esma European Securities and Markets Authority

Reply form for the Consultation Paper on MiFID II / MiFIR

19 December 2014

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper on MiFID II / MiFIR (reference ESMA/2014/1570), published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

i. use this form and send your responses in Word format (do not send pdf files except for annexes);

ii. do not remove the tags of type <ESMA_QUESTION_CP_MIFID_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and

iii. if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses are most helpful:

i. if they respond to the question stated;

ii. contain a clear rationale, and

iii. describe any alternatives that ESMA should consider.

To help you navigate this document more easily, bookmarks are available in "Navigation Pane" for Word 2010.

Naming protocol:

In order to facilitate the handling of stakeholders responses please save your document using the following format: ESMA_CP_MIFID_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were ESMA, the name of the reply form would be ESMA_CP_MIFID _ESMA_REPLYFORM or ESMA_CP_MIFID_ESMA_ANNEX1

Deadline

Responses must reach us by **2 March 2015**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your in-put/Consultations'.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the headings 'Legal notice' and 'Data protection'.

General information about respondent

Name of the company / organisation	FIA Europe
Confidential[1]	☐
Activity:	Other Financial service providers
Are you representing an association?	☒
Country/Region	Europe

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_CP_MIFID_1>

We set out below a summary of the main points raised by FIA Europe's members in this response.

<u>Information relating to execution of orders (Section 2.4 of the Consultation Paper)</u>

FIA Europe's members support the concerns that the Association for Financial Markets in Europe (AFME) have articulated in their response to RTS 6 and 7. Specifically, we believe that the current proposals, *inter alia*, do not differentiate adequately between different trading systems; could lead to the disclosure of commercially sensitive information (which could unfairly impact key market participants such as Systematic Internalisers (SI)); are duplicative; and could have a detrimental impact on client confidentiality.

<u>Transparency (Section 3 of the Consultation Paper)</u>

FIA Europe's members support transparency and have general concerns that incorrect liquidity assessments could lead to a reduction in transparency in exchange traded derivatives. The varied characteristics of different asset classes and the way in which these products are negotiated would not be captured by a 'one-size-fits-all' solution.

The COFIA approach adopted by ESMA to determine classes of financial instruments upon which a liquidity assessment would be carried out has resulted in some wider classes of financial instruments, particularly equity derivatives and commodity derivatives, not having sufficient granularity.

ESMA has achieved an acceptable level of granularity in the liquidity assessment for interest rate derivatives, however further granularity is required to set liquidity thresholds on some instruments, particularly swaptions. FIA Europe's members are concerned that the same level of detail in the analysis presented by ESMA has not been undertaken for equity and commodity derivatives. The analysis and liquidity determinations of equity and commodity derivatives may need to be completely overhauled.

[1] The field will used for consistency checks. If its value is different from the value indicated during submission on the website form, the latest one will be taken into account.

FIA Europe's members are concerned that, in some cases, incomplete data sets (e.g. not covering global markets) or wrong data sets (e.g. post-trade data rather than order-book data) were used to assess whether certain sub-classes of instruments have liquid markets. This risks arbitrary or inappropriate thresholds being set in the liquidity assessments for specific sub-classes. We propose that ESMA use the appropriate pre-trade order book data sets from the relevant trading venues.

FIA Europe's members consider that the current Large In Scale (LIS) and Size Specific To Instrument (SSTI) thresholds are not adequately calibrated, with some set too high and others too low. We propose that ESMA recalibrate these thresholds to set SSTI appropriately.

FIA Europe encourages ESMA to consider the appropriate application of the MiFIR pre- and post-trade transparency obligations and the derivatives trading obligation to package transactions.

Non-discriminatory Access (Sections 5.5 and 5.6 of the Consultation Paper)

FIA Europe's members are generally supportive of ESMA's proposals relating to non-discriminatory access, subject to clarification/amendment of certain provisions:

1. FIA Europe's members do not believe that the requirements of MiFIR Article 35(6)(e) have been accurately reflected in Article 12(1) of the draft RTS. FIA Europe proposes an alternative definition that is based upon the language already published by ESMA in one of its EMIR RTS relating to cross-product margining: Article 27(1) of Commission Delegated Regulation No. 153/2013;

2. It should be possible for a CCP or trading venue to reject an access request in part rather than only in whole;

3. A CCP must not be mandatorily required to grant an access request with respect to products that it does not currently clear and/or is outside the scope of its current EMIR authorisation;

4. Some FIA Europe members consider that *any* legal risks resulting from an access request that create significant undue risks for CCPs that cannot be managed should be a valid reason to deny access. Other FIA Europe members feel that the closed list specified by ESMA is sufficient;

5. A trading venue should be able to deny access on the basis of significant undue legal risks that cannot be managed relating to different trade acceptance models and sanctions etc.;

6. FIA Europe requests that ESMA clarify that the requirement regarding:

(i) fees is that the same *schedule* of fees relating to access applies. It is not required that the fees themselves be the same – provided they are *non-discriminatory*, fees charged to clearing members may differ;

(ii) collateral/margining is not that the processes be the same, but that they be *non-discriminatory*; and

(iii) netting is not that the processes be the same, but that they be *non-discriminatory*.

FIA Europe understands from its discussions with national competent authorities that these provisions are only intended to apply in instances where it has not proven possible to gain access to a venue or benchmark consensually – accordingly, nothing in RTS 24 is intended to, or does, preclude access being reached on mutually agreed terms within whatever timeframe the parties may agree.

Commodities (Section 7)

Ancillary Activities

FIA Europe's members:

1. ask for caution when setting the ancillary thresholds and urge ESMA to take into account the impact on liquidity, competition, and the European Commission policy and Capital Markets Union, if MiFID II is applied to a much wider group of market participants, particularly considering consequential regulation (EMIR and capital requirements under CRD IV). Our members also ask ESMA to provide market data for the trading activity test; and

2. are concerned about the consequences a calculation of capital employed for eligible activity and trading activity on a group basis would have on entities within a group that do not undertake MiFID II activities or only undertake privileged transactions (e.g. intra-group rather than market facing transactions). The proposed definition of "capital" cannot be applied to calculate capital employed for privileged transactions.

Position Limits and Position Reporting

FIA Europe's members:

1. believe deliverable supply is the right metric for spot month contracts but that open interest should be used as a metric for non-spot months. The term deliverable supply is not defined, making it difficult for FIA Europe members to assess the proposed baseline figure. For non-spot months' contracts, our members advocate the introduction of de minimis thresholds before applying position limits to permit contract growth;

2. believe that the definition of netting is too narrow and that it should be possible to net physical positions;

3. urge ESMA to allow disaggregation of independently managed businesses to which legal information barriers apply; and

4. recommend that ESMA consider the process used in the US (specifically, the form 40 regime set out in the CFTC rules), whereby the end user client can send relevant information directly to the CFTC without passing through the chain of intermediaries to protect client confidentiality and prevent conflicts with national privacy laws.

Market data and reporting (Section 8 of the Consultation Paper)

FIA Europe's members are supportive of ESMA's proposals relating to transaction reporting, subject to clarification/amendment of certain provisions, including but not limited to the following - FIA Europe's members:

1. request that ESMA clarify which events should be reported in the event of early ETD Option exercise;

2. feel that "transmission of order" as it stands will be extremely difficult to implement, due to the sheer volume of trades involved in the Exchange Traded Derivatives (ETD) asset class;

3. believe that, for ETD, ESMA is seeking to differentiate between client and house business using the term "Matched Principal". However, for ETD, the current interpretation of the word "simultaneous" is problematic. Accordingly, FIA Europe's members ask that ESMA amend the RTS for ETD, so that ESMA may achieve their desired outcome;

4. note that, for a number of ETD transaction types, the underlying deliverable is not always known, as such deliverable may come from a range of possible deliverables. As a result, a further reportable field is required to capture such optionality; and

5. request that ESMA clarify that it is acceptable to report "lapsed" client Legal Entity Identifiers (LEIs).

Post-trade issues: straight through processing (Section 9.1 of the Consultation Paper)

FIA Europe submits that the pre-trade checks to be performed by Trading Venues are not required in the ETD market, as the intention of the MiFIR level 1 text is already met through the market's current structure.

Article 29 (2) of MiFIR states that "CCPs, Trading Venues and investment firms which act as clearing members….shall have in place effective systems, procedures and arrangement in relation to cleared derivatives to ensure that transactions in cleared derivatives are submitted and accepted for clearing as quickly as technologically practicable using automated systems". Where binding contractual arrangements arise upon trade execution under the rulebooks of Trading Venues and CCPs, this requirement is met.

The introduction of pre-trade checks would cause significant disruption to the ETD market. Therefore, FIA Europe proposes that Article 3 of the draft RTS be amended so as to exclude from the pre-trade check requirement those orders that benefit from certainty of clearing upon trade execution through the binding contractual arrangements of the Trading Venue and CCP rulebooks.

Post-trade issues: indirect clearing (Section 9.2 of the Consultation Paper)

FIA Europe is pleased to submit these comments with respect to the draft Regulatory Technical Standards on Indirect Clearing (the "**RTS**") in response to questions 244 and 245 of ESMA's Consultation Paper on MiFID II/MiFIR (ESMA/2014/1570) (the "**CP**"). For ease of review, we have structured our response as follows:

Part I – A description of our key concerns regarding the current draft of the RTS and a summary of the proposed solutions;

Part II – A proposed revised draft of the RTS (the "**Revised Draft RTS**") which addresses our concerns with the current draft RTS and seeks to provide a robust and workable indirect clearing regime for exchange traded derivatives ("**ETD**"); and

Part III – A commentary table setting out in detail the basis for each of the amendments we propose to make to the RTS.

Our comments are limited to the technical standards which will apply in respect of indirect clearing arrangements with regard to ETD. We understand that ESMA is also planning to give further consideration to the existing technical standards regarding indirect clearing arrangements for OTC derivatives (the "**EMIR RTS**"). We welcome this and believe that the proposed amendments in the Revised Draft RTS would address many of the issues with the EMIR RTS that have disincentivised firms from offering indirect clearing services for OTC derivatives in accordance with those rules. However, it is important to note that there are differences between ETD and OTC derivatives, which mean that certain amendments to the Revised Draft RTS would likely be necessary to render them suitable for indirect clearing of OTC derivatives. With respect to indirect clearing of OTC derivatives, we have had the opportunity to review the responses of the International Swaps and Derivatives Association, Inc., and fully support those comments.

Part I: Key Concerns

The ETD market is an established, well-functioning and generally highly liquid market involving standardised products and most ETD products are already centrally cleared. Indirect clearing arrangements (particularly clearing arrangements where a global clearing services provider clears its clients' trades on CCPs on which the global clearing services provider is not a direct clearing member, via other entities which are direct clearing members) already form a part of the market standard model for ETD business. We are strongly of the view that application of the RTS, as currently drafted, would jeopardise the regulatory objective of access to markets, limiting access for ETD end users to global ETD markets and thereby reducing liquidity and increasing market risk.

While we acknowledge and appreciate that ESMA has sought to address some of the concerns raised by market participants in respect of the EMIR RTS, we believe that certain features of the RTS are likely to impose obligations with which ETD market participants will be unable to comply and/or will cause undue market disruption. We believe that these issues are contributing factors to the absence of an offering of indirect clearing services for OTC derivatives. In particular, we highlight the following concerns and proposed solutions:

Jurisdictional scope and conflict of laws

It is important that the RTS include sensible scope parameters to ensure that they apply to indirect clearing arrangements with an appropriate EU nexus and that they will be workable in practice. In the interests of legal certainty, we encourage ESMA to include those scope parameters in the operative provisions of the RTS themselves, rather than in accompanying Q&A. In our view the purpose of the RTS is to provide protections to EU indirect clients clearing through EU CCPs and the scope of the RTS should be limited accordingly. We also ask ESMA to consider limiting the application of the RTS to EU clients, as many of the conflict of laws issues highlighted in Part III of our response could be avoided by such scope limitation.

We note that unless ESMA limits the scope to EU clients only, clients outside of the EU will need to comply with their local laws and that those local laws will not necessarily be compatible with the RTS. This could effectively prevent a large number of existing clients (including US clients) providing indirect clearing services. In this regard, we draw ESMA's attention to the responses of our affiliate, FIA, which focuses on the impact of the RTS on the ability of US Futures Commission Merchants (FCMs) to provide services to their clients and the conflict of law between the RTS and the US Bankruptcy Code. We have had the opportunity to review the FIA's response and fully support their comments and conclusions.

Default management process

We are suggesting drafting amendments to achieve the following:

- clarity that the clearing member ('CM') is only required to take steps to return assets to indirect clients that have selected gross omnibus segregated accounts ('GOSA' or 'gross OSA') and that there are circumstances in which a CM is not able or permitted to make a return of assets or liquidation proceeds directly to the indirect clients. Instead, in those circumstances the clearing member should have flexibility to adopt procedures that contemplate making a payment of the liquidation proceeds to the insolvent client for the account of its indirect clients.

- clarity that for net omnibus segregated accounts ('NOSA' or 'net OSA') clients, a CM is expected to have a robust procedure to liquidate the portfolio and return assets to the client for the account of the indirect clients. Note: EMIR Article 48(7).

- clarity that the client is only required to include in its agreement with the indirect client terms to facilitate the prompt return of the liquidation proceeds to indirect clients, if the indirect client has selected gross OSA.

Scalabilty and implementation challenges

Whilst in the Revised Draft RTS we have sought to provide a workable framework for indirect clearing arrangements in respect of ETD, we anticipate that the implementation of the requirements in the Revised Draft RTS will entail a number of operational and implementation challenges, which, together, could result in the widespread cessation of indirect clearing arrangements in light of the resultant operational, legal/re-papering, business, capital and compliance requirements.

The scale of the market upheaval – not least the requirement for clearing members and clients to repaper all indirect clearing arrangements (i.e. thousands of legal relationships) to accommodate the RTS – cannot be underestimated. Operational changes will also be significant: the RTS introduce a new type of GOSA account and impose requirements as to the functionality associated with such account (in particular in respect of excess margin). Accordingly, CCPs, clearing members and clients will need to develop systems and procedures to support this new account functionality which may differ from CCP to CCP. The implementation challenges are likely to be heightened further by the fact that the requirements are due to come into force from **3 January 2017,** impacting all existing indirect clearing arrangements. In our view this timeline is likely to pose very serious problems for market participants, many of which will be required to reconsider the feasibility of an indirect clearing offering.

Other issues

- In the Article 39 EMIR context, it has been extremely difficult for CMs to obtain responses from clients on the type of account they desire. It is likely to be even more difficult to obtain account choices in the indirect clearing context, particularly given that many clients in indirect clearing arrangements are non-EU entities and may not feel compelled to pursue indirect clients for responses. Our drafting suggests that in the absence of the indirect client’s choice of account, notwithstanding the client’s reasonable efforts, the client should be able to “default” indirect clients to net OSA.

- Risk management obligations imposed on the CM need to be workable, clear, fair and comparable with the risk management obligations imposed on CCPs.

- Clearing chains which involve entities that receive ETD clearing services from indirect clients (‘longer chains’) are not subject to the RTS and we sought clarification to that end in the RTS via a drafting amendment which also ensures that the first four parties in the chain must always comply with the RTS, even if the chain contains more than four parties.

Furthermore, we also expect further issues to arise as market participants seek to implement the requirements and that ESMA will need to provide guidance on these and other issues. On such issues, we are keen to continue a constructive dialogue with ESMA and to ensure that they are addressed in a consistent manner.

Finally, we note that Annex A of the CP does not provide a cost-benefit analysis of the requirements of the RTS. Both the RTS and our Revised Draft RTS impose a number of obligations on CCPs, clearing members, clients and are likely to require a number of changes to established ETD markets. Prior to the promulgation of the final draft RTS it is therefore imperative that a full cost-benefit analysis is published and that market participants are given the opportunity to discuss the analysis with ESMA.
< ESMA_COMMENT_CP_MIFID_1>

2. Investor protection

Q1. Do you agree with the list of information set out in draft RTS to be provided to the competent authority of the home Member State? If not, what other information should ESMA consider?

<ESMA_QUESTION_CP_MIFID_1>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_1>

Q2. Do you agree with the conditions, set out in this CP, under which a firm that is a natural person or a legal person managed by a single natural person can be authorised? If no, which criteria should be added or deleted?

<ESMA_QUESTION_CP_MIFID_2>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_2>

Q3. Do you agree with the criteria proposed by ESMA on the topic of the requirements applicable to shareholders and members with qualifying holdings? If no, which criteria should be added or deleted?

<ESMA_QUESTION_CP_MIFID_3>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_3>

Q4. Do you agree with the approach proposed by ESMA on the topic of obstacles which may prevent effective exercise of the supervisory functions of the competent authority?

<ESMA_QUESTION_CP_MIFID_4>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_4>

Q5. Do you consider that the format set out in the ITS allow for a correct transmission of the information requested from the applicant to the competent authority? If no, what modification do you propose?

<ESMA_QUESTION_CP_MIFID_5>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_5>

Q6. Do you agree consider that the sending of an acknowledgement of receipt is useful, and do you agree with the proposed content of this document? If no, what changes do you proposed to this process?

<ESMA_QUESTION_CP_MIFID_6>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_6>

Q7. Do you have any comment on the authorisation procedure proposed in the ITS included in Annex B?

<ESMA_QUESTION_CP_MIFID_7>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_7>

Q8. Do you agree with the information required when an investment firm intends to provide investment services or activities within the territory of another Member State under the right of freedom to provide investment services or activities? Do you consider that additional information is required?

<ESMA_QUESTION_CP_MIFID_8>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_8>

Q9. Do you agree with the content of information to be notified when an investment firm or credit institution intends to provide investment services or activities through the use of a tied agent located in the home Member State?

<ESMA_QUESTION_CP_MIFID_9>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_9>

Q10. Do you consider useful to request additional information when an investment firm or market operator operating an MTF or an OTF intends to provide arrangements to another Member State as to facilitate access to and trading on the markets that it operates by remote users, members or participants established in their territory? If not which type of information do you consider useful to be notified?

<ESMA_QUESTION_CP_MIFID_10>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_10>

Q11. Do you agree with the content of information to be provided on a branch passport notification?

<ESMA_QUESTION_CP_MIFID_11>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_11>

Q12. Do you find it useful that a separate passport notification to be submitted for each tied agent the branch intends to use?

<ESMA_QUESTION_CP_MIFID_12>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_12>

Q13. Do you agree with the proposal to have same provisions on the information required for tied agents established in another Member State irrespective of the establishment or not of a branch?

<ESMA_QUESTION_CP_MIFID_13>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_13>

Q14. Do you agree that any changes in the contact details of the investment firm that provides investment services under the right of establishment shall be notified as a change in the particulars of the branch passport notification or as a change of the tied agent passport notification under the right of establishment?

<ESMA_QUESTION_CP_MIFID_14>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_14>

Q15. Do you agree that credit institutions needs to notify any changes in the particulars of the passport notifications already communicated?

<ESMA_QUESTION_CP_MIFID_15>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_15>

Q16. Is there any other information which should be requested as part of the notification process either under the freedom to provide investment services or activities or the right of establishment, or any information that is unnecessary, overly burdensome or duplicative?

<ESMA_QUESTION_CP_MIFID_16>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_16>

Q17. Do you agree that common templates should be used in the passport notifications?

<ESMA_QUESTION_CP_MIFID_17>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_17>

Q18. Do you agree that common procedures and templates to be followed by both investment firms and credit institutions when changes in the particulars of passport notifications occur?

<ESMA_QUESTION_CP_MIFID_18>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_18>

Q19. Do you agree that the deadline to forward to the competent authority of the host Member State the passport notification can commence only when the competent authority of the home Member States receives all the necessary information?

<ESMA_QUESTION_CP_MIFID_19>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_19>

Q20. Do you agree with proposed means of transmission?

<ESMA_QUESTION_CP_MIFID_20>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_20>

Q21. Do you find it useful that the competent authority of the host Member State acknowledge receipt of the branch passport notification and the tied agent passport notification under the right of establishment both to the competent authority and the investment firm?

<ESMA_QUESTION_CP_MIFID_21>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_21>

Q22. Do you agree with the proposal that a separate passport notification shall be submitted for each tied agent established in another Member State?

<ESMA_QUESTION_CP_MIFID_22>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_22>

Q23. Do you find it useful the investment firm to provide a separate passport notification for each tied agent its branch intends to use in accordance with Article 35(2)(c) of MiFID II? Changes in the particulars of passport notification

<ESMA_QUESTION_CP_MIFID_23>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_23>

Q24. Do you agree to notify changes in the particulars of the initial passport notification using the same form, as the one of the initial notification, completing the new information only in the relevant fields to be amended?

