of the current average of 10. Considering the fact that liquidity is the ability to find a counterparty in a relatively short period of time within a given trading day, a threshold of 100 trades per day has the practical implication that it represents an average of approximately 1 trade every 5 minutes on an 8-hour trading day. In contrast, a threshold of 10 trades represents just 1.25 trades per hour. Given that trading is rarely uniformly distributed throughout the day, the higher threshold is a better basis for determining liquidity.

For the same reason, a median is proposed as the minimum instead of a mean. The mean can simply be an alternate view of the sum count of trades per year.

3) Trade frequency and standard size rather than volume as liquidity indicators

Consider two instruments: Instrument 1 is traded on average once per day for 100,000 units and Instrument 2 is traded on average 10,000 times per day for 10 units. In both cases, the average volume will be 100,000 units per day. However, it would be very difficult to categorise Instrument 1 as liquid, whereas Instrument 2 can be considered to be very liquid for trade volumes of approximately 10 units.

We therefore recommend that trade frequency and standard size, excluding unrelated vectors such as price and currency, are both measured in order to determine liquidity.

4) Counterintuitive effects of a percentile-based approach

A percentile-based approach can lead to significant counterintuitive effects, which is important to keep in mind when setting LIS thresholds. We would like to illustrate this in the following:

Figure 1 represents the distribution of trade quantities in a highly liquid instrument.
Figure 1: Distribution of trade quantities in a highly liquid instrument

Source: ICE 2018.

Figure 2 is a similar chart for an instrument that exceeds 100 trades per day but has significantly lower liquidity.
Figure 2: Distribution of trade quantities in a low liquidity instrument

*Note: the number of trades is measured over a defined interval, in this case from 01.01.2018 to 17.05.2018.
Source: ICE, 2018.

Explanation: while the low-liquidity instrument in Figure 2 is showing the beginnings of developing liquidity in lower trade sizes as evident from the local spike at a quantity of 1, some metric specific to this instrument is still driving the trade sizes in increments of 5 unit multiples with specific drivers around the 50 level, whereas such drivers are no longer the main determinant of trade size in the high liquidity market in Figure 1.

Table 2 shows the basic statistics of the two instruments described above:

Table 2: Basic statistics of a high liquidity instrument and a low liquidity instrument

Liquidity	Mean	Median	Mode	Standard Deviation	Mode Trade Size as a percentage of Total Trades
High	2.59	1	1	12.01	77.66%
Low	39.61	40	50	36.12	36.02%

Any approach similar to the existing one using a central or percentile-based measure applied equally to these two examples will result in:

a. A low standard size for the high liquidity instrument;

b. A high standard size for the low liquidity instrument;
c. A low LIS for the high liquidity instrument (the 70th percentile is still 1 unit);
d. A high LIS for the low liquidity instrument (the 70th percentile is 50 units by trade and 72 units by volume).

The above results are counterintuitive and imply that the instrument with lower liquidity can support higher LIS levels than the high-liquidity instrument – when in fact the opposite is true. While the low liquidity instrument does typically trade in a higher size, the overall size of this market and trade frequency is dwarfed by the higher liquidity of the market. Therefore, setting a low LIS for high liquidity markets and a high LIS for low liquidity markets based on the standard trade size in either mean, median or mode terms is detrimental for the development of low liquidity markets. There is indeed a clear need for multiple approaches, or a scaled approach based on variations in distribution.

Q30: In relation to the segmentation criteria used for commodity derivatives: what is your view on the segmentation criteria currently used? Do you have suggestions to amend them? What is your view on ESMA's proposals SC1 to SC3? In your view, for which sub-asset classes the "delivery/cash settlement location" parameter is relevant?

We are of the view that the current segmentation criteria for commodity derivatives are insufficiently granular. This leads to certain commodity derivatives contracts being wrongly classified as liquid or subject to excessive LiS thresholds. We agree that a more efficient segmentation is required, extending the current one to all commodity derivatives.

This is the case for Oil commodity derivatives in particular as a number of contracts in that asset class, with the same grade underlying but delivered to different locations, have been made subject to the same requirements, resulting in discriminatory treatment of less liquid locations.