<ESMA_QUESTION_CP_MIFID_24>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_24>

Q25. Do you agree that all activities and financial instruments (current and intended) should be completed in the form, when changes in the investment services, activities, ancillary services or financial instruments are to be notified?

<ESMA_QUESTION_CP_MIFID_25>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_25>

Q26. Do you agree to notify changes in the particulars of the initial notification for the provision of arrangements to facilitate access to an MTF or OTF?

<ESMA_QUESTION_CP_MIFID_26>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_26>

Q27. Do you agree with the use of a separate form for the communication of the information on the termination of the operations of a branch or the cessation of the use of a tied agent established in another Member State?

<ESMA_QUESTION_CP_MIFID_27>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_27>

Q28. Do you agree with the list of information to be requested by ESMA to apply to third country firms? If no, which items should be added or deleted. Please provide details on your answer.

<ESMA_QUESTION_CP_MIFID_28>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_28>

Q29. Do you agree with ESMA's proposal on the form of the information to provide to clients? Please provide details on your answer.

<ESMA_QUESTION_CP_MIFID_29>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_29>

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

<ESMA_QUESTION_CP_MIFID_30>
FIA Europe supports the Association for Financial Markets in Europe's response as regards:

- the need for appropriate treatment of different trading systems e.g. RFQ/voice;
- the need to differentiate requirements for Systematic Internalisers (Sis) from those for trading venues;
- the need for a definition for "execution venue" to ensure that market makers and liquidity providers are not considered as such;
- the need to ensure that the requirements do not discourage SIs from performing their function;
- the need to avoid duplicative data reporting;
- the need to adapt requirements to different asset classes.

We request that ESMA treat FIA Europe's response as if it included the full text of AFME's response.
<ESMA_QUESTION_CP_MIFID_30>

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

<ESMA_QUESTION_CP_MIFID_31>
We do not support having "point-in-time information" disclosed and therefore do not believe that ranges should apply.
<ESMA_QUESTION_CP_MIFID_31>

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

<ESMA_QUESTION_CP_MIFID_32>
FIA Europe supports the Association for Financial Markets in Europe's response, in particular:

- the need for more tailoring to different types of venue; and
- the impracticality of some of the proposed requirements in RFQ and voice trading markets.

We request that ESMA treat FIA Europe's response as if it included the full text of AFME's response.
<ESMA_QUESTION_CP_MIFID_32>

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

<ESMA_QUESTION_CP_MIFID_33>
FIA Europe supports the Association for Financial Markets in Europe's response, and its concerns about duplicative reporting and client confidentiality.

We request that ESMA treat FIA Europe's response as if it included the full text of AFME's response.
<ESMA_QUESTION_CP_MIFID_33>

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

<ESMA_QUESTION_CP_MIFID_34>
FIA Europe supports the Association for Financial Markets in Europe's response, and its proposed use of percentages as opposed to aggregate values.

We request that ESMA treat FIA Europe's response as if it included the full text of AFME's response.
<ESMA_QUESTION_CP_MIFID_34>

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

<ESMA_QUESTION_CP_MIFID_35>
FIA Europe supports the Association for Financial Markets in Europe's response, in particular the need not to require publication of commercially sensitive information.

We request that ESMA treat FIA Europe's response as if it included the full text of AFME's response.
<ESMA_QUESTION_CP_MIFID_35>

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

<ESMA_QUESTION_CP_MIFID_36>
FIA Europe supports the Association for Financial Markets in Europe's response, in particular the need for a narrower application of Article 6 such that is should only apply to the top five execution venues.

We request that ESMA treat FIA Europe's response as if it included the full text of AFME's response.
<ESMA_QUESTION_CP_MIFID_36>

3. Transparency

Q37. Do you agree with the proposal to add to the current table a definition of request for quote trading systems and to establish precise pre-trade transparency requirements for trading venues operating those systems? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_37>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_37>

Q38. Do you agree with the proposal to determine on an annual basis the most relevant market in terms of liquidity as the trading venue with the highest turnover in the relevant financial instrument by excluding transactions executed under some pre-trade transparency waivers? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_38>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_38>

Q39. Do you agree with the proposed exhaustive list of negotiated transactions not contributing to the price formation process? What is your view on including non-standard or special settlement trades in the list? Would you support including non-standard settlement transactions only for managing settlement failures? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_39>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_39>

Q40. Do you agree with ESMA's definition of the key characteristics of orders held on order management facilities? Do you agree with the proposed minimum sizes? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_40>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_40>

Q41. Do you agree with the classes, thresholds and frequency of calculation proposed by ESMA for shares and depositary receipts? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_41>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_41>

Q42. Do you agree with the classes, thresholds and frequency of calculation proposed by ESMA for ETFs? Would you support an alternative approach based on a single large in scale threshold of €1 million to apply to all ETFs regardless of their liquidity? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_42>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_42>

Q43. Do you agree with the classes, thresholds and frequency of calculation proposed by ESMA for certificates? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_43>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_43>

Q44. Do you agree with the proposed approach on stubs? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_44>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_44>

Q45. Do you agree with the proposed conditions and standards that the publication arrangements used by systematic internalisers should comply with? Should systematic internalisers be required to publish with each quote the publication of the time the quote has been entered or updated? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_45>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_45>

Q46. Do you agree with the proposed definition of when a price reflects prevailing conditions? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_46>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_46>

Q47. Do you agree with the proposed classes by average value of transactions and applicable standard market size? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_47>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_47>

Q48. Do you agree with the proposed list of transactions not contributing to the price discovery process in the context of the trading obligation for shares? Do you agree that the list should be exhaustive? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_48>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_48>

Q49. Do you agree with the proposed list of information that trading venues and investment firms shall made public? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_49>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_49>

Q50. Do you consider that it is necessary to include the date and time of publication among the fields included in Table 1 Annex 1 of Draft RTS 8? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_50>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_50>

Q51. Do you agree with the proposed list of flags that trading venues and investment firms shall made public? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_51>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_51>

Q52. Do you agree with the proposed definitions of normal trading hours for market operators and for OTC? Do you agree with shortening the maximum possible delay to one minute? Do you think some types of transactions, such as portfolio trades should benefit from longer delays? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_52>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_52>

Q53. Do you agree that securities financing transactions and other types of transactions subject to conditions other than the current market valuation of the financial instrument should be exempt from the reporting requirement under article 20? Do you think other types of transactions should be included? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_53>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_53>

Q54. Do you agree with the proposed classes and thresholds for large in scale transactions in shares and depositary receipts? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_54>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_54>

Q55. Do you agree with the proposed classes and thresholds for large in scale transactions in ETFs? Should instead a single large in scale threshold and deferral period apply to all ETFs regardless of the liquidity of the financial instrument as described in the alternative approach above? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_55>
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<ESMA_QUESTION_CP_MIFID_55>

Q56. Do you agree with the proposed classes and thresholds for large in scale transactions in certificates? Please provide reasons for your answers

<ESMA_QUESTION_CP_MIFID_56>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_56>

Q57. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer for SFPs and for each of type of bonds identified (European

Sovereign Bonds, Non-European Sovereign Bonds, Other European Public Bonds, Financial Convertible Bonds, Non-Financial Convertible Bonds, Covered Bonds, Senior Corporate Bonds-Financial, Senior Corporate Bonds Non-Financial, Subordinated Corporate Bonds-Financial, Subordinated Corporate Bonds Non-Financial) addressing the following points:

(1) Would you use different qualitative criteria to define the sub-classes with respect to those selected (i.e. bond type, debt seniority, issuer sub-type and issuance size)?

(2) Would you use different parameters (different from average number of trades per day, average nominal amount per day and number of days traded) or the same parameters but different thresholds in order to define a bond or a SFP as liquid?

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

<ESMA_QUESTION_CP_MIFID_57>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_57>

Q58. Do you agree with the definitions of the bond classes provided in ESMA's proposal (please refer to Annex III of RTS 9)? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_58>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_58>

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

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

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

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

<ESMA_QUESTION_CP_MIFID_59>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_59>

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

<ESMA_QUESTION_CP_MIFID_60>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_60>

Q61. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer for each of the asset classes identified (FRA, Swaptions, Fixed-to-Fixed single currency swaps, Fixed-to-Float single currency swaps, Float -to- Float

single currency swaps, OIS single currency swaps, Inflation single currency swaps, Fixed-to-Fixed multi-currency swaps, Fixed-to-Float multi-currency swaps, Float -to-Float multi-currency swaps, OIS multi-currency swaps, bond options, bond futures, interest rate options, interest rate futures) addressing the following points:

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

(2) Would you use different parameters (among those provided by Level 1, i.e. the average frequency and size of transactions, the number and type of market participants, the average size of spreads, where available) or the same parameters but different thresholds in order to define a sub-class as liquid (state also your preference for option 1 vs. option 2, i.e. application of the tenor criteria as a range as in ESMA's preferred option or taking into account broken dates. In the latter case please also provide suggestions regarding what should be set as the non-broken dates)?

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

<ESMA_QUESTION_CP_MIFID_61>

<u>Introduction</u>

FIA Europe disagrees with ESMA's determinations of liquidity for interest rate derivatives.

FIA Europe will provide comments in relation to exchange traded interest rate derivatives which are traded on a regulated market for the purposes of Article 28 MiFIR.

These include:

- Bond Futures
- Interest Rate Futures
- Futures on Swapnotes
- Bond Options
- Interest Rate Options
- Options on Swapnotes
- Swaptions

<u>Exchange Traded Derivatives (ETD) versus OTC</u>

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

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

- The 10 year Euro Swapnote listed in Table 5, Annex III of RTS 9 is economically extremely similar to a 10 year Euro fixed-float swap listed in Table 23 of the same annex. The former is proposed to have an LIS threshold of €10 million, whilst the latter is proposed to have an LIS of €165 million.
- Three month Euribor interest rate futures listed in Table 7, Annex III of RTS 9 are economically extremely similar to 3 month Euribor FRAs listed in Table 15 of the same annex. The former is proposed to have an LIS threshold of €10 million, whilst the latter are proposed to have LIS of €525 – 1,000 million depending on tenor. We also note that, in Table 11, options (which we presume to be exchange traded options, although RTS 9 is unclear on this) on 3 month Euribor futures are proposed to have an LIS of €15 billion.
- 5 year Sterling swapnotes, shown in table 11 on page 117 of the Consultation Paper are found to be illiquid and proposed to have an LIS threshold of €10 million. These are economically extremely similar to 10 year GBP fixed-float swaps listed in Table 23, Annex III of RTS 9 as liquid with an LIS threshold of €90mm.

FIA Europe's reading of the RTS gives us an impression that different asset classes were addressed by different teams/taskforces, and we fail to recognise the application of a consistent approach between different asset classes, or sometimes between subsets of different asset classes.

General comments/observations

We note that ESMA's transparency proposals regarding ETD will have negative effects on transparent order book trading and, thus, will have the opposite effects of MIFID II/R and G20 goals. Furthermore, ETDs already are characterised by high pre- and post-trade transparency, by providing price, size and depth towards the market, and trade reporting close to real time, or with sufficient delay to capture market needs, but never later than after the end-of-day batch run of T. Batch produced reports will already contain information subject to non-disclosure limits.

While the legislative goal is fully supported by FIA Europe's membership, the conversion steps proposed by ESMA are of concern, when focusing on ETDs specifically. It needs to be acknowledged that liquidity formation in ETDs is different and exchanges have already established frameworks, rules and processes, in order to create and support a public central order book.

Regulated exchanges will operate a central order book with extensive pre- and post-trade transparency. The key exceptions to this arrangement are: (i) block trading facilities, and (ii) platforms or arrangements that allow a degree of negotiation of the terms of the transaction prior to a completed transaction being submitted to either the order book or directly to the central counterparty for clearing.

The exchanges' block trading facilities have been developed over a number of decades and allow market participants that are seeking to transact in sizeable "blocks" to agree their transactions away from the central order book. Nevertheless block trades obtain other benefits of exchange trading: namely, block trades are subject to exchange supervision and conduct regulation. The trades are reported to the market shortly after conclusion and the transactions may be cleared alongside and are fungible with transactions which have been concluded on the central order book.

As such the size at which members are permitted to conclude block trades away from the central order book and the time within which a block transaction is reported to the exchange and on to the market has been developed on a contract by contract basis for a number of years, and under the supervision and scrutiny of national competent authorities. It would be unfortunate if the proposed MiFIR requirements unnecessarily "cut across" these transparent and well- functioning arrangements.

As a general matter, usually the very first step hereby is to introduce 'mature' products to a central clearing environment. The dynamic procedure established under the discretion of exchanges ensures that product specific steps are taken, when attracting formerly bilaterally traded products into a multilateral trading and clearing environment.

Accordingly, exchanges (and clearinghouses) adjust pre- and post-trade transparency parameters, like block sizes and a form of deferred publication sizes, along the product life cycle with the ultimate goal to concentrate liquidity formation in the public central limit order book. Therefore, in the early stage of the product life cycle block sizes are kept on low levels to offer an alternative to OTC traded markets. In more mature stages of the product life cycle block sizes are increased, when the market has moved to central clearing and liquidity providers support the transparent public central limit order book.

As a result, exchanges have, e.g. succeeded in offering certain standardised options, volatility and dividend derivatives into an environment where they can be traded in a public central order book, despite their product characteristics sometimes making it challenging to form and concentrate liquidity. The approach taken by exchanges is fully in line with the G20 mandate and legislative objectives under MiFIR.

Consequently, exchange discretion in achieving the steps described should not be limited by a too generic and static transparency regime. This raises severe concerns, as certain approaches described in the consultation paper will negatively impact ETDs which clearly is not the intention of the Level I text.

Key concerns/key messages/key recommendations

FIA Europe supports transparency, however ESMA should bear in mind that products have developed to suit the needs of investors and consequently have different characteristics and have evolved differently. The varied characteristics of different asset classes and the way in which these products are negotiated would not be captured by a **'one-size-fits-all'** solution. Consequently, ESMA needs to consider that liquidity cannot be forced onto central limit order books across all asset classes without negatively impacting the ability to execute transactions such as price slippage or order delay.

When exchange traded derivative contracts are launched, such new products are usually highly illiquid and usually rely on market makers and incentives for market participants trading in those instruments to generate any meaningful level of liquidity over time. If new products were to be caught by the Regulatory Technical Standards (RTS) as having a liquid market, the uptake of such products could be significantly hampered, consequently damaging innovation and competition.

The assessment on interest rate swaps has achieved an acceptable level of granularity. However, some products, particularly swaptions, do not reflect the nature of the products. With this in mind, we propose that assessments are verified using a wider range of sub-classes to achieve a level of granularity appropriate to the market.

In order to facilitate the phasing in of transparency requirements with minimal disruption to the markets, we propose that ESMA, in preparing the final RTSs, divide RTS 9 into a number of modular RTSs covering the liquid market assessment and LIS/SSTI thresholds separately for each asset class. We also propose that ESMA take into account the potential disruption to liquidity in markets by setting appropriately broad thresholds so as not to capture dubious or marginal products and amend these RTSs individually at a later stage once an appropriate amount of data has been collected to set liquidity and LIS/SSTI thresholds appropriate to the different sub-classes of instruments.

The data set used by ESMA to analyse the liquidity profile of different instruments was post-trade data, which may not accurately represent the depth of liquidity in markets as this data represents executed transactions and does not give an indication of open interest in a given instrument. Conscious of the time constraints which ESMA faces, **we propose that ESMA use the appropriate pre-trade order book data sets from the relevant trading venues** to verify the results of certain instruments, which have been set out in the draft RTS. This will enable ESMA to assure that ESMA's interpretation of instruments with a liquid market will reflect more accurately the liquidity profile of instruments.

ESMA used data relating to the period between 1 June 2013 and 31 May 2014. This period may be too short to accurately represent the variety of trading conditions over a longer period. Accordingly, **we propose that ESMA, in reassessing the liquidity profiles of different instruments, use broader data sets, representing a longer period**, to get a 'normalised' representation of trading throughout a trading year.

We question the use of notional traded values denominated in Euro as is set out in the Consultation Paper. Such an approach is not appropriate for a number of reasons:

(i) the denomination in Euro means that instruments which are not denominated in Euro would automatically carry a foreign exchange risk in analysing whether these instruments have a liquid market or not;

(ii) the denomination in Euro also fails to take into account that instruments are traded in lots of contracts rather than notional value;

(iii) depending on the value of the underlying asset, some instruments with higher values require fewer contracts to be considered liquid, whereas instruments with lower values would require a disproportionate number of contracts to be captured by this.

Consequently, we advocate an approach to the determination of liquid markets by considering the average periodic number of contracts (number of lots and lot sizes) rather than notional value.

We emphasize our concerns that the given time line is not sufficient for ESMA to deliver the required RTS. ESMA has a very short timeframe within which to deliver their final recommendations following the closing of the consultation period. Some of the proposals put forward could result in a decrease in transparency and therefore achieve an outcome opposite to the G20 mandate of increased transparency in financial markets. With this in mind, FIA Europe and its members offer their assistance to ESMA to assess liquidity on a more appropriate level.

<u>Liquid Market Definition</u>

The 'liquid market' definition cannot be considered adequate as a basis for determining pre- and post-trade transparency thresholds for ETDs. ***It is critical that the transparency determination considers liquidity of ETDs at the most granular level***. Otherwise, the basis for calibration is incorrect and will form the root cause for a negative impact on ETDs transparency and upon the willingness of market participants to provide liquidity in contracts incorrectly labelled. Ultimately, such incorrect labelling will increase transaction costs for end users of interest rate derivative markets.

We support ISDA's position on the taking into account of broken dates in accepting ESMA's preference for Option 1 for the general test of liquidity, but encourage ESMA to distinguish between broken-dated and benchmark maturity swaps for the purposes of calibrating the derivatives trading obligation.

However, for the general test of liquidity, we suggest that the classes of financial instruments included in Annex III of draft RTS 9 are further refined as per the discussion in the sections below.

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

We generally agree with ESMA's proposed criteria to define sub-classes in relation to all interest rate derivatives.

However, for Bond Futures, Futures on Swapnotes, Exchange Traded Bond Options and Exchange Traded Options on Swapnotes, which all trade with substantially all liquidity in the front contract, and liquidity in the second contract only in the last few weeks immediately prior to the front contract's maturity, ESMA can better capture this predictable life cycle dynamic. We therefore recommend ESMA to form meaningful liquidity bands taking into account rolling over of contracts. In addition no broadly covering exemptions shall be applied due to maturities.

For Interest Rate Futures and Exchange Traded Options on Interest Rate Futures, which trade with liquidity spread across a broad strip of multiple contracts, the use of a single 3 months' time to maturity is inadequate. These contracts are very similar to FRAs (and, at longer maturities, forward-starting swaps), where we note that ESMA has used multiple maturity sub-classes for the FRAs in each currency. We recommend that ESMA applies a similar approach for Interest Rate Futures and Exchange Traded Options on Interest Rate Futures. For instance, each strip of contracts could be readily subdivided into blocks of four contracts (each representing a year's maturity range), and liquidity assessed (and LIS calibrated) at the level of each year (e.g. front 4 contracts, contracts 5-8, 9-13 and so on). This would better capture the parallels with FRAs. We also consider that ESMA should bear the similarities of these Exchange Traded futures and option contracts with FRAs, swaps and swaptions when calibrating LIS/SSTI as well as assessing liquidity.

(2) <u>Would you use different parameters (among those provided by Level 1, i.e. the average frequency and size of transactions, the number and type of market participants, the average size of spreads, where available) or the same parameters but different thresholds in order to define a sub-class as liquid (state also your preference for option 1 vs. option 2, i.e. application of the tenor criteria as a range as in ESMA's preferred option or taking into account broken dates. In the latter case please also provide suggestions regarding what should be set as the non-broken dates)?</u>

We generally agree with the parameters used to define sub-classes as liquid, although one trade per day and €5 million notional per day appear to be too low to be consistent with the MiFIR definition of a liquid market.

We recognise that liquidity across a number of contracts is concentrated in the front months of a series, with liquidity dropping off significantly after that point. We therefore recommend ESMA to form meaningful liquidity bands taking into account rolling over of contracts, and no broadly covering exemptions shall be applied. Due to maturities the assessment should be made for each contract, or groups of contracts, across the strip of contracts.

For specific contracts in ESMA's analysis, we have the following comments:

a) Table 10, page 116 of the Consultation Paper (Bond Futures)

- We would expect the following contracts to be listed with time to maturity of up to 3 months. Specifically, we would generally expect the contract less than 3 months to be liquid if the contract >= 3 months is found to be liquid. And we would not generally expect the contract >= 3 months to be found to be liquid (particularly if the time to maturity is redefined to be >= 4 months).

- Ultra Long Bund (Buxl)
- Medium BTP
- Long Bund
- Long Swiss Confederation Bond
- Medium Bund (Bobl)
- Medium OAT
- Medium Spanish Government Bond
- Medium Swiss Confederation Bond
- Short BTP
- Short Bund (Schatz)
- Short Spanish Government Bond
- Ultra Long Gilt

We cannot follow why ESMA observes so many trades in the Long Gilt >= 3 months. Generally, we observe most liquidity in the Long Gilt contract up to 3 months. The trade counts and volumes observed by ESMA in the Long Gilt up to 3 months seem extremely low, and it is inconceivable that there would be almost three times as much volume in the Long Gilt as in the Long Bund, since the Long Bund is the most liquid Bond future in Europe.

(b) Table 11, page 117 of the Consultation Paper (Swapnote Futures): we are surprised that ESMA has found most trading activity to be in contracts >= 3 months rather than up to 3 months. We recommend that these contracts be re-assessed with the Time to Maturity at 4 months. We also recommend that ESMA consider the similarities between these contracts and Swaps of comparable maturities.

(c) Table 12, page 118 of the Consultation Paper (Interest Rate Futures): we recommend that each strip of contracts be reconsidered at a more granular level by maturity (potentially subdividing each strip into blocks of 4 contracts). We also recommend that ESMA consider the similarities between these contracts and FRAs and Swaps of comparable maturities.

In relation to **swaptions in** particular, we propose that ESMA achieve a **higher level of granularity** to define sub-classes. In particular, the sub-classes appropriate to define the sub-classes would be a currency criterion, an underlying index criterion (e.g. LIBOR, Euribor, OIS), an underlier tenor criterion and an option tenor criterion. We support ISDA's proposal here, which recommends defining sub-classes for swaptions using the following taxonomy:

- Currency
- Underlying index (LIBOR, EURIBOR, OIS, Inflation, etc.)

- Tenor of underlier, classifying using the same classes used for interest rate swaps
- Tenor of option, broken down into at least six sub-classes per currency, index and underlier:
    - 0 – 6 months
    - 6 months – 1 year
    - 1 year – 2 years
    - 2 years – 5 years
    - 5 years – 10 years
    - Over 10 years

(3) <u>Would you define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)?</u>

We broadly support ESMA's proposal for classes declared as liquid and illiquid.

However, we note that the assessment for swaptions should be refined in order to achieve the appropriate level of granularity for the market. Therefore, FIA Europe disagrees that all swaptions in 5 currencies (EUR, USD, GBP, JPY and AUD) be considered liquid. Instead, ESMA should repeat their analysis at a more granular level, which we expect to result in only short-dated options (less than 1-2 years) on short- to medium- dated (2- to 10 year) vanilla swap underliers in 2-3 currencies to be identified to be liquid.

On interest rate swaps, we consider that ESMA's varying the criteria for number of trades per day from 1 to 2, and notional per day from 10 to 100 million is inappropriate and has resulted in many illiquid sub-classes being identified as liquid. There is a particular need to reclassify Multi-Currency Swaps and Single Currency Inflation swaps as illiquid. Single Currency float-float and OIS swaps also require reassessment using consistent criterion.

Further, new contracts in competition with listed contracts will be illiquid at launch, but sit within a liquid class as per ESMA's table. We suggest that newly listed 'look-a-like' products or brand new products aligned with a liquid class are given 1 years grace to assess liquidity before being formally defined.

We also suggest that EMSA clarify how potential new instruments e.g. longer dated or US/non-European currency denominated products would be treated.

<u>Package Transactions</u>

FIA Europe encourages ESMA to consider the appropriate application of the MiFIR pre- and post-trade transparency obligations and the derivatives trading obligation, to package transactions. We consider that MiFIR is flexible enough to empower ESMA to specify how package transactions are to be treated, and it is important to do so, otherwise investors could lose the advantages of the ability to transact certain package types and will experience increased transaction costs and execution risk as a consequence of having to trade different components separately, of being unable to obtain appropriate waivers and deferrals.

Package transactions often feature ETDs (for example, strategies (including rolls, calendar spreads, packs and bundles), and Exchange For Physicals (EFPs or basis trades)). FIA Europe's membership is therefore supportive of ISDA's detailed proposals for the definition of a package transaction, the appropriate classification of package transactions into liquid and illiquid classes, and the calibration of SSTI and LIS for packages and would recommend ESMA to adopt this proposal.
<ESMA_QUESTION_CP_MIFID_61>

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

<ESMA_QUESTION_CP_MIFID_62>

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

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

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

To reflect this, we recommend the following amendments to the definitions set out in Section 3 of Annex III of RTS 9:

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

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

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

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

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

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

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

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

- Tables 9 and 10 (Bond options) should be relabelled as "Options on Bond Futures" so that it is clear what products are covered by these tables. The current labelling does not sufficiently reflect that these products are exchange-traded derivatives with bond futures underliers (as opposed to cash bond underliers, which would generally be considered as Debt Options).
- A provision should be added after the definition of "Interest rate option class not having a liquid market" to clarify that Tables 11 and 12 only apply to interest rate derivatives which are exchange-traded derivatives, as follows:

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

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

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

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

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

We recommend that the following amendments and additions are made to the definitions in sections 3 and 4 of Annex III of RTS 9 to ensure the accuracy of the contract types described:

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

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

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

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

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

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

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

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

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

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

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

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

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

  ‘Swaption class not having a liquid market’ means an interest rate swaption which is not a swaption liquid class.

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

  ‘Forward rate agreement (FRA)’ means a forward rate agreement contract on an interest rate.

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

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

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

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

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

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

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

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

- If ESMA agrees with FIA Europe’s proposal in response to Question 61 that Swaptions should be classified more granularly, ESMA will need to define the terms Option Tenor and Tenor of Underlier. We propose the following definitions :

  - ‘Option tenor’ means the time period from trade date to expiry date of the option.

  - ‘Tenor of underlier’ means the time period from the expiry date of the option until the maturity of the underlier.

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

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

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

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

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

(iv) Other amendments

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

<ESMA_QUESTION_CP_MIFID_62>

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

<ESMA_QUESTION_CP_MIFID_63>

Introduction

Prior to presenting our views, we have some opening remarks:

We propose that ESMA use the appropriate pre-trade order book data sets from the relevant trading venues.

ESMA used data relating to the period between 1 June 2013 and 31 May 2014. This period may be too short to accurately represent the variety of trading conditions over a longer period. Accordingly, **we propose that ESMA, in re-assessing the liquidity profiles of different instruments, use broader data sets, representing a longer period**, to get a 'normalised' representation of trading throughout a trading year.

We question the use of notional traded values denominated in Euro as is set out in the Consultation Paper. Such an approach is not appropriate for a number of reasons:

(i) the denomination in Euro means that instruments which are not denominated in Euro would automatically carry a foreign exchange risk in analysing whether these instruments have a liquid market or not;

(ii) the denomination in Euro also fails to take into account that instruments are traded in lots of contracts rather than notional value;

(iii) depending on the value of the underlying asset, some instruments with higher values require fewer contracts to be considered liquid, whereas instruments with lower values would require a disproportionate number of contracts to be captured by this.
Consequently, we advocate an approach to the determination of liquid markets by considering **number of contracts** (number of lots and lot sizes) rather than notional value.

We are concerned that the given time line is not sufficient for ESMA to deliver the required RTS. ESMA has a very short timeframe within which to deliver their final recommendations following the closing of the consultation period. Some of the proposals put forward could result in a decrease in transparency and therefore achieve an outcome opposite to the G20 mandate of increased transparency in financial markets. With this in mind, FIA Europe and its members offer their assistance to ESMA to assess liquidity on a more appropriate level.

Further, new contracts in competition with listed contracts will be illiquid at launch, but sit within a liquid class as per ESMA's table. We suggest that newly listed 'look-a-like' products or brand new products aligned with a liquid class are given 1 years grace to assess liquidity before being formally defined.

General comments/observations

We note that ESMA's transparency proposals regarding ETD will have negative effects on transparent order book trading and, thus, will have the opposite effects of MIFID II/R and

G20 goals. Furthermore, ETDs already are characterised by high pre- and post-trade transparency, by providing price, size and depth towards the market, and trade reporting close to real time, or with sufficient delay to capture market needs, but never later than after the end-of-day batch run of T. Batch produced reports will already contain information subject to non-disclosure limits.

While the legislative goal is fully supported by FIA Europe's membership, the conversion steps proposed by ESMA are of concern, when focusing on ETDs specifically. It needs to be acknowledged that liquidity formation in ETDs is different and exchanges have already established frameworks, rules and processes, in order to create and support a public central order book.

Regulated exchanges will operate a central order book with extensive pre- and post-trade transparency. The key exceptions to this arrangement are: (i) block trading facilities, and (ii) platforms or arrangements that allow a degree of negotiation of the terms of the transaction prior to a completed transaction being submitted to either the order book or directly to the central counterparty for clearing.

The exchanges' block trading facilities have been developed over a number of decades and allow market participants that are seeking to transact in sizeable "blocks" to agree their transactions away from the central order book. Nevertheless block trades obtain other benefits of exchange trading: namely, block trades are subject to exchange supervision and conduct regulation. The trades are reported to the market shortly after conclusion and the transactions may be cleared alongside and are fungible with transactions which have been concluded on the central order book.

As such the size at which members are permitted to conclude block trades away from the central order book and the time within which a block transaction is reported to the exchange and on to the market has been developed on a contract by contract basis for a number of years, and under the supervision and scrutiny of national competent authorities. It would be unfortunate if the proposed MiFIR requirements unnecessarily "cut across" these transparent and well- functioning arrangements.

As a general matter, usually the very first step hereby is to introduce 'mature' products to a central clearing environment. The dynamic procedure established under the discretion of exchanges ensures that product specific steps are taken, when attracting formerly bilaterally traded products into a multilateral trading and clearing environment.

Accordingly, exchanges (and clearinghouses) adjust pre- and post-trade transparency parameters, like block sizes and a form of deferred publication sizes, along the product life cycle with the ultimate goal to concentrate liquidity formation in the public central limit order book. Therefore, in the early stage of the product life cycle block sizes are kept on low levels to offer an alternative to OTC traded markets. In more mature stages of the product life cycle block sizes are increased, when the market has moved to central clearing and liquidity providers support the transparent public central limit order book.

As a result, exchanges have, e.g. succeeded in offering certain standardised options, volatility and dividend derivatives into an environment where they can be traded in a public central order book, despite their product characteristics sometimes making it challenging to form and concentrate liquidity. The approach taken by exchanges is fully in line with the G20 mandate and legislative objectives under MiFIR.

Consequently, exchange discretion in achieving the steps described should not be limited by a too generic and static transparency regime. This raises severe concerns, as certain approaches described in the consultation paper will negatively impact ETDs which clearly is not the intention of the Level I text.

<u>Option 1 v Option 2</u>

Generally, FIA Europe has supported the IBIA approach to equity derivatives in determining whether an instrument has a liquid market. With this in mind, **we prefer Option 1 with some modifications, particularly related to the time to maturity barrier and the selected contracts**, to capture the nuances of the equity derivatives market.

These modifications are:

- forming meaningful liquidity bands taking into account rolling over of contracts, and no broadly covering exemptions shall be applied due to maturities; the assessment should be made for each contract, or groups of contracts, across the strip of contracts; and

- an excluded contracts regime (e.g. where the underlying is illiquid)

<ESMA_QUESTION_CP_MIFID_63>

Q64. If you do not agree with ESMA's proposal for the definition of a liquid market, please specify for each of the asset classes identified (stock options, stock futures, index options, index futures, dividend index options, dividend index futures, stock dividend options, stock dividend futures, options on a basket or portfolio of shares, futures on a basket or portfolio of shares, options on other underlying values (i.e. volatility index or ETFs), futures on other underlying values (i.e. volatility index or ETFs):

(1) your alternative proposal

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

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

<ESMA_QUESTION_CP_MIFID_64>
Whilst we noted the level of detail in the analysis presented by ESMA of interest rate derivatives, we are extremely concerned that the same degree of analysis has not been undertaken for equity derivatives. We observe, for example, that ESMA has presented analysis of exchange traded interest rate derivatives at the level of each contract, a level of analysis completely absent for equity derivatives. Furthermore, ESMA has not utilised any data concerning OTC equity derivatives, and we therefore consider that ESMA cannot determine any such contracts to be liquid until this analysis is completed and presented for comment. Whilst there are certain areas (noted in response to Question 61) that the analysis of interest rate derivatives can be enhanced, the analysis and liquidity determinations of equity derivatives may need to be completely overhauled.

Liquid Market Definition

The 'liquid market' definition cannot be considered adequate as a basis for determining pre- and post-trade transparency thresholds for equity ETDs. For this reason, it is important that the transparency regime captures liquidity along the understanding of ETDs, and not on the notion of liquidity as understood in terms of the derivatives trading obligation. Otherwise, the basis for calibration is incorrect and will form the root cause for a negative impact on ETDs transparency.

FIA Europe and its members do not agree with Option 2.

We propose that ESMA provide a definitive list of instruments which are considered liquid in Annex III of RTS 9.

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

Broadly, we support the criteria used to define sub-classes of:

- **Instrument Type**
- **Underlying Type**

We suggest the inclusion of a **time to maturity criterion** forming meaningful liquidity bands taking into account rolling over of contracts, and no broadly covering exemptions shall be applied due to maturities; the assessment should be made for each contract, or groups of contracts, across the strip of contracts

We also suggest the inclusion of a **'liquidity profile of the underlying' criterion** as explained further in the section below.

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

(i) Classes of Financial Instrument

Certain sub-classes of instruments proposed in the draft RTS are very thinly traded and consequently, these should be classified as illiquid. These are:

Dividend Index

- Futures
- Options

Stock Dividend

- Futures
- Options

Basket/Portfolio

- Futures
- Options

Underlying Value

- Futures
- Options

ESMA should focus on the following:

Stock

- Futures
- Options

Index

- Futures
- Options

(ii) Time to Maturity

ESMA should form meaningful liquidity bands taking into account rolling over of contracts, and no broadly covering exemptions shall be applied due to maturities; the assessment should be made for each contract, or groups of contracts, across the strip of contracts.

(iii) Liquidity Status of Underlying

It is also worth considering that an illiquid underlying instrument is likely to have illiquid derivatives. Consequently, we suggest that **derivatives of underlying instruments which have been deemed to be illiquid** should also be **considered illiquid**.

(iv) Distribution of Trade Sizes

ESMA should examine the distribution of lot sizes in pre-trade data and determine an appropriate **average volume of contracts to be traded** and **the number of days of days traded** to be equal to an appropriate proportion of the available trading days for each sub-class.

Would FIA Europe define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)?

We propose that ESMA produce a more granular level of detail on the type of instruments which should be declared as liquid or illiquid.

<ESMA_QUESTION_CP_MIFID_64>

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

<ESMA_QUESTION_CP_MIFID_65>

(i) <u>Amendments to clarify the treatment of ETD equity derivatives</u>

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

The definitions provided in Section 4 of Annex III of RTS 9 are insufficiently clear and contribute to the confusion described above in respect of the sub-classes of equity derivatives listed in table 32 of Section 3 of Annex III of RTS 9. In particular, we recommend the following amendments to the definitions set out in Section 4 of Annex III of RTS 9:

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

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

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

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

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

(ii) <u>Amendments to ensure the accuracy of the contract types described</u>

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

‘Volatility index’ means an index relating to the volatility of a specific underlying index of equities.

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

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

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

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

(iv) Other amendments

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

<ESMA_QUESTION_CP_MIFID_65>

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

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

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

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

<ESMA_QUESTION_CP_MIFID_66>

Whilst we noted the level of detail in the analysis presented by ESMA of interest rate derivatives, we are extremely concerned that the same degree of analysis has not been undertaken for commodity derivatives. We observe, for example, that ESMA has presented analysis of exchange traded interest rate derivatives at the level of each contract, a level of analysis completely absent for commodity derivatives, including metal contracts. Furthermore, ESMA has not utilised any data concerning OTC commodity derivatives, and we therefore consider that ESMA cannot determine any such contracts to be liquid until this analysis is completed and presented for comment. Whilst there are certain areas that the analysis of interest rate derivatives can be enhanced, the analysis and liquidity determinations of commodity derivatives may need to be completely overhauled.

Key concerns/key messages/key recommendations

There has been a general concern about the level of granularity achieved across all commodity derivative asset classes (i.e. metals, energy, agricultural). The liquidity assessment has not applied the same amount of granularity as observed for interest rate derivatives.

Commodities derivatives are global markets which are traded across a number of exchanges in a number of jurisdictions including several outside of Europe. With this in mind, we propose that **ESMA undertake an analysis of global commodities markets**, not just European, as liquidity will be centred on the larger commodity contracts, such as CME Oil Futures.

The data set used by ESMA to analyse the liquidity profile of different instruments was post-trade data, which may not accurately represent the depth of liquidity in markets as this data represents executed transactions and does not give an indication of open interest in a given instrument. With this in mind, **we propose that ESMA use the appropriate pre-trade order book data sets from the relevant trading venues**.

ESMA used data relating to the period between 1 June 2013 and 31 May 2014. This period may be too short to accurately represent the variety of trading conditions over a longer period. Accordingly, **we propose that ESMA, in reassessing the liquidity profiles of different instruments, use broader data sets, representing a longer period**, to get a 'normalised' representation of trading throughout a trading year.

We question the use of notional traded values denominated in Euro as is set out in the Consultation Paper. Such an approach is not appropriate for a number of reasons:

(i) the denomination in Euro means that instruments which are not denominated in Euro would automatically carry a foreign exchange risk in analysing whether these instruments have a liquid market or not;

(ii) the denomination in Euro also fails to take into account that instruments are traded in lots of contracts rather than notional value;

(iii) depending on the value of the underlying asset, some instruments with higher values require fewer contracts to be considered liquid, whereas instruments with lower values would require a disproportionate number of contracts to be captured by this.
Consequently, we advocate an approach to the determination of liquid markets by considering **number of** tonnes (quantities by weight) rather than notional value.

We are concerned that the given time line is not sufficient for ESMA to deliver the required RTS. ESMA has a very short timeframe within which to deliver their final recommendations following the closing of the consultation period. Some of the proposals put forward could result in a decrease in transparency and therefore achieve an outcome opposite to the G20 mandate of increased transparency in financial markets. With this in mind, FIA Europe and its members offer their assistance to ESMA to assess liquidity on a more appropriate level.

Further, new contracts in competition with listed contracts will be illiquid at launch, but sit within a liquid class as per ESMA's table. We suggest that newly listed 'look-a-like' products or brand new products aligned with a liquid class are given 1 years grace to assess liquidity before being formally defined.

Liquid Market Definition

FIA Europe is concerned with the overall methodology applied for commodity contracts and the impact this may have on future calibrations of the liquid market definition. The fact that an instrument trades on a single occasion during the day would not normally be classed as a "liquid" contract. In addition, €100,000 as applied to the calculations in metal contracts is a very small figure when considering the volume of the metal commodity markets specifically and the volumes traded daily. We recommend to ESMA when trying to capture contracts for which there is true liquidity in the market, it would be more appropriate to increase both the average trades placed per day and the notional amount traded per day and then give NCAs the ability to set these limits.

Therefore, the 'liquid market' definition cannot be considered adequate as a basis for determining pre- and post-trade transparency thresholds for Metal ETD. For this reason, it is important that the transparency regime captures liquidity along the understanding of ETDs, and not on the notion of liquidity as understood in terms of the derivatives trading obligation. Otherwise, the basis for calibration is incorrect and will form the root cause for a negative impact on ETDs transparency.

We propose that ESMA provide a definitive list of instruments which are considered liquid in Annex III of RTS 9, subject to the refinements discussed below.

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

We support the inclusion of the following criteria:

- **Underlying Type**
- **Specific Underlying Metal**

Given that these criteria do not take account of the liquidity variance dependent on the settlement date of a contract, we suggest the inclusion of a **time to maturity criterion**.

The settlement date for derivatives is a very significant criterion in assessing whether or not it is liquid and contracts should be divided on this basis. For example, an exchange may see significant trading activity on a particular day for an aluminium contract which has a settlement date in three months' time, however on the same day there may not be any trades for an aluminium contract which has a settlement date in two weeks' time.