We support proposals SC1 and SC2 for the added benefit they would provide in making data for different commodity classes more comparable. However, we strongly recommend setting a generous timeline and work solely in a forward-looking way.
We do not support proposal SC3, as introducing a new field (instead of adapting the currently available ones, as proposed in SC1 and SC2) would in turn make a costly adaption of trading systems necessary.

Q31: What is your view on the analysis and proposals related to the pre-trade LIS thresholds for commodity derivatives? Which proposal to mitigate the counterintuitive effect of the current percentile approach do you prefer (i.e. keep the current methodology but modify its parameters, or change the methodology e.g. using a different metric for the liquidity criteria)? Please justify your views and proposals with quantitative elements where available.

We recommend that both Level 1 and Level 2 provisions are revised.

We support revising the LiS calculation methodology in line with recommendations set out in Q29.

We support revising the Illiquid Instrument waiver threshold in line with recommendations set out in Q29.

We support the introduction of hedging exemption to financial counterparties as set out in Q1.

Level 1: We recommend that the hedging exemption in MiFIR Article 8(1) is extended to cover all market participants managing risks arising from activity in the physical market, including financial counterparties. Such solution would allow the building of liquidity in the order book to continue, without jeopardising the ability of commodity derivatives markets to fulfil their function. We further propose to extend the so-called "negotiated transaction waiver" for equity instruments (Art. 4 (1) (b) MiFIR) to bilaterally negotiated commodity derivative transactions. This waiver allows trading participants to individually agree on the price and volume of the trade before transmitting it to the trading platform for the purpose of clearing. For this purpose, the conditions of the present negotiated transaction waiver for equity instruments need to be adapted to the specifics of the commodity (derivatives) markets and their participants, in particular to allow a sufficient volume of pre-arranged trades to be registered at exchanges for the purpose of voluntary clearing.

Level 2: Such change should be combined with amendments in RTS 2, which would remove the current factors leading to inappropriate thresholds. The current methodology and its segmentation approach (such as liquidity accumulation across venues) has led to a significant number of niche and nascent products being inappropriately (re-) classified as liquid, and thus becoming subject to significantly broader transparency requirements, which were previously reserved for developed markets. Therefore, we are of the view that the methodology should be amended in line with the following recommendations.

Exclusion of price factor from the calculation of IL and LIS thresholds

The inclusion of price in the calculation of LIS and IL threshold values can lead to misinterpretations and indeed confusion when measuring liquidity in instruments that are not natively defined in notional value and result in: price movements occurring in the same direction as changes in liquidity exaggerate the liquidity changes; price movements which occur in the opposite direction mute the change in liquidity; and price movements without a change in liquidity make liquidity appear more volatile than it actually is. Liquidity should therefore not be measured by using the notional value of transactions. Instead, we recommend that any liquidity analysis is normalised to a base quantity unit that is native to the asset class. For commodities, this will typically be a specific unit of measure (e.g. barrels, tons, MW, etc.).

Counterintuitive effects of a percentile-based approach

A percentile-based approach can lead to significant counterintuitive effects, which is important to keep in mind when setting LIS thresholds. Any approach similar to the existing one using a central or percentile-based measure will result in:

- A low standard size for the high liquidity instrument;
- A high standard size for the low liquidity instrument;
- A low LIS for the high liquidity instrument;
- A high LIS for the low liquidity instrument.

The above results are counterintuitive and imply that the instrument with lower liquidity can support higher LIS levels than the high-liquidity instrument – when in fact the opposite is true. While the low liquidity instrument does typically trade in a higher size, the overall size of this market and trade frequency is dwarfed by the higher liquidity of the market. Therefore, setting a low LIS for high liquidity markets and a high LIS for low liquidity markets based on the standard trade size in either mean, median or mode terms is detrimental for the development of low liquidity markets. There is indeed a clear need for a more tailored approach, or a scaled approach based on variations in distribution.

Please note that any proposals for revised thresholds are based on the assumption that, for the bucket grouping according to time to delivery, each financial instrument (e.g. Phelix Monthly Futures) is considered individually for the purpose of the calculation. For example, the July 18 expiry in the Phelix Monthly Futures would not be placed in one maturity bucket with other futures products with the same underlying, e.g. the Second Week July 18 Phelix Weekly Futures. Any other way of conducting these calculations would inevitably produce inaccurate outcomes in terms of liquidity profiles of the instruments in question.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 74 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.