For precious metals, it may be appropriate to include a **point of delivery criterion** to establish the most liquid contracts.

Commodities markets are global markets and are broadly traded and denominated in US Dollar. Although similar contracts denominated in different currencies exist, these contracts actually derive their liquidity from the underlying US Dollar denominated market. Consequently and for the purpose of simplification, we suggest that the **notional currency criterion of a contract is removed** as it does not add value to the determination.

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

FIA Europe agrees with the parameters. However, we recommend that the quantities should be per tonne rather than per lot. This is because a "lot" is not uniform across trading venues and could therefore introduce a false picture of volume or liquidity.

(i) Distribution of Trade Sizes

ESMA should examine the distribution of lot sizes in pre-trade data and determine an appropriate **average volume of contracts to be traded** and **the number of days of days traded** to be equal to an appropriate proportion of the available trading days for each sub-class.

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

We propose that ESMA produce a more granular level of detail on the type of instruments which should be captured by this classification.
<ESMA_QUESTION_CP_MIFID_66>

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

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

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

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

<ESMA_QUESTION_CP_MIFID_67>

<u>Introduction:</u>

Prior to presenting our views, we have some opening remarks:

Commodities derivatives are global markets which are traded across a number of exchanges in a number of jurisdictions including several outside of Europe. With this in mind, we propose that **ESMA undertake an analysis of global commodities markets**, not just European, as liquidity will be centred around the larger commodity contracts, such as CME Oil Futures.

The data set used by ESMA to analyse the liquidity profile of different instruments was post-trade data, which may not accurately represent the depth of liquidity in markets as this data represents executed transactions and does not give an indication of open interest in a given instrument. **We therefore propose that ESMA use the appropriate pre-trade order book data sets from the relevant trading venues**.

ESMA used data relating to the period between 1 June 2013 and 31 May 2014. This period may be too short to accurately represent the variety of trading conditions over a longer period. Accordingly, **we propose that ESMA, in reassessing the liquidity profiles of different instruments, use broader data sets, representing a longer period**, to get a 'normalised' representation of trading throughout a trading year.

We question the use of notional traded values denominated in Euro as is set out in the Consultation Paper. Such an approach is not appropriate for a number of reasons:

(i) the denomination in Euro means that instruments which are not denominated in Euro would automatically carry a foreign exchange risk in analysing whether these instruments have a liquid market or not;

(ii) the denomination in Euro also fails to take into account that instruments are traded in lots of contracts rather than notional value;

(iii) depending on the value of the underlying asset, some instruments with higher values require fewer contracts to be considered liquid, whereas instruments with lower values would require a disproportionate number of contracts to be captured by this.

Consequently, we advocate an approach to the determination of liquid markets by considering **number of contracts** (number of lots and lot sizes) rather than notional value.

We are concerned that the given time line is not sufficient for ESMA to deliver the required Regulatory Technical Standard ('RTS'). ESMA has a very short timeframe within which to deliver their final recommendations following the closing of the consultation period. Some of the proposals put forward could result in a decrease in transparency and therefore achieve an outcome opposite to the G20 mandate of increased transparency in financial markets. We encourage ESMA to calibrate the transparency requirements appropriately. FIA Europe and its members offer their assistance to ESMA to assess liquidity on a more appropriate level.

Further, new contracts in competition with listed contracts will be illiquid at launch, but sit within a liquid class as per ESMA's table. We suggest that newly listed 'look-a-like' products or brand new products aligned with a liquid class are given 1 years grace to assess liquidity before being formally defined.

General comments/observations

We note that ESMA's transparency proposals regarding ETD will have negative effects on transparent order book trading and, thus, will have the opposite effects of MIFID II/R and G20 goals. Furthermore, ETDs already are characterised by high pre- and post-trade transparency, by providing price, size and depth towards the market, and trade reporting close to real time, or with sufficient delay to capture market needs, but never later than after the end-of-day batch run of T. Batch produced reports will already contain information subject to non-disclosure limits.

While the legislative goal is fully supported by FIA Europe's membership, the conversion steps proposed by ESMA are of concern, when focusing on ETDs specifically. It needs to be acknowledged that liquidity formation in ETDs is different and exchanges have already established frameworks, rules and processes, in order to create and support a public central order book.

Regulated exchanges will operate a central order book with extensive pre- and post-trade transparency. The key exceptions to this arrangement are: (i) block trading facilities, and (ii) platforms or arrangements that allow a degree of negotiation of the terms of the transaction prior to a completed transaction being submitted to either the order book or directly to the central counterparty for clearing.

The exchanges' block trading facilities have been developed over a number of decades and allow market participants that are seeking to transact in sizeable "blocks" to agree their transactions away from the central order book. Nevertheless block trades obtain other benefits of exchange trading: namely, block trades are subject to exchange supervision and conduct regulation. The trades are reported to the market shortly after conclusion and the transactions may be cleared alongside and are fungible with transactions which have been concluded on the central order book.

As such the size at which members are permitted to conclude block trades away from the central order book and the time within which a block transaction is reported to the exchange and on to the market has been developed on a contract by contract basis for a number of years, and under the supervision and scrutiny of national competent authorities. It would be unfortunate if the proposed MiFIR requirements unnecessarily "cut across" these transparent and well- functioning arrangements.

As a general matter, usually the very first step hereby is to introduce 'mature' products to a central clearing environment. The dynamic procedure established under the discretion of exchanges ensures that product specific steps are taken, when attracting formerly bilaterally traded products into a multilateral trading and clearing environment.

Accordingly, exchanges (and clearinghouses) adjust pre- and post-trade transparency parameters, like block sizes and a form of deferred publication sizes, along the product life cycle with the ultimate goal to concentrate liquidity formation in the public central limit order book. Therefore, in the early stage of the product life cycle block sizes are kept on low levels to offer an alternative to OTC traded markets. In more mature stages of the product life cycle block sizes are increased, when the market has moved to central clearing and liquidity providers support the transparent public central limit order book.

As a result, exchanges have, e.g. succeeded in offering certain standardised options, volatility and dividend derivatives into an environment where they can be traded in a public central order book, despite their product characteristics sometimes making it challenging to form and concentrate liquidity. The approach taken by exchanges is fully in line with the G20 mandate and legislative objectives under MiFIR.

Consequently, exchange discretion in achieving the steps described should not be limited by a too generic and static transparency regime. This raises severe concerns, as certain approaches described in the consultation paper will negatively impact ETDs which clearly is not the intention of the Level I text.

Liquid Market Definition

The 'liquid market' definition cannot be considered adequate as a basis for determining pre- and post-trade transparency thresholds for Energy ETD. For this reason, it is important that the transparency regime captures liquidity along the understanding of ETDs, and not on the notion of liquidity as understood in terms of the derivatives trading obligation. Otherwise, the basis for calibration is incorrect and will form the root cause for a negative impact on ETDs transparency.

By way of examples, in the case of oil futures, all of which have been categorised into one of two sub-classes (i.e. "Oil up to 3 months" and "Oil greater than 3 months").

Those categories include an extensive array of heterogeneous products, ranging from highly liquid benchmark products such as the Brent Futures Contract and a myriad of niche and nascent products which, by their very nature, are much less liquid. A much more granular categorisation process is necessary in order to conduct an appropriate liquidity assessment, similar to that which has been applied by ESMA for interest rate derivatives.

We propose that ESMA provide a definitive list of instruments which are considered liquid in Annex III of RTS 9, subject to the refinements discussed below.

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

We support the inclusion of the following criteria:

- Underlying Type
- Specific Underlying Source of Energy
- Time to maturity

On oil, we recommend ESMA to apply a higher level of granularity which is necessary, as the COFIA approach has not adequately captured the nature of the market. We suggest the inclusion of:

- Type of Oil Product Criterion – i.e. crude or refined oil products;
- Region;
- Underlying Reference Rate criterion/ Price Reporting Agency reference rate – i.e. PLATTS, Argus, etc.;
- Outright or differential contract; and
- Type of differential contract criterion – i.e. spread contract, crack contract.

These criteria could potentially be extended to other energy products.

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

(i) Distribution of Trade Sizes

ESMA should examine the distribution of lot sizes in pre-trade data and determine an appropriate **average volume of contracts to be traded** and **the number of days of days traded** to be equal to an appropriate proportion of the available trading days for each sub-class.

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

We question the range of electricity contracts included in Annex III. We note that the only contract included is an SEK denominated contract, with all others being considered illiquid. This is not representative of the European energy market.

We question the exclusion of coal as well as the limited range of natural gas contracts.

We question the exclusion of what is arguably one of the most liquid Oil Futures contracts, the ICE Brent Futures contract. This is a systemically important contract (noted in the Bank of England / HM Treasury / Financial Conduct Authority 'Fair and Effective Market Review' (FEMR) as one of the critical benchmarks for the FEMR in the United Kingdom) which, through the ICE Brent Futures Index, acts as a benchmark for oil prices across the globe and is used to hedge across energy markets (even against exposures of contracts which are not economically equivalent). Classifying this contract as illiquid is not representative of the characteristics of the contract.

We propose that ESMA produce a more granular level of detail on the type of instruments which should be captured by this classification.
<ESMA_QUESTION_CP_MIFID_67>

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

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

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

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

<ESMA_QUESTION_CP_MIFID_68>

Introduction

Prior to presenting our views, we have some opening remarks:

Commodities derivatives are global markets which are traded across a number of exchanges in a number of jurisdictions including several outside of Europe. With this in mind, we propose that **ESMA undertake an analysis of global commodities markets**, not just European, as liquidity will be centred around the larger commodity contracts.

The data set used by ESMA to analyse the liquidity profile of different instruments was post-trade data, which may not accurately represent the depth of liquidity in markets as this data represents executed transactions and does not give an indication of open interest in a given instrument. With this in mind, **we propose that ESMA use the appropriate pre-trade order book data sets from the relevant trading venues**.

ESMA used data relating to the period between 1 June 2013 and 31 May 2014. This period may be too short to accurately represent the variety of trading conditions over a longer period. Accordingly, **we propose that ESMA, in reassessing the liquidity profiles of different instruments, use broader data sets, representing a longer period**, to get a 'normalised' representation of trading throughout a trading year.

We question the use of notional traded values denominated in Euro as is set out in the Consultation Paper. Such an approach is not appropriate for a number of reasons:

(i) the denomination in Euro means that instruments which are not denominated in Euro would automatically carry a foreign exchange risk in analysing whether these instruments have a liquid market or not;

(ii) the denomination in Euro also fails to take into account that instruments are traded in lots of contracts rather than notional value;

(iii) depending on the value of the underlying asset, some instruments with higher values require fewer contracts to be considered liquid, whereas instruments with lower values would require a disproportionate number of contracts to be captured by this.

Consequently, we advocate an approach to the determination of liquid markets by considering **number of contracts** (number of lots and lot sizes) rather than notional value.

We are concerned that the given time line is not sufficient for ESMA to deliver the required Regulatory Technical Standard ('RTS'). ESMA has a very short timeframe within which to deliver their final recommendations following the closing of the consultation period. Some of

the proposals put forward could result in a decrease in transparency and therefore achieve an outcome opposite to the G20 mandate of increased transparency in financial markets. With this in mind, FIA Europe and its members offer their assistance to ESMA to assess liquidity on a more appropriate level.
Further, new contracts in competition with listed contracts will be illiquid at launch, but sit within a liquid class as per ESMA's table. We suggest that newly listed 'look-a-like' products or brand new products aligned with a liquid class are given 1 years grace to assess liquidity before being formally defined.

<u>Liquid Market Definition</u>

We propose that ESMA provide a definitive list of instruments which are considered liquid in Annex III of RTS 9, subject to the refinements discussed below.

(1) **<u>Would you use different qualitative criteria to define the sub-classes?</u>**

We support the inclusion of the following criteria:

- **Specific Underlying Commodity**

We suggest that, as a general rule, **contracts with a time to maturity in excess of 6 months should be classified as illiquid**.

Of those contracts with a time to maturity of less than 6 months, we propose using a liquidity analysis based on the total notional contracts on each instrument in a given period.

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

(i) Distribution of Trade Sizes

ESMA should examine the distribution of lot sizes in pre-trade data and determine an appropriate **average volume of contracts to be traded** and **the number of days of days traded** to be equal to an appropriate proportion of the available trading days for each sub-class.

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

We propose that ESMA produce a more granular level of detail on the type of instruments which should be captured by this classification.
<ESMA_QUESTION_CP_MIFID_68>

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

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

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

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

<ESMA_QUESTION_CP_MIFID_69>
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Q70. Do you agree with ESMA's proposal with regard to the content of pre-trade transparency? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_70>
FIA Europe broadly agrees with the content of the pre-trade transparency reports for electronic venues.

We recommend ESMA to allow a carve out for open outcry trading. It allows trades to be completed in an open and transparent forum through which global reference prices for the contracts traded during each session to be discovered. It is the unique transparency and fairness that is present in these sessions that have allowed the references prices discovered on the platform to have gained such importance globally. In order to ensure the prices are set fairly without considering issues such as volume weightings all trades are done based simply on a price and settlement price. At no point are volumes quoted before the trade is completed. Whilst this permits the reference prices to be fair and reflect the underlying value of the metal, it means that open outcry trading venues will be unable to comply with the pre-transparency obligations that ESMA is proposing.

<u>Request for quote (RFQ) trading models</u>

ESMA's proposed definition of the RFQ trading model includes the word "published" rather than "provided" (which was contained in the definition proposed in the May 2014 Discussion Paper). The definition of RFQ system should describe the trading system and not prescribe what should be published. Because there is no requirement for a venue operating an RFQ system to publish quotes on trades in illiquid instruments or trades above SSTI, the inclusion of the word published is inaccurate and could have the consequence of requiring all quotes to be made public despite the clear provisions of the MiFIR text. Furthermore, none of the other trading systems listed in Table 1, Annex 1 of RTS 9 include the word published despite also having pre-trade transparency requirements in certain circumstances.

ESMA's proposed definition of RFQ system should be amended to read as follows:

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

Package Transactions

FIA Europe encourages ESMA to consider the appropriate application of the MiFIR pre- and post-trade transparency obligations and the derivatives trading obligation to package transactions. We consider that MiFIR is flexible enough to empower ESMA to specify how package transactions are to be treated, and it is important to do so, otherwise investors could lose the advantages of the ability to transact certain package types and will experience increased transaction costs and execution risk as a consequence of having to trade different components separately, of being unable to obtain appropriate waivers and deferrals. Package transactions often feature ETDs (for example, strategies (including rolls, calendar spreads, packs and bundles), and Exchange For Physicals (EFPs or basis trades)). FIA Europe's membership is therefore supportive of ISDA's detailed proposals for the definition of a package transaction, the appropriate classification of package transactions into liquid and illiquid classes, and the calibration of SSTI and LIS for packages and would urge ESMA to adopt this proposal.
<ESMA_QUESTION_CP_MIFID_70>

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

<ESMA_QUESTION_CP_MIFID_71>
Yes. FIA Europe supports ESMA's proposal with regard to the order management facilities waiver as the waiver is proposed to be available down to the smallest trading quantity established by the trading venue.

<ESMA_QUESTION_CP_MIFID_71>

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

<ESMA_QUESTION_CP_MIFID_72>
We suggest that ESMA clarify the timeframe for the obligation for trading venues to provide an 'indicative price that is close to the price of the trading interest'. We understand that such prices should be disseminated by the trading venue to the public only at the moment a RFQ is inserted in the system and, as a reply to the RFQ, binding answers are provided on the requesting member by liquidity providers. In such situations, indicative prices could be generated on the basis of the answers to the RFQ (e.g. average bid and offer prices).

If the requirement for the Trading Venue is to publish indicative prices on a continuous basis, relying on information on the order-book could not be sufficient to establish indicative prices for a size comparable to the SSTI of the instrument.
<ESMA_QUESTION_CP_MIFID_72>

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

<ESMA_QUESTION_CP_MIFID_73>
FIA Europe agrees for it to be essential to include the date and time of publication among the fields included in Annex II, Table 1 of RTS 9. FIA Europe recommends not to include the "Instrument identification code type" field.

FIA Europe considers that an Instrument Identification code field can be appropriately adopted for listed ETD given their standardised contract terms. We disagree, however, with ESMA's view that this proposed "Instrument identification code type" field will ever be sufficient to provide the level of transparency for OTC derivatives that MiFIR is seeking. The operational issues arising from this proposed table field are numerous and that, for the timing being, there is no unique way to identify instruments at a sufficiently granular level across different derivative classes. ESMA appears to be grossly underestimating the feasibility of classifying every derivative sufficiently uniquely that the price terms become comparable, but not clouded by other, non-comparable derivatives. In our view, it would be more pragmatic and informative for this field to be replaced with identification of each of the terms of the trade in multiple fields. This is the solution adopted by the CFTC for the Part 43 reporting requirement for certain derivatives transactions. The role of the contract identifier should be limited to classifying derivatives at a high level to aid users of the post-trade transparency reports in identifying contracts of a particular class.

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

(i) Two GBP interest rate swaps with trade date 3 March 2015 and effective date 3 March 2015, one of which has end date 3 March 2025 and one 4 March 2025 will have different market rates even if traded at the same instant using the same underlying market reference yield curve. They have different contract roll dates (payment dates of the fixed and floating cashflows), and different initial fixings. Classifying them under the same identifier will give market participants a misleading impression of the rates being traded. It would therefore be necessary to have a different identifier for each combination of days on the yield curve (effective date, maturity date). The permutations would run into the billions and it is impractical and unnecessary to attempt to do this.

(ii) Two otherwise identical swaps, but using different day count fractions, reset periods or underlying reference indices (e.g. 3 month or 6 month LIBOR) will have different market rates. Again, the permutations run into billions for any given yield curve, and it is impractical to attempt a different identifier for each combination, but would give a misleading impression of market values should different combinations be bucketed under the same identifier.

(iii) Cleared and uncleared swaps with otherwise the same contract terms would have different market rates.

(iv) Swaptions will have multiple strike prices, exercise styles, underlying indices, option tenors and underlier tenors. Capturing this level of detail through simply an identifier and a single price field for premium will be impractical.

(v) A swap traded at a rate that is transacted with an off-market together with payment of an upfront fee (as is commonly done when terminating early bilateral derivatives, or trading swaps against bonds with a fixed coupon) is not comparable to a swap traded on market without a fee (typically called a Par swap). For the post-trade information to be useful, market participants need to be able to identify those swaps traded with a fee (in other words, it is insufficient to have a single field for “price”; a swap with an off-market coupon needs a rate and a fee field in order to be fully evaluated.

Given the above scenarios, and the complexity of classifying every derivative with an identifier, FIA Europe strongly recommends against using a single identifier field. We are concerned that the industry will undertake extensive and expensive efforts to classify derivatives under ESMA’s proposal, but that it will not deliver the transparency that MiFIR is seeking, and which will cause the RTS to have to be revisited at a future date and a subsequent re-implementation of trade reporting flows. Far simpler, we consider, for the post-trade reporting fields to be sufficiently numerous as to allow identification of all economic terms of derivative transactions.
<ESMA_QUESTION_CP_MIFID_73>

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

<ESMA_QUESTION_CP_MIFID_74>
FIA Europe does not agree with ESMA’s proposal on the applicable flags. FIA Europe is generally in favour of limiting the usage of flagged trades. Their use may hinder accurate timely reporting through trades being erroneously flagged.

However, we note and welcome that reference has been made to packaged transactions in the Consultation Paper at Q74. We agree that packaged transactions should feature more prominently as to the type of trading facility which can be operated by a trading venue – we emphasise that these transactions should be accommodated in the future.
<ESMA_QUESTION_CP_MIFID_74>

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

(1) a 3-year initial implementation period

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

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

<ESMA_QUESTION_CP_MIFID_75>
FIA Europe agrees with the 3-year implementation period and a maximum delay of 15 minutes during this period. FIA Europe recommends the maximum delay of 15 minutes should be maintained on an ongoing basis and not reduced to 5 minutes after 3 years. Given existing price discovery and trading mechanisms we see little benefit in subsequently reducing the post trade delay to 5 minutes. The longer period makes allowance for the time necessary for certain bespoke products. If necessary, a review could be conducted after 3 years exploring the necessity of reducing the delay to 5 minutes.

FIA Europe recommends that the reporting rules for derivative trades should, as far as possible, be aligned globally.
<ESMA_QUESTION_CP_MIFID_75>

Q76. Do you agree that securities financing transactions and other types of transactions subject to conditions other than the current market valuation of the

financial instrument should be exempt from the reporting requirement under article 21? Do you think other types of transactions should be included? Please provide reasons for your answers.

<ESMA_QUESTION_CP_MIFID_76>
Yes. FIA Europe agrees that securities financing transactions and other types of transaction should be exempt from the reporting requirements. FIA Europe does not recommend including other types of transactions.

We note that the European Commission are currently preparing a securities financing transactions (SFT) regulation which incorporates a reporting regime for such transactions. It would be inappropriate to apply these pre- and post-trade transparency requirements to these transactions.

We also note that the definitions of SFT in the RTS do not correspond with the definition of SFT in the regulation, which are materially different and should be aligned.

<ESMA_QUESTION_CP_MIFID_76>

Q77. Do you agree with ESMA's proposal for bonds and SFPs? Please specify, for each type of bonds identified, if you agree on the following points, providing reasons for your answer and if you disagree providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

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

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

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

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

<ESMA_QUESTION_CP_MIFID_77>
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Q78. Do you agree with ESMA's proposal for interest rate derivatives? Please specify, for each sub-class (FRA, Swaptions, Fixed-to-Fixed single currency swaps, Fixed-to-Float single currency swaps, Float -to- Float single currency swaps, OIS single currency swaps, Inflation single currency swaps, Fixed-to-Fixed multi-currency swaps, Fixed-to-Float multi-currency swaps, Float -to- Float multi-currency swaps, OIS multi-currency swaps, bond options, bond futures, interest rate options, interest rate futures) if you agree on the following points providing reasons for your answer and, if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

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

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

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

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

<ESMA_QUESTION_CP_MIFID_78>

(1) <u>deferral period set to 48 hours</u>

FIA Europe agrees with a deferral period of 48 hours for transactions that are LIS, and transactions above the SSTI. However, even after 48 hours, unmasking volume can be extremely detrimental to the abilities of a market maker to unwind risk resulting from a large transaction, and therefore 48 hours is only adequate if NCAs permit extended volume omission as envisaged under the supplementary deferral regime. We encourage ESMA to do everything possible to ensure a harmonised, EU-wide post-trade transparency regime including broad adoption of the supplementary deferral regime.

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

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

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

We propose instead that the SSTI threshold should either be set at the median trade size (50th percentile of transaction sizes) for transactions in the relevant sub-class. The appeal of using the median size is that ESMA can be sure that half of transactions in any liquid sub-class would be subject to pre-trade transparency, and would not experience deferred publication. We consider it would accord better with a normal market transaction at which liquidity providers could be reasonably expected to hedge their risks (as per MiFIR Article 9(5)(d). Furthermore, breaking the link to LIS would prevent the SSTI being skewed by individual, large transactions (which could be a result under ESMA's current proposal for LIS calibration).

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

We propose that ESMA look at existing block thresholds in place on regulated markets for most liquid interest rate instruments and consider whether they find these effective. ESMA should consider the percentile distribution of notional/volumes on a product-by-product basis.

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

FIA Europe agrees that the LIS should be recalibrated on a dynamic basis. However, we do not endorse Option 2 as currently constructed. In particular, we disagree with:

- Criterion 2 (the proposed volume measure). The determination of whether a transaction is large compared to market size should not be conflated with the volume of trading in that market and instead can be derived from the distribution of trade sizes alone. The volume measure would appear to be policy driven, without any basis in a natural reading of transactions that are large compared to normal market size.

- Criterion 3 (the proposed threshold floor). We disagree with ESMA's proposal to include a "floor" in option 2 once annual recalibration commences after 2017. In our view, this is an arbitrary device intended to result in an extra-large number that is inconsistent with the definition of a Large-in-Scale transaction in MiFIR.

Therefore, we recommend using only the percentile of trades to calibrate the LIS (i.e. criterion 1).
Whilst we agree with the use of criterion 1, we believe that the percentile level used for the LIS threshold should be varied according to the homogeneity of the class in order to compensate for in accuracies in the liquidity determination. Where ESMA has determined liquidity at a granular level (e.g. the Bond Futures shown in Table 5, Annex III of RTS9) the proposed LIS threshold of the 90th percentile transaction size is appropriate. For broader, less homogenous classes (e.g. swaptions as currently classified by ESMA), the LIS threshold should be lower than the 90th percentile transaction size, potentially as low as the 50th percentile, in order to compensate for the lack of granularity in the composition of the class.

(4) <u>pre-trade and post-trade thresholds set at the same size</u>

The approaches described by ESMA are contrary to the principles used by exchanges for setting such thresholds for ETDs. ESMA proposes that post-trade deferred publication levels shall be set equal to pre-trade large-in-scale sizes. Based on the description of how pre-trade levels are determined, the current regulatory proposal implies that only a fraction of the current block trade sizes in ETDs will be considered large-in-scale. ***If the reduced levels of relevant pre- trade thresholds are also used to set deferred publication levels, transparency will be irrevocably lost in ETDs.*** To demonstrate a more appropriate example, e.g an exchange allows forms of deferred publication, also known as non-disclosure, mostly for equity options. In this case, non-disclosure is limited to a set of instruments. Furthermore, the intention at that exchange is to only allow deferred publication in multiples of the block size. In addition, only a small fraction of the trading in block sizes is deferred under non-disclosure until after end-of-day, with reporting after the end-of-day batch run, and not T+ 5 days, as evidence suggests in the bond market.

<u>Package Transactions</u>

FIA Europe encourages ESMA to consider the appropriate application of the MiFIR pre- and post-trade transparency obligations and the derivatives trading obligation, to package transactions. We consider that MiFIR is flexible enough to empower ESMA to specify how package transactions are to be treated, and it is important to do so, otherwise investors could lose the advantages of the ability to transact certain package types and will experience increased transaction costs and execution risk as a consequence of having to trade different components separately, of being unable to obtain appropriate waivers and deferrals. Package transactions often feature ETDs (for example, <u>strategies</u> (including rolls, calendar spreads, packs and bundles), and <u>Exchange For Physicals</u> (EFPs or basis trades)). FIA Europe's membership is therefore supportive of ISDA's detailed proposals for the definition of a package transaction, the appropriate classification of package transactions into liquid and illiquid classes, and the calibration of SSTI and LIS for packages and would urge ESMA to adopt this proposal.

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

FIA Europe does not agree with the Large in Scale Thresholds (LIS). FIA Europe members believe that as much transparency as is appropriate is good for the market and consequently the LIS thresholds proposed by ESMA for interest rate derivatives in Tables 5-12 of Annex III of RTS 9 executed on a trading venue:

- are insufficiently sensitive to the differences in liquidity between contracts;
- show insufficient awareness of the current manner in which exchange traded manage large orders through the use of Block trading facilities and associated minimum block sizes;
- show insufficient awareness of the similarities between certain Exchange Traded Derivatives and comparable OTC equivalents.

ESMA's analysis has resulted in some liquid products having low thresholds and illiquid products having high thresholds – this has resulted in cases from the use of post-trade data rather than order-book data. FIA Europe recommends ESMA to use individual order book data, not volumes in order to determine LIS thresholds. If levels are too high, counterparties will not be able to hedge a position and ultimately result in higher costs for end consumers. FIA Europe's membership criticises them in multiple cases, to be too low which is likely to result in a dramatic reduction in current levels of pre-trade transparency. In other cases, they are far too high and consequently would be inoperable for all but the very largest transactions. ESMA should be mindful that a one-size-fits-all solution to determining LIS thresholds will render variable results due to the varied nature of products – these thresholds should be re-calibrated at least annually to allow determination of the appropriate levels.

Futures exchanges have historically enhanced transparency for standardized contracts through the use of central limit order books. Exchanges have also typically offered Block trading facilities in order to permit the execution of large transactions away from the order book, but always under the rules of the exchange (which typically consider amongst other elements, the times within which such trades must be reported to the exchange Block size thresholds are comparable in usage to the Large-in-Scale thresholds envisaged under MiFIR, and have generally been calibrated by exchanges, under regulatory oversight, to cater for differences between different contracts). For example, a liquid and mature instrument like the Bund future on an exchange has a block size of 2000 contracts (lots, equivalent to €200 million), which can be considered comparable to a large-in-scale threshold. In contrast, the many illiquid futures and options instruments have low block sizes to attract order flow in such instruments to central infrastructures (CCPs & trading venue). For example, equity options have a block size of 250 or even 1 contract (lot), because the characteristic of options and the various degrees of liquidity formation demand a dynamic approach to achieve the goal to attract products to the public central order book. Thus higher transparency thresholds often cannot be justified, because these would contradict the overarching goal to bring instruments onto a multilateral environment.

By way of example, and to provide evidence we make reference to ESMA's proposed LIS threshold for the Three Month Euribor Future is €10 million (nominal value), whereas the proposed threshold for the Option on the Three Month Euribor Future is €15 billion. In contrast, e.g. ICE Futures Europe applies the same LIS threshold of €3 billion for both near-dated Three Month Euribor Futures and Options contracts in recognition of the fact that they are not traded in isolation but in conjunction with one another. On the same venue, the LIS thresholds are lower (i.e. €500 million) for the far-dated versions of the contracts, reflecting lower liquidity in the longer-dated contracts of the maturity curve.

A €10 million transaction in the Three Month Euribor Future (which equates to 10 lots) is extremely small. In contrast, there are typically many thousands of lots available at the best bid and the best offer in the most active maturities of the Three Month Euribor Futures in the transparent central order book operated by exchanges. The LIS threshold calculated by ESMA fails to take account of that liquidity – as measured by the available pre-trade data – because ESMA's methodology is based solely on post-trade data. It has to be noted that using post-trade data in isolation is misleading because it fails to take into account that an order which enters the central order book is likely to be matched against many separate countervailing orders, rather than just one. This is particularly true in the case of products which are subject to a trade matching algorithm which is based, wholly or in part, on pro-rata matching rather than price/time matching.

As a result, post-trade data can only provide the false impression that the market comprises a large number of relatively small trading interests, when in fact the opposite is the case. The outcome is that ESMA has proposed that the most liquid interest rate futures in Europe be given LIS thresholds which are extremely low and which bear no relationship with the size of orders which can be easily accommodated into fully transparent central order books without experiencing execution delay or price slippage. This is the case not just for Three Month Euribor Futures, but also for other interest rate futures and bond futures which are included in Tables 5-8 of RTS 9.

Furthermore, ESMA has failed to account for the similarities between the Euribor Interest Rate Futures in Table 11 of Annex III, RTS9, and Euro FRAs shown in Table 15 of the same annex. The LIS threshold for Euribor futures is proposed to be €10 million, but for EUR FRAs between €525 and 1,000 million depending on maturity. ESMA should review the proposed thresholds for both the ETD and OTC contracts in the RTS in light of the obvious similarities between these contracts, regardless of whether the derivative is packaged in an Exchange Traded or OTC format. Another relevant example here is the 10 year EUR Swapnote futures, shown to have LIS thresholds of €10 million in Table 5 of Annex III, RTS 9, and a 10 year EUR swap, proposed to have an LIS threshold of €165 million in Table 23 of the same annex.

We recommend that ESMA adopts a suitable methodology and collects pre-trade data from trading venues in order to apply a suitable methodology. By way of verification, we recommend that such thresholds should correspond with existing thresholds set by exchanges, which take into account the size of orders that can be placed in the order book without impacting execution time or price. Anecdotal evidence suggests that exchanges set levels of LIS thresholds at approximately the top 6.5% of orders.

For interest rate futures and bond futures contracts, FIA Europe believes that – and as is the case today - calibration of LIS thresholds should be undertaken in a manner which takes account of the liquidity available at the best bid and best offer for the product in question.

The LIS threshold for options based on such futures should be set in a way which reflects the manner in which those products are traded in conjunction with each other. Exchanges originally set interest rate option Block Trade thresholds on the basis of a ratio of two options contracts to one underlying futures contract in order to reflect the 50% delta of an at-the-money option. This was later changed to a one-to-one ratio, in part to reflect the fact that there was a liquidity gap between the options Block Trade threshold and the size of order which could, in practice, be executed in the options central order book without experiencing significant execution delay and/or price slippage.

Recommendation – suggested approach for ETDs

The goal should be to implement Level 1 in a prudent way that does not diminish the high transparency levels already achieved by exchanges in ETDs. The all-encompassing objective of exchanges is to develop instruments and create readiness for liquidity formation in a public order-book ESMA should ensure thresholds for transparency levels are dynamically addressed, taking into account the nature of the products. In order to ensure the overall goal, it is recommended to consider the approach of exchanges when determining thresholds and to closely liaise with exchanges to incorporate the expertise already deployed in ETDs.

Liquid market definition

Regarding the liquidity in instrument types, futures are mostly front-month traded instruments, with the exception of money market, dividend and volatility derivatives. Futures predominantly trade in electronic order-books. Options trading interest is spread out in the dimensions call/put, strike and expiration. In addition, in index options, most options volume trades as multi-leg options strategy. Fragmented liquidity and trading bespoke option and option strategies leads to a higher level of voice negotiation. This can result in qualitative adjustments to block trade sizes to remain attractive over OTC alternatives of bilaterally trading exchange listed look-alikes. Therefore, the determination of liquidity needs to take into account these aspects to result in meaningful thresholds. While the IBIA approach has unfortunately been dismissed, in interest rate derivatives a granular COFIA has been used that forms a good basis. Further refinement would result in more meaningful bands and ultimately thresholds, if the aspects described above are also taken into consideration.

Pre- and post-trade requirement exemptions

Pre-trade waivers - Large in scale/ Size specific (i.e. block sizes on exchanges) & illiquid markets

As a first indicator, the share of block volume is considered in a product to determine thresholds.

Then, the trade size distribution for screen and block trades are considered separately. Size buckets are set and evaluated for the number of trades at a given size, as well as the cumulative volume and share of overall volume traded at such a size. Both trade frequency and the share of large trade sizes for the instrument overall are considered in the approach.

While the determination of average trade sizes allows further gauging of common and larger trade sizes, the initial order size must also be considered.[2] In electronic markets, and

[2]Only considering traded sizes will understate order sizes and liquidity of an instrument. Evaluation of Bund options volumes in 2013 implies that solely regarding traded sizes can understate the size of initially placed orders by a factor of 6.

particularly in options, price guidance is given by quotes. Trade initiators rarely trade at these quoted prices (5-20% of options screen volume), and mostly enter limit orders mid-market. The difference between order and trade sizes is twofold. Firstly, a trade initiator may slice an order into suborders to minimize market impact by trading 500 futures or options via 5 orders at 100 contracts. Trade records provide evidence for this practice as the trade executions feature the same counterparty on the trade at identical prices with subsequent, virtually identical timestamps. Secondly, other market participants respond to incoming orders from trade initiators in a competitive fashion with immediate-or-cancel (IOC) orders. The initial order of 500 contracts placed a tick under the best quoted offer may be traded by, for example, 3 market makers sending IOCs in 100, 100 and 300 contracts.

Post-trade deferrals (i.e. non-disclosure on exchanges)

Non-disclosure thresholds are set as multiples of block trade thresholds. This is currently available for equity futures, equity options and select index products resulting in delayed reporting after the end-of-day batch run. These levels are critical from a trading and risk management perspective and must balance the interests of those involved and not involved in such trades. Such, deferred publication allows a market participant involved in very large trades to hedge and risk manage these, and to provide this service as such. The size of such trades however can impact price levels for the given instrument; hence the non-involved parties are interested in immediate publication to minimize their risk of mispricing.

In the past, a range of alternatives of objectives have been discussed with market participants:

- 99.5 % of all trades should be disclosed;
- Only trades bigger than 5% of the average daily volume should be non-disclosed;
- Trades of sizes counting for less than 95% of all volumes should be disclosed; and
- 10 times the Minimum Block Trade size should define non-disclosure.

<ESMA_QUESTION_CP_MIFID_78>

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

(1) deferral period set to 48 hours

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

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

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

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the

thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.

<ESMA_QUESTION_CP_MIFID_79>

(1) <u>deferral period set to 48 hours</u>

FIA Europe agrees with a deferral period of 48 hours for transactions that are LIS, and transactions above the SSTI. However, even after 48 hours, unmasking volume can be extremely detrimental to the abilities of a market maker to unwind risk resulting from a large transaction, and therefore 48 hours is only adequate if NCAs permit extended volume omission as envisaged under the supplementary deferral regime. We encourage ESMA to aim to ensure a harmonised, EU-wide post-trade transparency regime including broad adoption of the supplementary deferral regime.

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

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

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

We propose instead that the SSTI threshold should either be set at the median trade size (50th percentile of transaction sizes) for transactions in the relevant sub-class. The appeal of using the median size is that ESMA can be sure that half of transactions in any liquid sub-class would be subject to pre-trade transparency, and would not experience deferred publication. We consider it would accord better with a normal market transaction at which liquidity providers could be reasonably expected to hedge their risks (as per MiFIR Article 9(5)(d). Furthermore, breaking the link to LIS would prevent the SSTI being skewed by individual, large transactions (which could result under ESMA's current proposal for LIS calibration).

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

We propose that ESMA look at existing block thresholds in place on regulated markets for most liquid commodity instruments and consider whether they find these effective. ESMA should consider the percentile distribution of notional/volumes on a product-by-product basis.

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

FIA Europe agrees that the LIS should be recalibrated on a dynamic basis. However, we do not endorse Option 2 as currently constructed. In particular, we disagree with:

- Criterion 2 (the proposed volume measure). The determination of whether a transaction is large compared to market size should not be conflated with the volume of trading in that market and instead can be derived from the distribution of trade sizes alone. The volume measure would appear to be policy driven, without any basis in a natural reading of transactions that are large compared to normal market size.

- Criterion 3 (the proposed threshold floor). We disagree with ESMA's proposal to include a "floor" in option 2 once annual recalibration commences after 2017. In our view, this is an arbitrary device intended to result in an extra-large number that is inconsistent with the definition of a Large-in-Scale transaction in MiFIR.

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

Whilst we agree with the use of criterion 1, we believe that the percentile level used for the LIS threshold should be varied according to the homogeneity of the class in order to compensate for in accuracies in the liquidity determination

(4) <u>pre-trade and post-trade thresholds set at the same size</u>

The approaches described by ESMA are contrary to the principles used by exchanges for setting such thresholds for ETDs. ESMA proposes that post-trade deferred publication levels shall be set equal to pre-trade large-in-scale sizes. Based on the description of how pre-trade levels are determined, the current regulatory proposal implies that only a fraction of the current block trade sizes in ETDs will be considered large-in-scale. ***If the reduced levels of relevant pre- trade thresholds are also used to set deferred publication levels, transparency will be irrevocably lost in ETDs.*** To demonstrate a more appropriate example, e.g. an exchange allows forms of deferred publication, also known as non-disclosure, mostly for equity options. In this case, non-disclosure is limited to a set of instruments. Furthermore, the intention at an exchange is to only allow deferred publication in multiples of the block size. In addition, only a small fraction of the trading in block sizes is deferred under non-disclosure until after end-of-day, with reporting after the end-of-day batch run, and not T+ 5 days, as examples as evidence suggests in the bond market.

<u>Package Transactions</u>

FIA Europe recommends ESMA to consider the appropriate application of the MiFIR pre- and post-trade transparency obligations and the derivatives trading obligation, to package transactions. We consider that MiFIR is flexible enough to empower ESMA to specify how package transactions are to be treated, and it is important to do so, otherwise investors could lose the advantages of the ability to transact certain package types and will experience increased transaction costs and execution risk as a consequence of having to trade different components separately, of being unable to obtain appropriate waivers and deferrals. Package transactions often feature ETDs (for example, <u>strategies</u> (including rolls, calendar spreads, packs and bundles), and <u>Exchange For Physicals</u> (EFPs or basis trades)). FIA

Europe's membership is therefore supportive of ISDA's detailed proposals for the definition of a package transaction, the appropriate classification of package transactions into liquid and illiquid classes, and the calibration of SSTI and LIS for packages and would urge ESMA to adopt this

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

FIA Europe does not agree with the Large in Scale Thresholds (LIS). FIA Europe members believe that as much transparency as is appropriate is good for the market and consequently the LIS thresholds proposed by ESMA for commodity derivatives in Tables 34-44 of Annex III of RTS 9 executed on a trading venue:

- are insufficiently sensitive to the differences in liquidity between contracts;

- show insufficient awareness of the current manner in which exchange traded manage large orders through the use of Block trading facilities and associated minimum block sizes; and

- show insufficient awareness of the similarities between certain Exchange Traded Derivatives and comparable OTC equivalents.

ESMA’s analysis has resulted in some liquid products having low thresholds and illiquid products having high thresholds – this has resulted in cases from the use of post-trade data rather than order-book data. FIA Europe recommends ESMA to use individual order book data, not volumes in order to determine LIS thresholds. If levels are too high, counterparties will not be able to hedge a position and ultimately result in higher costs for end consumers. FIA Europe’s membership criticises them in multiple cases, to be too low which is likely to result in a dramatic reduction in current levels of pre-trade transparency. In other cases, they are far too high and consequently would be inoperable for all but the very largest transactions. ESMA should be mindful that a one-size-fits-all solution to determining LIS thresholds will render variable results due to the varied nature of products – these thresholds should be re-calibrated at least annually to allow determination of the appropriate levels.

Futures exchanges have historically enhanced transparency for standardised contracts through the use of central limit order books. Exchanges have also typically offered Block trading facilities in order to permit the execution of large transactions away from the order book, but always under the rules of the exchange (which typically consider amongst other elements, the times within which such trades must be reported to the exchange Block size thresholds are comparable in usage to the Large-in-Scale thresholds envisaged under MiFIR), and have generally been calibrated by exchanges, under regulatory oversight, to cater for differences between different contracts. For example, a liquid and mature instrument like the Bund future on an exchange has a block size of 2000 contracts (lots, equivalent to €200 million), which can be considered comparable to a large-in-scale threshold. In contrast, the many illiquid futures and options instruments have low block sizes to attract order flow in such instruments to central infrastructures (CCPs & trading venue). For example, equity options have a block size of 250 or even 1 contract (lot), because the characteristic of options and the various degrees of liquidity formation demand a dynamic approach to achieve the goal to attract products to the public central order book. Thus higher transparency thresholds often cannot be justified, because these would contradict the overarching goal to bring instruments onto a multilateral environment.

By way of example, the LIS thresholds calculated by ESMA fail to take account of the potential market impact of an order – as measured by the available pre-trade data – because ESMA's methodology is based solely on post-trade data. In contrast, the approach of trading venues is to set Block Trade thresholds for energy contracts principally on the current liquidity in the contract – which is assessed using pre-trade data - and the commercial activity that underpins trading in the central order book.

In addition to the above comments, we have specific comments relating to the other Energy contracts.

Firstly, we note that coal is not listed in the identified sub-classes (page 137 of the Consultation Paper, Tables 23 and 24) nor has ESMA proposed for coal LIS and SSTI thresholds (pages 180 and 181 of RTS 9 in Annex B of the Consultation Paper - Tables 38, 39 and 40). ESMA should set suitable thresholds for this important asset class.

Secondly, in relation to utility contracts (such as natural gas), maturity (3 months or less) is not a meaningful parameter alone as liquidity is not necessarily concentrated in the front months. Delivery periods would provide an additional parameter that would capture particular contracts in the utilities sector that are in fact more liquid further along the curve (e.g. calendar months or seasons).

We recommend that ESMA adopts a suitable methodology and collects pre-trade data from trading venues in order to apply a suitable methodology. By way of verification, we recommend that such thresholds should correspond with existing thresholds set by exchanges, which take into account the size of orders that can be placed in the order book without impacting execution time or price. Anecdotal evidence suggests that exchanges set levels of LIS thresholds at approximately the top 6.5% of orders.

Recommendation – prudent approach for ETDs

The goal should be to implement Level 1 in a prudent way that does not diminish the high transparency levels already achieved by exchanges in ETDs. The all-encompassing objective of exchanges is to develop instruments and create readiness for liquidity formation in a public order-book. ESMA should ensure thresholds for transparency levels are dynamically addressed, taking into account the nature of the products. In order to ensure the overall goal, it is recommended to consider the approach of exchanges when determining thresholds and to closely liaise with exchanges to incorporate the expertise already deployed in ETDs.

Liquid market definition

Regarding the liquidity in instrument types, futures are mostly front-month traded instruments, with the exception of money market, dividend and volatility derivatives. Futures predominantly trade in electronic order-books. Options trading interest is spread out in the dimensions call/put, strike and expiration. In addition, in index options, most options volume trades as multi-leg options strategy. Fragmented liquidity and trading bespoke option and option strategies leads to a higher level of voice negotiation. This can result in qualitative adjustments to block trade sizes to remain attractive over OTC alternatives of bilaterally trading exchange listed look-alikes. Therefore, the determination of liquidity needs to take into account these aspects to result in meaningful thresholds. While the IBIA approach has unfortunately been dismissed, in interest rate derivatives a granular COFIA has been used that forms a good basis. Further refinement would result in more meaningful bands and ultimately thresholds, if the aspects described above are also taken into consideration. **Regarding the analyses performed by ESMA on commodity derivatives, clearly the COFIA approach chosen is too aggregated**. It is suggested to form more bands in order to capture instruments into the right level of liquidity. Proposals of more meaningful numbers could range around the proposed levels by ESMA and taking into consideration the data and experience of exchanges in that respect. Ultimately, ESMA needs to determine the market impact, in order to determine the LIS or SSTI. It is recommended to actually look in the order books and take pre-trade information into account. Basically, market impact begins after the best bid and best offer. If ESMA could define the levels by looking into the aggregated volume at the next level after the best bid and best offer, this would be the benchmark for ESMA to ensure the levels prescribed are not entirely wrong.

Pre- and post-trade requirement exemptions

Pre-trade waivers - Large in scale/ Size specific (i.e. block sizes on exchanges) & illiquid markets

As a first indicator, the share of block volume is considered in a product to determine thresholds.

Then, the trade size distribution for screen and block trades are considered separately. Size buckets are set and evaluated for the number of trades at a given size, as well as the cumulative volume and share of overall volume traded at such a size. Both trade frequency and the share of large trade sizes for the instrument overall are considered in the approach.

While the determination of average trade sizes allows further gauging of common and larger trade sizes, the initial order size must also be considered.

<ESMA_QUESTION_CP_MIFID_79>

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

(1) deferral period set to 48 hours

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

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

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

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

<ESMA_QUESTION_CP_MIFID_80>

(1) <u>deferral period set to 48 hours</u>

FIA Europe agrees with a deferral period of 48 hours for transactions that are LIS, and transactions above the SSTI. However, even after 48 hours, unmasking volume can be extremely detrimental to the abilities of a market maker to unwind risk resulting from a large transaction, and therefore 48 hours is only adequate if NCAs permit extended volume omission as envisaged under the supplementary deferral regime. We encourage ESMA to do everything possible to ensure a harmonised, EU-wide post-trade transparency regime including broad adoption of the supplementary deferral regime.

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

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

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

We propose instead that the SSTI threshold should either be set at the median trade size (50th percentile of transaction sizes) for transactions in the relevant sub-class. The appeal of using the median size is that ESMA can be sure that half of transactions in any liquid sub-class would be subject to pre-trade transparency, and would not experience deferred publication. We consider it would accord better with a normal market transaction at which liquidity providers could be reasonably expected to hedge their risks (as per MiFIR Article 9(5)(d). Furthermore, breaking the link to LIS would prevent the SSTI being skewed by individual, large transactions (which could result under ESMA's current proposal for LIS calibration).

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

We propose that ESMA look at existing block thresholds in place on regulated markets for most liquid equity derivatives instruments and consider whether they find these effective. ESMA should consider the percentile distribution of notional/volumes on a product-by-product basis.

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

FIA Europe agrees that the LIS should be recalibrated on a dynamic basis. However, we do not endorse Option 2 as currently constructed. In particular, we disagree with:

- Criterion 2 (the proposed volume measure). The determination of whether a transaction is large compared to market size should not be conflated with the volume of trading in that market and instead can be derived from the distribution of trade sizes alone. The volume measure would appear to be policy driven, without any basis in a natural reading of transactions that are large compared to normal market size.

- Criterion 3 (the proposed threshold floor). We disagree with ESMA's proposal to include a "floor" in option 2 once annual recalibration commences after 2017. In our view, this is an arbitrary device intended to result in an extra-large number that is inconsistent with the definition of a Large-in-Scale transaction in MiFIR.

Therefore, we recommend using only the percentile of trades to calibrate the LIS (i.e. criterion Whilst we agree with the use of criterion 1, we believe that the percentile level used for the LIS threshold should be varied according to the homogeneity of the class in order to compensate for in accuracies in the liquidity determination. Where ESMA has determined liquidity at a granular level (e.g. the Bond Futures shown in Table 5, Annex III of RTS9) the proposed LIS threshold of the 90th percentile transaction size is appropriate. For broader, less homogenous classes (e.g. swaptions as currently classified by ESMA), the LIS threshold should be lower than the 90th percentile transaction size, potentially as low as the 50th percentile, in order to compensate for the lack of granularity in the composition of the class.

(4) <u>pre-trade and post-trade thresholds set at the same size</u>

The approaches described by ESMA are contrary to the principles used by exchanges for setting such thresholds for ETDs. ESMA proposes that post-trade deferred publication levels shall be set equal to pre-trade large-in-scale sizes. Based on the description of how pre-trade levels are determined, the current regulatory proposal implies that only a fraction of the current block trade sizes in ETDs will be considered large-in-scale. ***If the reduced levels of relevant pre- trade thresholds are also used to set deferred publication levels, transparency will be irrevocably lost in ETDs.*** To demonstrate a more appropriate example, e.g an exchange allows forms of deferred publication, also known as non-disclosure, mostly for equity options. In this case, non-disclosure is limited to a set of instruments. Furthermore, the intention at that exchange is to only allow deferred publication in multiples of the block size. In addition, only a small fraction of the trading in block sizes is deferred under non-disclosure until after end-of-day, with reporting after the end-of-day batch run, and not T+ 5 days, as examples as evidence suggests in the bond market.

(5) <u>large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to</u>

recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.

FIA Europe does not agree with the Large in Scale Thresholds (LIS). FIA Europe members believe that as much transparency as is appropriate is good for the market and consequently the LIS thresholds proposed by ESMA for equity derivatives in Tables 32-33 of Annex III of RTS 9 executed on a trading venue:

- are insufficiently sensitive to the differences in liquidity between contracts;
- show insufficient awareness of the current manner in which exchange traded manage large orders through the use of Block trading facilities and associated minimum block sizes;
- show insufficient awareness of the similarities between certain Exchange Traded Derivatives and comparable OTC equivalents.

ESMA's analysis has resulted in some liquid products having low thresholds and illiquid products having high thresholds – this has resulted in cases from the use of post-trade data rather than order-book data. FIA Europe recommends ESMA to use individual order book data, not volumes in order to determine LIS thresholds. If levels are too high, counterparties will not be able to hedge a position and ultimately result in higher costs for end consumers. FIA Europe's membership criticises them in multiple cases, to be too low which is likely to result in a dramatic reduction in current levels of pre-trade transparency. In other cases, they are far too high and consequently would be inoperable for all but the very largest transactions. ESMA should be mindful that a one-size-fits-all solution to determining LIS thresholds will render variable results due to the varied nature of products – these thresholds should be re-calibrated at least annually to allow determination of the appropriate levels.

Futures exchanges have historically enhanced transparency for standardized contracts through the use of central limit order books. Exchanges have also typically offered Block trading facilities in order to permit the execution of large transactions away from the order book, but always under the rules of the exchange (which typically consider amongst other elements, the times within which such trades must be reported to the exchange Block size thresholds are comparable in usage to the Large-in-Scale thresholds envisaged under MiFIR), and have generally been calibrated by exchanges, under regulatory oversight, to cater for differences between different contracts. For example, a liquid and mature instrument like the Bund future on an exchange has a block size of 2000 contracts (lots, equivalent to €200 million, which can be considered comparable to a large-in-scale threshold. In contrast, the many illiquid futures and options instruments have low block sizes to attract order flow in such instruments to central infrastructures (CCPs & trading venue). For example, equity options have a block size of 250 or even 1 contract (lot), because the characteristic of options and the various degrees of liquidity formation demand a dynamic approach to achieve the goal to attract products to the public central order book. Thus higher transparency thresholds often cannot be justified, because these would contradict the overarching goal to bring instruments onto a multilateral environment.

As a result, post-trade data can only provide the false impression that the market comprises a large number of relatively small trading interests, when in fact the opposite is the case. The outcome is that ESMA has proposed that the most liquid equity derivatives futures in Europe be given LIS thresholds which are extremely low and which bear no relationship with the size of orders which can be easily accommodated into fully transparent central order books without experiencing execution delay or price slippage. This is the case not just for Three Month Euribor Futures, but also for other interest rate futures and bond futures which are included in Tables 5-8 of RTS 9.

We recommend that ESMA adopts a suitable methodology and collects pre-trade data from trading venues in order to apply a suitable methodology. By way of verification, we recommend that such thresholds should correspond with existing thresholds set by exchanges, which take into account the size of orders that can be placed in the order book without impacting execution time or price. Anecdotal evidence suggests that exchanges set levels of LIS thresholds at approximately the top 6.5% of orders.

For equity futures contracts, FIA Europe believes that – and as is the case today - calibration of LIS thresholds should be undertaken in a manner which takes account of the liquidity available at the best bid and best offer for the product in question.

The LIS threshold for options based on such futures should be set in a way which reflects the manner in which those products are traded in conjunction with each other. Exchanges originally set equity option Block Trade thresholds on the basis of a ratio of two options contracts to one underlying futures contract in order to reflect the 50% delta of an at-the-money option. This was later changed to a one-to-one ratio, in part to reflect the fact that there was a liquidity gap between the options Block Trade threshold and the size of order which could, in practice, be executed in the options central order book without experiencing significant execution delay and/or price slippage.

Recommendation – prudent approach for ETDs

The goal should be to implement Level 1 in a prudent way that does not diminish the high transparency levels already achieved by exchanges in ETDs. The all-encompassing objective of exchanges is to develop instruments and create readiness for liquidity formation in a public order-book. ESMA should ensure thresholds for transparency levels are dynamically addressed, taking into account the nature of the products. In order to ensure the overall goal, it is recommended to consider the approach of exchanges when determining thresholds and to closely liaise with exchanges to incorporate the expertise already deployed in ETDs.

Liquid market definition

Regarding the liquidity in instrument types, futures are mostly front-month traded instruments, with the exception of money market, dividend and volatility derivatives. Futures predominantly trade in electronic order-books. Options trading interest is spread out in the dimensions call/put, strike and expiration. In addition, in index options, most options volume trades as multi-leg options strategy. Fragmented liquidity and trading bespoke option and option strategies leads to a higher level of voice negotiation. This can result in qualitative adjustments to block trade sizes to remain attractive over OTC alternatives of bilaterally trading exchange listed look-alikes. Therefore, the determination of liquidity needs to take into account these aspects to result in meaningful thresholds. While the IBIA approach has unfortunately been dismissed, in interest rate derivatives a granular COFIA has been used that forms a good basis. Further refinement would result in more meaningful bands and ultimately thresholds, if the aspects described above are also taken into consideration.

Regarding the analyses performed by ESMA on equity derivatives, clearly the COFIA approach chosen is too aggregated. It is suggested to form more bands in order to capture instruments into the right level of liquidity. Proposals of more meaningful numbers could range around the proposed levels by ESMA and taking into consideration the data and experience of exchanges in that respect. Ultimately, ESMA needs to determine the market impact, in order to determine the LIS or SSTI. It is recommended to actually look in the order books and take pre-trade information into account. Basically, market impact begins after the best bid and best offer. If ESMA could define the levels by looking into the aggregated volume at the next level after the best bid and best offer, this would be the benchmark for ESMA to ensure the levels prescribed are not entirely wrong.

Pre- and post-trade requirement exemptions

Pre-trade waivers - Large in scale/ Size specific (i.e. block sizes on exchanges) & illiquid markets

As a first indicator, the share of block volume is considered in a product to determine thresholds.

Then, the trade size distribution for screen and block trades are considered separately. Size buckets are set and evaluated for the number of trades at a given size, as well as the cumulative volume and share of overall volume traded at such a size. Both trade frequency and the share of large trade sizes for the instrument overall are considered in the approach.

While the determination of average trade sizes allows further gauging of common and larger trade sizes, the initial order size must also be considered.[3] In electronic markets, and particularly in options, price guidance is given by quotes. Trade initiators rarely trade at these quoted prices (5-20% of options screen volume), and mostly enter limit orders mid-market. The difference between order and trade sizes is twofold. Firstly, a trade initiator may slice an order into suborders to minimize market impact by trading 500 futures or options via 5 orders at 100 contracts. Trade records provide evidence for this practice as the trade executions feature the same counterparty on the trade at identical prices with subsequent, virtually identical timestamps. Secondly, other market participants respond to incoming orders from trade initiators in a competitive fashion with immediate-or-cancel (IOC) orders. The initial order of 500 contracts placed a tick under the best quoted offer may be traded by, for example, 3 market makers sending IOCs in 100, 100 and 300 contracts.

Post-trade deferrals (i.e. non-disclosure on exchanges)

Non-disclosure thresholds are set as multiples of block trade thresholds. This is currently available for equity futures, equity options and select index products resulting in delayed reporting after the end-of-day batch run. These levels are critical from a trading and risk management perspective and must balance the interests of those involved and not involved in such trades. Such deferred publication allows a market participant involved in very large

[3] Only considering traded sizes will understate order sizes and liquidity of an instrument. Evaluation of Bund options volumes in 2013 implies that solely regarding traded sizes can understate the size of initially placed orders by a factor of 6.

trades to hedge and risk manage these, and to provide this service as such. The size of such trades however can impact price levels for the given instrument; hence the non-involved parties are interested in immediate publication to minimize their risk of mispricing.

In the past, a range of alternatives of objectives have been discussed with market participants:

- 99.5 % of all trades should be disclosed,
- Only trades bigger than 5% of the average daily volume should be non-disclosed,
- Trades of sizes counting for less than 95% of all volumes should be disclosed,
- 10 times the Minimum Block Trade size should define non-disclosure, and
- In equity options, an exchange has set the non-disclosure limits so that on an annual average of the top 5% of block trades are subject to deferred publication.

<ESMA_QUESTION_CP_MIFID_80>

Q81. Do you agree with ESMA's proposal for securitised derivatives? Please specify if you agree on the following points providing reasons for your answer and if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

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

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

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

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

<ESMA_QUESTION_CP_MIFID_81>
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<ESMA_QUESTION_CP_MIFID_81>

Q82. Do you agree with ESMA's proposal for emission allowances? Please specify if you agree on the following points providing reasons for your answer and if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

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

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

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

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e.

option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.**

<ESMA_QUESTION_CP_MIFID_82>
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<ESMA_QUESTION_CP_MIFID_82>

Q83. Do you agree with ESMA's proposal in relation to the supplementary deferral regime at the discrection of the NCA? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_83>
FIA Europe welcomes ESMA's proposals of four weeks volume omission under the supplementary deferral regime (and further detail around the publication of averages). The discretionary element that rest with NCAs might in practice poses some concerns in relation subsequently different application within European Member States once the requirements are applicable. We recommend ESMA to encourage aiming for a high degree of harmonisation within Europe member States, including broad adoption of the supplementary deferral regime.

However, we note the complexity and high number of possible different outcomes. In respect of volume omission, four weeks will be acceptable for the majority of transactions, but for occasional very large transactions or in bespoke instruments, four weeks will not be enough and up to three months would be required.
<ESMA_QUESTION_CP_MIFID_83>

Q84. Do you agree with ESMA's proposal with regard to the temporary suspension of transparency requirements? Please provide feedback on the following points:

(1) the measure used to calculate the volume as specified in Annex II, Table 3

(2) the methodology as to assess a drop in liquidity

(3) the percentages determined for liquid and illiquid instruments to assess the drop in liquidity. Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_84>
NCAs need to be in a position to temporarily suspend transparency requirements taking into consideration changing market conditions, particularly in stressed market conditions. In our view, this means that NCAs must be able to act within hours of becoming aware of a significant decline in liquidity. The current proposal, which requires 30 days of trading data, would not permit NCAs to act with sufficient speed to adequately respond to a significant drop in liquidity.

NCAs should have regard to a wider range of factors than just trading volumes when assessing whether there has been a significant drop in liquidity. For example, if prices move by a certain amount, NCAs should be able to temporarily suspend transparency obligation if they have reasonable grounds to believe that the price movements have been caused by a significant drop in liquidity.

The framework proposed for NCA's temporary suspension powers is highly dependent on a sufficiently granular determination of derivative sub-classes. Indeed, Article 9(5)(a) of MiFIR indicates that the temporary suspension powers should be applied on an instrument basis. Despite this reference in Article 9(5)(a) of MiFIR, we understand that ESMA intends for NCAs to assess whether there has been a significant decline in liquid on a sub-class basis (using the same COFIA sub-classes proposed by ESMA for the purposes of the liquid market definition). As we have stated in our responses to earlier questions, we believe that ESMA needs to adopt a more granular classification of sub-classes across all derivative asset classes. The percentages proposed by ESMA to determine whether there has been a significant drop in liquidity should reflect the homogeneity of the class of financial instruments. If ESMA does not propose to adopt a uniformly granular classification across all derivative asset classes, then the thresholds proposed for the temporary suspension regime should be lower for those classes of derivatives which are more heterogeneous.

In the May 2014 discussion paper, ESMA proposed a percentage decline of 80% for instruments with a liquid market and a percentage decline of 60% for instruments which do not have a liquid market (this is summarised in paragraph 4 on page 314 of the Consultation Paper). We note that ESMA's current proposal (as outline in the Consultation Paper and reflected in Article 14 of RTS9) requires a higher percentage decline for illiquid instruments than liquid instruments – it now requires a percentage decline of 60% for instruments with a liquid market and 80% for instruments which do not have a liquid market. ESMA has not explained in the Consultation Paper why it has made this change. We therefore query whether this change was intentional. <ESMA_QUESTION_CP_MIFID_84>

Q85. Do you agree with ESMA's proposal with regard to the exemptions from transaprency requirements in respect of transactions executed by a member of the ESCB? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_85>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_85>

Q86. Do you agree with the articles on the double volume cap mechanism in the proposed draft RTS 10? Please provide reasons to support your answer.

<ESMA_QUESTION_CP_MIFID_86>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_86>

Q87. Do you agree with the proposed draft RTS in respect of implementing Article 22 MiFIR? Please provide reasons to support your answer.

<ESMA_QUESTION_CP_MIFID_87>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_87>

Q88. Are there any other criteria that ESMA should take into account when assessing whether there are sufficient third-party buying and selling interest in the class of derivatives or subset so that such a class of derivatives is considered sufficiently liquid to trade only on venues?

<ESMA_QUESTION_CP_MIFID_88>
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<ESMA_QUESTION_CP_MIFID_88>

Q89. Do you have any other comments on ESMA's proposed overall approach?

<ESMA_QUESTION_CP_MIFID_89>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_89>

Q90. Do you agree with the proposed draft RTS in relation to the criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU?

<ESMA_QUESTION_CP_MIFID_90>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_90>

Q91. Should the scope of the draft RTS be expanded to contracts involving European branches of non-EU non-financial counterparties?

<ESMA_QUESTION_CP_MIFID_91>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_91>

Q92. Please indicate what are the main costs and benefits that you envisage in implementing of the proposal.

<ESMA_QUESTION_CP_MIFID_92>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_92>

4. Microstructural issues

Q93. Should the list of disruptive scenarios to be considered for the business continuity arrangements expanded or reduced? Please elaborate.

<ESMA_QUESTION_CP_MIFID_93>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_93>

Q94. With respect to the section on Testing of algorithms and systems and change management, do you need clarification or have any suggestions on how testing scenarios can be improved?

<ESMA_QUESTION_CP_MIFID_94>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_94>

Q95. Do you have any further suggestions or comments on the pre-trade and post-trade controls as proposed above?

<ESMA_QUESTION_CP_MIFID_95>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_95>

Q96. In particular, do you agree with including "market impact assessment" as a pre-trade control that investment firms should have in place?

<ESMA_QUESTION_CP_MIFID_96>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_96>

Q97. Do you agree with the proposal regarding monitoring for the prevention and identification of potential market abuse?

<ESMA_QUESTION_CP_MIFID_97>
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<ESMA_QUESTION_CP_MIFID_97>

Q98. Do you have any comments on Organisational Requirements for Investment Firms as set out above?

<ESMA_QUESTION_CP_MIFID_98>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_98>

Q99. Do you have any additional comments or questions that need to be raised with regards to the Consultation Paper?

<ESMA_QUESTION_CP_MIFID_99>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_99>

Q100. Do you have any comments on Organisational Requirements for trading venues as set out above? Is there any element that should be clarified? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_100>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_100>

Q101. Is there any element in particular that should be clarified with respect to the outsourcing obligations for trading venues?

<ESMA_QUESTION_CP_MIFID_101>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_101>

Q102. Is there any additional element to be addressed with respect to the testing obligations?

<ESMA_QUESTION_CP_MIFID_102>
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<ESMA_QUESTION_CP_MIFID_102>

Q103. In particular, do you agree with the proposals regarding the conditions to provide DEA?

<ESMA_QUESTION_CP_MIFID_103>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_103>

Q104. Do you agree with the proposed draft RTS? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_104>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_104>

Q105. Should an investment firm pursuing a market making strategy for 30% of the daily trading hours during one trading day be subject to the obligation to sign a market making agreement? Please give reasons for your answer.

<ESMA_QUESTION_CP_MIFID_105>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_105>

Q106. Should a market maker be obliged to remain present in the market for higher or lower than the proposed 50% of trading hours? Please specify in your response the type of instrument/s to which you refer.

<ESMA_QUESTION_CP_MIFID_106>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_106>

Q107. Do you agree with the proposed circumstances included as "exceptional circumstances"? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_107>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_107>

Q108. Have you any additional proposal to ensure that market making schemes are fair and non-discriminatory? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_108>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_108>

Q109. Do you agree with the proposed regulatory technical standards? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_109>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_109>

Q110. Do you agree with the counting methodology proposed in the Annex in relation to the various order types? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_110>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_110>

Q111. Is the definition of "orders" sufficiently precise or does it need to be further supplemented? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_111>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_111>

Q112. Is more clarification needed with respect to the calculation method in terms of volume?

<ESMA_QUESTION_CP_MIFID_112>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_112>

Q113. Do you agree that the determination of the maximum OTR should be made at least once a year? Please specify the arguments for your view.

<ESMA_QUESTION_CP_MIFID_113>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_113>

Q114. Should the monitoring of the ratio of unexecuted orders to transactions by the trading venue cover all trading phases of the trading session including auctions, or just the continuous phase? Should the monitoring take place on at least a monthly basis? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_114>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_114>

Q115. Do you agree with the proposal included in the Technical Annex regarding the different order types? Is there any other type of order that should be reflected? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_115>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_115>

Q116. Do you agree with the proposed draft RTS with respect to co-location services? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_116>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_116>

Q117. Do you agree with the proposed draft RTS with respect to fee structures? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_117>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_117>

Q118. At which point rebates would be high enough to encourage improper trading? Please elaborate.

<ESMA_QUESTION_CP_MIFID_118>
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<ESMA_QUESTION_CP_MIFID_118>

Q119. Is there any other type of incentives that should be described in the draft RTS?

<ESMA_QUESTION_CP_MIFID_119>
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<ESMA_QUESTION_CP_MIFID_119>

Q120. Can you provide further evidence about fee structures supporting payments for an "early look"? In particular, do you agree with ESMA's preliminary view regarding the differentiation between that activity and the provision of data feeds at different latencies?

<ESMA_QUESTION_CP_MIFID_120>
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<ESMA_QUESTION_CP_MIFID_120>

Q121. Can you provide examples of fee structures that would support non-genuine orders, payments for uneven access to market data or any other type of abusive behaviour? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_121>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_121>

Q122. Is the distinction between volume discounts and cliff edge type fee structures in this RTS sufficiently clear? Please elaborate

<ESMA_QUESTION_CP_MIFID_122>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_122>

Q123. Do you agree that the average number of trades per day should be considered on the most relevant market in terms of liquidity? Or should it be considered on another market such as the primary listing market (the trading venue where the financial instrument was originally listed)? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_123>
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<ESMA_QUESTION_CP_MIFID_123>

Q124. Do you believe a more granular approach (i.e. additional liquidity bands) would be more suitable for very liquid stocks and/or for poorly liquid stocks? Do you consider the proposed tick sizes adequate in particular with respect to the smaller price ranges and less liquid instruments as well as higher price ranges and highly liquid instruments? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_124>
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<ESMA_QUESTION_CP_MIFID_124>

Q125. Do you agree with the approach regarding instruments admitted to trading in fixing segments and shares newly admitted to trading? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_125>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_125>

Q126. Do you agree with the proposed approach regarding corporate actions? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_126>
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<ESMA_QUESTION_CP_MIFID_126>

Q127. In your view, are there any other particular or exceptional circumstances for which the tick size may have to be specifically adjusted? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_127>
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<ESMA_QUESTION_CP_MIFID_127>

Q128. In your view, should other equity-like financial instruments be considered for the purpose of the new tick size regime? If yes, which ones and how should their tick size regime be determined? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_128>
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<ESMA_QUESTION_CP_MIFID_128>

Q129. To what extent does an annual revision of the liquidity bands (number and bounds) allow interacting efficiently with the market microstructure? Can you propose other way to interact efficiently with the market microstructure? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_129>
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<ESMA_QUESTION_CP_MIFID_129>

Q130. Do you envisage any short-term impacts following the implementation of the new regime that might need technical adjustments? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_130>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_130>

Q131. Do you agree with the definition of the "corporate action"? Please provide reasons for your answer.

<ESMA_QUESTION_CP_MIFID_131>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_131>

Q132. Do you agree with the proposed regulatory technical standards?

<ESMA_QUESTION_CP_MIFID_132>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_132>

Q133. Which would be an adequate threshold in terms of turnover for the purposes of considering a market as "material in terms of liquidity"?

<ESMA_QUESTION_CP_MIFID_133>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_133>

5. Data publication and access

Q134. Do you agree with ESMA's proposal to allow the competent authority to whom the ARM submitted the transaction report to request the ARM to undertake periodic reconciliations? Please provide reasons.

<ESMA_QUESTION_CP_MIFID_134>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_134>

Q135. Do you agree with ESMA's proposal to establish maximum recovery times for DRSPs? Do you agree with the time periods proposed by ESMA for APAs and CTPs (six hours) and ARMs (close of next working day)? Please provide reasons.

<ESMA_QUESTION_CP_MIFID_135>
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<ESMA_QUESTION_CP_MIFID_135>

Q136. Do you agree with the proposal to permit DRSPs to be able to establish their own operational hours provided they pre-establish their hours and make their operational hours public? Please provide reasons. Alternatively, please suggest an alternative method for setting operating hours.

<ESMA_QUESTION_CP_MIFID_136>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_136>

Q137. Do you agree with the draft technical standards in relation to data reporting services providers? Please provide reasons.

<ESMA_QUESTION_CP_MIFID_137>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_137>

Q138. Do you agree with ESMA's proposal**?**

<ESMA_QUESTION_CP_MIFID_138>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_138>

Q139. Do you agree with this definition of machine-readable format, especially with respect to the requirement for data to be accessible using free open source software, and the 1-month notice prior to any change in the instructions?

<ESMA_QUESTION_CP_MIFID_139>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_139>

Q140. Do you agree with the draft RTS's treatment of this issue?

<ESMA_QUESTION_CP_MIFID_140>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_140>

Q141. Do you agree that CTPs should assign trade IDs and add them to trade reports? Do you consider necessary to introduce a similar requirement for APAs?

<ESMA_QUESTION_CP_MIFID_141>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_141>

Q142. Do you agree with ESMA's proposal? In particular, do you consider it appropriate to require for trades taking place on a trading venue the publication time as assigned by the trading venue or would you recommend another timestamp (e.g. CTP timestamp), and if yes why?

<ESMA_QUESTION_CP_MIFID_142>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_142>

Q143. Do you agree with ESMA's suggestions on timestamp accuracy required of APAs? What alternative would you recommend for the timestamp accuracy of APAs?

<ESMA_QUESTION_CP_MIFID_143>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_143>

Q144. Do you agree with ESMA's proposal? Do you think that the CTP should identify the original APA collecting the information form the investment firm or the last source reporting it to the CTP? Please explain your rationale.

<ESMA_QUESTION_CP_MIFID_144>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_144>

Q145. Do you agree with the proposed draft RTS? Please indicate which are the main costs and benefits that you envisage in case of implementation of the proposal.

<ESMA_QUESTION_CP_MIFID_145>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_145>

Q146. Do you agree with the proposed draft RTS? Please indicate which are the main costs and benefits that you envisage in case of implementation of the proposal.

<ESMA_QUESTION_CP_MIFID_146>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_146>

Q147. With the exception of transaction with SIs, do you agree that the obligation to publish the transaction should always fall on the seller? Are there circumstances under which the buyer should be allowed to publish the transaction?

<ESMA_QUESTION_CP_MIFID_147>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_147>

Q148. Do you agree with the elements of the draft RTS that cover a CCP's ability to deny access? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_148>

For the most part, we agree. We have set out our proposed draft changes at the bottom of this section of our response. In line with the membership of FIA Europe, the responses to this consultation relate to derivatives, unless otherwise stated.

The main areas in which the views of FIA Europe's members differ from ESMA are as follows (all references to Recitals and Articles are to Recitals and Articles in RTS 24, unless otherwise stated):

1. We note that Recital (2) states that "**differences between financial and commodities and other non-financial derivatives have also to be taken into account**" but no further details are (nor are proposed to be) specified in the RTS. We propose some minor amendments to the drafting of Recital (2) below;

2. Contrary to Recital (7), we do not consider it the intent of the level 1 text to require, via these access provisions, that all CCPs in Europe be expected mandatorily agree to clear absolutely any and all forms of financial instruments, nor do we see a policy justification for such approach. With respect to derivatives, the level 1 text does not grant a sufficiently long enough time period to establish an access arrangement for **products outside of a CCP's current EMIR authorisation and/or that are not cleared by the CCP today**. However, a consensual extension by the CCP of its EMIR authorisation may be reasonable and achievable within the level 1 timeframes, with sufficient pre-planning;

3. **A CCP should be able to deny an access request in part, but not in whole,** if only part of that access request causes the recipient CCP a significant undue risk that it cannot manage;

4. We do not consider that **incompatibility of IT systems** is likely to be an issue in practice, even for smaller market infrastructure providers within the European Economic Area, given the number of third party vendors that offer solutions in this area already;

5. We do not consider that **incompatibility of trading venue and CCP rulebooks** is likely to be an issue in practice, given that the scenarios identified (use of different trade acceptance models and the risk that a CCP may not be able to enforce its rules relating to close out netting and default procedures) have already been identified as legal risks for a CCP to deny access. Further, rules are merely contractual documents that can be amended to grant an access request;

6. Parts of Article 4 would benefit from clarification that certain applicable risks cannot be managed despite the CCP and trading venue "**having made reasonable efforts in cooperation with the trading venue requesting access**";

7. Some FIA Europe members call for ESMA to consider that the **list of significant undue legal risks that cannot be adequately managed** that can be a ground for denial of access by a CCP should be an *open-ended* list. Conversely, other FIA Europe Members agree with ESMAs' proposals for a finite list; and

8. Some FIA Europe members consider that there is undue focus in the RTS on whether individual risks are significant and undue. CCPs take a holistic view of risk management – while individual risks may be of less significance, they can cumulatively amount to a significant risk for a CCP. EMIR and the CPMI-IOSCO PFMIs require CCPs to take an integrated and comprehensive view of all relevant risks.

   Conversely, other FIA Europe Members agree with ESMAs' proposals that there should be a limited list of grounds on which a CCP can deny access requests itself with the CCP's competent authority being tasked with taking a holistic view of whether the access request would compromise a CCP's risk management. Those other members consider that ESMA's proposals in this regard give effect to the legislative intention behind Articles 35 and 36, as set out in Recital 38 of MiFIR, to remove "commercial barriers that can be used to prevent competition in the clearing of financial instruments".

We set out more detail on each of these points in turn below and set out our proposed specific drafting changes to the relevant Articles and Recitals at the end of this section of our response that address these and other issues.

1. **<u>Differences in derivative instruments</u>**

We understand from the Financial Conduct Authority that ESMA does not intend to set out the ways in which the differences between various types of derivative instruments should be taken into account when considering an access request. We do not object to that approach, but suggest some minor changes to the drafting of recital (2) to clarify the intent of the provision.

2. **<u>Clearing products outside of a CCP's current EMIR authorisation categories and/or not currently cleared by the CCP</u>**

Contrary to Recital (7), we do not consider it the intent of the level 1 text to require, via these access provisions, that all CCPs in Europe be expected mandatorily agree to clear absolutely any and all forms of financial instruments, nor do we see a policy justification for such approach. With respect to derivatives (as opposed to cash equities), the level 1 text does not grant a sufficiently long enough time period to establish an access arrangement for products outside of a CCP's current EMIR authorisation. The same consideration applies to products included within a CCP's current EMIR authorisation, but not currently cleared (e.g. different country's interest rates futures, different types of commodities etc.). However, a consensual extension by the CCP of its EMIR authorisation may be reasonable and achievable within the level 1 timeframes, with sufficient pre-planning.

Further, we do not consider that the expectation that a CCP will clear whatever financial instruments a trading venue asks of it, even if such financial instruments fall outside of the CCP's existing EMIR authorisation categorisation, is prudent or technologically or operationally achievable within the 6 to 9 month time limits set down in the level 1 text.

Such proposals hugely underestimate the complexity of connecting two venues to one another and, in particular, the time it would take to ensure that products that are new to the CCP can operationally be cleared by it and prudently risk managed.

If a recipient CCP currently only clears one product (for example, metals) and as a result of these measures is required to clear a product that is outside of its EMIR authorisation (for example, interest rate swaps), it is foreseeable that achieving this may take longer than the 6-9 months permitted in the level 1 text. The same consideration applies to products included within a CCP’s current EMIR authorisation, but not currently cleared (e.g. different country’s interest rates futures, different types of commodities etc.).

Therefore, regarding derivatives clearing, it would be difficult in practice to comply, all within the short 6-9 months laid down by the level 1 text, with:

- CCPs hiring the relevant human resources, building the necessary IT systems, drafting (and have approved by its college) the CCP rulebook and setting up the applicable risk management systems; and

- trading members of the trading venue and clearing members of the CCP building the necessary IT systems; drafting, negotiating and executing with their clients such changes to their terms of business as may be necessary to support such access arrangement; setting up the applicable risk management systems; and updating their internal execution and clearing procedures and practices (including their best execution policies).

If ESMA were to mandate such an approach, they risk the recipient CCP *automatically* rejecting any such request immediately out of hand, on the basis of either Article 3(1) (*denial of access based on operational risk and complexity*) or Article 4(1)(c) (*significant undue legal risks that cannot be managed*).

Recent experience of a member exchange venue migrating from one derivatives CCP to another is that it can easily take 18-24 months to set up an access arrangement (i.e. much longer that is permitted by the level 1 text).

We do believe that any attraction exists for the trading venue in asking a CCP to clear a product that falls outside of its existing EMIR authorisation categories, given that the CCP will have no existing expertise in clearing such products.

The way the provision is currently phrased suggests that the CCP may only deny access on the basis of not being able to manage the risks of not having the correct EMIR authorisation. It is not clear to FIA Europe’s members how a CCP would be expected to manage the risks of undertaking activities for which it is not currently EMIR-authorised.

Given the above concerns, we propose that a new Article 1(4) be added to RTS 24, to make clear that a CCP may therefore elect to deny any access request that falls outside of its current EMIR authorisation.

The same logic also applies to requiring a CCP to clear a product that it does not currently clear, which is *within* its current EMIR authorization - given the breadth of underlying assets, this is particularly true of the "Commodities" EMIR authorization category: clearing of emissions and gas works fundamentally differently from the clearing of a copper contract".

A *consensual* extension by the CCP of its EMIR authorisation is reasonable, as in those circumstances it is likely in practice that the CCP will have carried out several months, or even years, of pre-planning, ahead of receiving the formal access request, to make the access request a reality within the 6-9 month timeframes laid down by level 1. We note that the implementation of access for physically settled contracts is inherently more complex (due to the need to also consider access to delivery mechanisms etc.) than for cash settled contracts and, accordingly, granting access to clear any physically settled contracts is likely to take significantly more time than for cash settled contracts.

3. **Partial denial of access**

A CCP should be able to partially grant or deny access, rather than the denial be "all or nothing". If a trading venue asks for access for 3 different types of financial instruments, but it is only possible to facilitate the clearing of 2 of them, the CCP should be able to agree to the access request for those 2 financial instruments whilst denying access for the third financial instrument that creates significant undue risks that cannot be managed.

4. **Incompatibility of IT systems**

Some of FIA Europe's members feel that Article 3(2)(a) gives undue weight to the risk of the IT systems of the trading venue and CCP being incompatible to such an extent that they give rise to risks that cannot be managed in due time.

Whilst acknowledging that ESMA needs to draft provisions that work for all 31 member states of the European Economic Area (and the market infrastructures within those member states), trading venues that are operating under MiFID and CCPs authorised under EMIR are technologically sophisticated entities that should be able to develop their connectivity protocols within a reasonable timeframe to facilitate access. Further, there are a number of third party vendors that specialise in providing such connectivity, so we do not anticipate this being an issue in practice, even for smaller market infrastructure providers within the EEA.

It is likely that the trading venue and CCP will, in practice, talk informally ahead of a formal access request being submitted pursuant to these provisions. Accordingly, any incompatibility of IT systems is likely to be identified as part of those informal discussions and work begun on resolving the issues even before the access request is submitted – to do otherwise would be imprudent on the requestors part, where the requestor knows or suspects that the IT systems of the two venues are currently incompatible, given the requestor will not want to give the receiving of the request a ground to deny access.

Nevertheless if, despite such discussions and potential available solutions, the IT systems remain incompatible such that they still give rise to significant undue risks that cannot be mitigated, then this remains a valid reason for rejection of access. Any workaround solution to achieve connectivity will has the potential to introduce additional operational risk. Given the importance of IT systems to the operations of a CCP or trading venue, the introduction of additional complexity and operational risk to the IT system must be carefully reviewed to ensure that the resilience of the IT systems is not compromised.

5. **Incompatibility of trading venue and CCP rulebooks**

We do not consider this to be a likely ground for denying access in practice, given the scenarios already identified by ESMA as legal risks that may justify a CCP denying an access request (use of different trade acceptance models and the risk that a CCP may not be able to enforce its rules relating to close-out netting and default procedures).

It is likely that the trading venue and CCP will, in practice, talk informally ahead of a formal access request being submitted pursuant to these provisions. Accordingly, any incompatibility of rulebooks is likely to be identified as part of those informal discussions and work begun on resolving the issues even before the access request is submitted – to do otherwise would be imprudent on the requestors part, where the requestor knows or suspects that the rulebooks of the two venues are currently incompatible, given the requestor will not want to give the receiving of the request a ground to deny access.

Nevertheless if, despite such discussions and potential available solutions, the rulebooks remain incompatible such that they still give rise to significant undue risks that cannot be mitigated, then this remains a valid reason for rejection of access.

6. **All reasonable efforts**

So as to ensure consistency with Article 1(2) and to support its application, we believe it would be helpful to clarify the drafting in Articles 4(1)(d) and 4(2) such that those grounds for denial of access only apply if the CCP has made "all reasonable efforts" to address such issues. It should also be incumbent on the trading venue to make "all reasonable efforts" to address such issues.

7. **Legal risks**

We do not believe that is the regulators' intentions that CCPs should be granting access in circumstances where to do so would expose them to significant undue legal risks that cannot be managed.

The effect of Article 4(2), as drafted by ESMA, is that only the two specific situations specified in Article 4(2)(i) and (ii) that give rise to legal risks would permit denial of access by a CCP.

Some FIA Europe members consider that *any* legal risks resulting from an access request that create significant undue risks for CCPs that cannot be managed should be a valid reason to deny access. There are two elements to this issue: firstly, the fact that the list proposed by ESMA in Article 4(2) only includes two specific legal risks (when many more are relevant) and secondly the interaction of these provisions with EMIR (which provides for other specific legal risks that the CCP must manage). In the view of these members, to only reflect the two situations specified in Article 4(2) means that all other instances of legal risk (including but not limited to those that are "significant undue legal risks" that cannot be adequately managed) must be accepted by the CCP, in specific contravention of EMIR and the CPMI-IOSCO PFMIs, which each require that CCPs specifically mitigate other forms of legal risk:

(a) Article 5(4) of RTS 153/2012 requires that a CCP "shall identify and analyse potential conflicts of law issues and develop rules and procedures to mitigate legal risk resulting from such issues".

(b) the same example as given in footnote 12 for EMIR is found in EN 3.1.11 of the PFMIs.

We propose that a reference to non-compliance with EMIR or equivalent third country regulation (by which we most obviously mean the US Dodd-Frank Act) should be added to the list of illustrative legal risks in Article 4(2). The reference to Dodd-Frank is most relevant to those EU-based CCPs that are registered as DCOs in the US.

Accordingly, such members consider that whilst it is appropriate to provide an illustrative list of significant undue legal risks in Article 4(2), the list *should not be exhaustive*. In the event that ESMA agree, we suggest that the opening paragraph of Article 4(2) be amended to read: "A CCP may refuse an access request in whole or in part based on legal risk as referred to in subparagraph (~~c~~d) of the previous paragraph. Such legal risks include, but are not limited to, situations where, as a result of granting access and having made reasonable efforts in conjunction with the trading venue, the CCP: …".

Other FIA Europe members are supportive of ESMA's proposal to narrowly define the range of legal risks for which a CCP may decide to deny an access request and consider it to be in line with the intention in the Level 1 text (set out in Recital 38) to remove commercial barriers that can be used to prevent competition in the clearing of financial instruments. Those members consider that the range of legal risks should not be made exhaustive given that the national competent authority already has a very wide scope to deny an access request under Article 7. To the extent the CCP is concerned about legal risks not within Article 4(2), it will be able to advocate to its national competent authority to deny the access request. In this regard, the interests of the national competent authority and the CCP are aligned as a national competent authority will not wish to introduce an unmanageable legal risk to a critical and systemically important element of the market infrastructure it supervises. Additionally, those members consider that the national competent authority's involvement in a decision relating to legal risk will ensure that trading venues that were denied access will have greater confidence that no other factors were weighed in the denial decision.

8. **Significant undue risks**

We note that ESMA has been tasked with specifying the conditions under which an access request may be denied by a CCP, *including* where there are significant undue risks that cannot be adequately managed. We query whether ESMA's approach of stating that access can be denied *only* where there are significant undue risks that cannot be adequately managed is in line with the mandate given to ESMA under Article 35(6)(a) of MiFIR.

Some FIA Europe members consider that there is undue focus in the RTS on whether individual risks are significant and undue. CCPs take a holistic view of risk management – while individual risks may be of less significance, they can cumulatively amount to a significant risk for a CCP. EMIR and the CPMI-IOSCO PFMIs require CCPs to take an integrated and comprehensive view of all relevant risks.

Conversely, other FIA Europe Members agree with ESMAs' proposals that there should be a limited list of grounds on which a CCP can deny access requests itself with the CCP's competent authority being tasked with taking a holistic view of whether the access request would compromise a CCP's risk management. Those other members consider that ESMA's proposals in this regard give effect to the legislative intention behind Articles 35 and 36, as set out in Recital 38 of MiFIR, to remove "commercial barriers that can be used to prevent competition in the clearing of financial instruments".

9. Proposed drafting changes

Recital (2)

(2) Articles 35 and 36 of Regulation (EU) 600/2014 mandate granting access in relation to financial instruments. The application of the requirements in this Regulation has to take into account the differences resulting from the whole spectrum of different financial instruments. For example, managing risks in relation to derivatives may be more complex and challenging than in relation to securities. The differences between financial and commodities and other non-financial derivatives ~~have~~ should also to be taken into account when considering an access request.

Recital (7)

(7) When a trading venue requests access to a CCP concerning instruments currently not ~~covered under the CCP's authorisation~~ cleared by the CCP and the CCP does not deny the access request, the latter should launch a clearing service for such instruments (unless one of the grounds set out herein permits the denial of access), including where necessary requesting an extension of its authorisation to the competent authority of the Member State where it is established, which should in turn immediately transmit all information received from the applicant CCP to the college of the CCP. The relevant competent authority should duly consider the opinion of the college on the extension of authorisation according to Regulation (EU) No. 648/2012.

Article 1

Title 1
Non-discriminatory access to ~~ccps~~ CCPs and trading venues

Section 1
Denial of access by a CCP or a trading venue

Article 1
Common conditions on the denial of access by a CCP or a trading venue

(1) Upon receipt of an access request pursuant to Article 35 or 36 of Regulation (EU) No 600/2014, a~~A~~ CCP ~~and~~ or a trading venue, as applicable,

shall assess whether granting access will create any of the risks specified in Articles 2 to 6 and make arrangements to manage any risk identified.

(2) Subject to Article 1(4), a ~~A~~ CCP ~~and~~or a trading venue may deny such access only if, after making all reasonable efforts to manage its risks in accordance with previous paragraph, there remain significant undue risks that cannot be managed.

(3) Subject to Article 1(4), if ~~If~~ a CCP or trading venue denies access, it shall identify which risks specified in Articles 2 to 6 would result from granting access and why those risks cannot be managed.

(4) A CCP shall be entitled to deny an access request if the granting of such access would require an extension of the scope of contracts covered by the CCP's initial or subsequent authorisation under Regulation (EU) No. 648/2012.

Article 2

Part I

Conditions under which a CCP may deny an access request

Article 2

Denial of access based on the anticipated volume of transactions

A CCP may deny an access request in whole or in part on grounds of the anticipated volume of transactions only when the reasonably anticipated volume of transactions arising from such access would create significant undue risks by:

(a) exceeding the scalable design of the CCP to such an extent that the CCP cannot reasonably adapt its systems so as to deal with the anticipated volume in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought; or

(b) exceeding the planned capacity of the CCP in a way that the CCP would not reasonably be able to acquire the required extra capacity ~~in due time~~ in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought.

Article 3

Article 3

Denial of access based on operational risk and complexity

1. A CCP may deny an access request in whole or in part on grounds of operational risk and complexity arising from such access only when it cannot adopt arrangements to adequately manage those risks such that there would be significant undue risk remaining.

2. For the purposes of the previous paragraph, relevant types of risks are, among others:

(a) Incompatibility of CCP and trading venue IT systems such that the CCP cannot provide for connectivity between the systems;

(b) that the CCP does not have, nor is it able to ~~get~~procure, at reasonable cost in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought ~~in due time~~, the necessary human resources with the necessary knowledge, skills and experience to perform its functions regarding the risk stemming from additional financial instruments where these differ from financial instruments already cleared by the CCP.

Article 4

Article 4

Denial of access based on other factors creating significant undue risks

1. In addition to the circumstances identified in Articles 2 and 3 of this Regulation, a CCP may deny an access request in whole or in part, only when it cannot adopt arrangements to adequately manage any of the following risks arising from granting access such that there would be significant undue risk remaining:

    (a) the CCP does not currently clear contracts of the type for which access is being requested and would be unable to launch a clearing service in the necessary timescales;

    (b) the CCP does not have, nor is it able to ~~get~~ procure in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought, the necessary authorisations consistent with meeting the relevant requirements set out in Title IV of Regulation (EU) No 648/2012 regarding the financial instruments in question;

    (~~b~~c) granting access would threaten the economic viability of the CCP or its ability to meet minimum capital requirements under Article 16 of Regulation (EU) No 648/2012;

    (~~c~~d) legal risks; or

    (~~d~~e) there is an incompatibility of CCP and trading venue rules that the CCP cannot remedy in cooperation with the trading venue, having made all reasonable efforts.

2. A CCP may refuse an access request in whole or in part based on legal risk as referred to in subparagraph (~~c~~d) of the previous paragraph~~,~~ where, as a result of granting access and having made reasonable efforts in conjunction with the trading venue, the CCP:

    (a) would not be able to enforce its rules relating to close out netting and default procedures; ~~or~~

    (b) cannot manage the risks arising from the simultaneous use of different trade acceptance models~~.~~; or

    (c) would cease to be in compliance with its obligations under Regulation (EU) No 648/2012 or, if applicable, equivalent third country regulation.

<ESMA_QUESTION_CP_MIFID_148>

Q149. Do you agree with the elements of the draft RTS that cover a trading venue's ability to deny access? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_149>

We agree with ESMA that it is appropriate to specify fewer grounds for a trading venue to deny access to a CCP, given the number of significant undue risks are likely to be fewer.

We have set out our proposed draft changes at the bottom of this section of our response.

In summary:

1. A trading venue should be able to deny an access request in part.

2. Certain legal risks should be another ground for denial of access by a trading venue.

3. As with our comments regarding CCPs denying access:

   (a) some FIA Europe members consider that there is undue focus in the RTS on whether individual risks are significant and undue. Trading venues take a holistic view of risk management – while individual risks may be of less significance, they can cumulatively amount to a significant risk for a trading venue. Conversely, other FIA Europe members agree with ESMA's proposals; and

   (b) the drafting should clarify that the necessary arrangements cannot be adopted <u>in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought.</u>

1. **<u>Partial denial of access</u>**

A trading venue should be able to partially grant or deny access, rather than the denial be "all or nothing". If a CCP asks for access for 3 different types of financial instruments, but it is only possible to facilitate the trading of 2 of them, the trading venue should be able to agree to the access request for those 2 financial instruments whilst denying access for the third financial instrument that creates significant undue risks that cannot be managed.

2. **<u>Incompatibility of IT systems</u>**

This section of our response essentially mirrors our response above on Q148, but from a trading venue perspective.

Some of FIA Europe's members feel that Article 5(2) gives undue weight to the risk of the IT systems of the trading venue and CCP being incompatible to such an extent that they give rise to risks that cannot be managed in due time.

Whilst acknowledging that ESMA needs to draft provisions that work for all 31 member states of the European Economic Area (and the market infrastructures within those member states), trading venues that are operating under MiFID and CCPs authorised under EMIR are technologically sophisticated entities that should be able to develop their connectivity protocols within a reasonable timeframe to facilitate access. Further, there are a number of third party vendors that specialise in providing such connectivity.

It is likely that the trading venue and CCP will, in practice, talk informally ahead of a formal access request being submitted pursuant to these provisions. Accordingly, any incompatibility of IT systems is likely to be identified as part of those informal discussions and work begun on resolving the issues even before the access request is submitted – to do otherwise would be imprudent on the requestors part, where the requestor knows or suspects that the IT systems of the two venues are currently incompatible, given the requestor will not want to give the receiving of the request a ground to deny access.

Nevertheless if, despite such discussions and potential available solutions, the IT systems remain incompatible such that they still give rise to significant undue risks that cannot be mitigated, then this remains a valid reason for rejection of access. Any workaround solution to achieve connectivity has the potential to introduce additional operational risk. Given the importance of IT systems to the operations of a CCP or trading venue, the introduction of additional complexity and operational risk to the IT system must be carefully reviewed to ensure that the resilience of the IT systems is not compromised.

3. **Legal Risks**

Any venue (CCP or trading venue) should be able to deny access based upon legal risks: on grounds of systemic integrity and market stability, it is not appropriate for execution or clearing venues to be required to take on significant undue legal risks that cannot be managed. This has been reflected *for CCPs* in Article 4(1)(c), but also needs to be included in Article 6 *for trading venues*.

At a minimum, a trading venue must be able to deny access on legal grounds if the granting of access to a CCP would lead to significant undue risk that cannot be adequately managed due to different trade acceptance models or concerns relating to sanctions etc.

The current definitive list of grounds for rejection in Article 6(1) would not permit such a rejection by a trading venue on these grounds, but it would be clearly be appropriate for the trading venue to reject an access request in such circumstances – a mechanic in the drafting must be included to enable it to do so.

4. **Significant Undue Risks**

We note that ESMA has been tasked with specifying the conditions under which an access request may be denied by a CCP, *including* where there are significant undue risks that cannot be adequately managed. We query whether ESMA's approach of stating that access can be denied *only* where there are significant undue risks that cannot be adequately managed is in line with the mandate given to ESMA under Article 36(6)(a) of MiFIR.

Some FIA Europe members consider that there is undue focus in the RTS on whether individual risks are significant and undue. Trading venues take a holistic view of risk management – while individual risks may be of less significance, they can cumulatively amount to a significant risk for a trading venue. EMIR and the CPMI-IOSCO PFMIs require CCPs to take an integrated and comprehensive view of all relevant risks.

Conversely, other FIA Europe Members agree with ESMAs' proposals that there should be a limited list of grounds on which a trading venue can deny access requests itself with the trading venue's competent authority being tasked with taking a holistic view of whether the access request would compromise a trading venue's risk management. Those other members consider that ESMA's proposals in this regard give effect to the legislative intention behind Articles 35 and 36, as set out in Recital 38 of MiFIR, to remove "commercial barriers that can be used to prevent competition in the clearing of financial instruments".

5. **"In due time"**

This section of our response essentially mirrors our response above on Q148, but from a trading venue perspective.
As with our response to Question 148 with respect to CCPs, the key point is that these issues cannot be mitigated in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought.

6. **Proposed drafting changes**

Article 5

Part II

Conditions under which a Trading Venue may deny an access request

Article 5

Denial of access based on operational risk and complexity

1. A trading venue may deny an access request in whole or in part on the grounds of operational risk and complexity arising from such access only when it cannot having made reasonable efforts in co-operation with the CCP in time for the proposed start of clearing by the CCP of the financial instruments for which access is being sought. adopt arrangements to adequately manage those risks such that there would be significant undue risk remaining.

2. For the purposes of the previous paragraph, relevant types of relevant risk are, among others, the incompatibility of CCP and trading venue IT systems such that the trading venue cannot provide for connectivity between the systems.

Article 6

Denial of access based on other factors creating significant undue risks

1. In addition to the circumstances identified in the previous article a trading venue may deny an access request in whole or in part only when it cannot in time for the proposed start of clearing by the CCP of the financial instruments for which

access is being sought, adopt arrangements to adequately manage any of the following risks arising from granting access such that there would be significant undue risk remaining:

(a) threat to the economic viability of the trading venue or its ability to meet minimum capital requirements under Article 47(1)(f) of Directive 2014/65/EU; ~~and~~

(b) incompatibility of trading venue and CCP rules that the trading venue cannot remedy in cooperation with the CCP; or

(c) legal risks.

2. For the purposes of paragraph 1(c), a trading venue may refuse an access request in whole or in part based on legal risk as referred to in subparagraph (c) of the previous paragraph where, as a result of granting access:

(a) the trading venue cannot manage the risks arising from the simultaneous use of different trade acceptance models; and

(b) the CCP requesting access not having in place arrangements that enable the trading venue to meet its obligations with respect to applicable sanctions regimes, anti-corruption legislation or other regulatory requirements.

<ESMA_QUESTION_CP_MIFID_149>

Q150. In particular, do you agree with ESMA's assessment that the inability to acquire the necessary human resources in due time should not have the same relevance for trading venues as it has regarding CCPs?

<ESMA_QUESTION_CP_MIFID_150>
Yes.
<ESMA_QUESTION_CP_MIFID_150>

Q151. Do you agree with the elements of the draft RTS that cover an CA's ability to deny access? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_151>
Broadly, we agree. We have set out our proposed draft changes at the bottom of this section of our response.

In summary:

1. MiFIR Article 35(4) (b) requires that the list of grounds for denial of access by a CA not be cumulative – any *individual* ground should entitle a CA to deny a request;

2. we recommend that a degree of objectivity be introduced to Article 7(a);

3. a CA must be able to deny access on grounds related to trading members, clearing members and their clients, even if a CCP is not granted such rights;

4. We request that ESMA clarify the intent behind the words "have a wider negative impact on the market"; and

5. We request that ESMA clarify the intent behind the words "legal obligations".

1. **Grounds for denial by a Competent Authority**

MiFIR Article 35(4)(b) requires that the list of grounds for denial of access by a CA not be cumulative: specifically, it states that "The competent authority of a CCP or that of the trading venue shall grant a trading venue access to a CCP only where such access…would not threaten the smooth and orderly functioning of the markets, in particular due to liquidity fragmentation, ***or*** would not adversely affect systemic risk.".

Accordingly, it is not open to ESMA to specify that the conditions in Article 7 of RTS 24 be cumulative in the manner proposed: by requiring all grounds for denial to also result in "significant undue risks…that would have a wider negative impact on the market", ESMA would change the "or" (highlighted immediately above) into an "and", which is contrary to the wording of the level 1 text.

To avoid conflation of the two separate limbs of MiFID Article 35(4)(b), ESMA should provide that any one of the grounds listed, on its own, should be sufficient grounds for the CA to deny access. These are all reasons for concern for a regulator.

2. **Article 7(a) – "unlikely to meet its legal obligations"**

We understand that the intent of this clause is to acknowledge that a venue can quickly go from being compliant to being non-compliant with its legal obligations.
Members are concerned by the lack of objectivity regarding the use of the word "unlikely" and therefore propose that a reasonableness test be introduced. We set out specific drafting below.

Secondly, we assume that ESMA is referring to a trading venue/CCP's "regulatory" obligations under relevant legislation and rules, including capital requirements and on-going compliance with authorisations and licenses, rather than *contractual* obligations. As drafted, it is not clear to what "legal obligations" is referring – clarification of this point is important, given that it is a ground to deny access.

3. **The interests of trading members, clearing members and their clients**

We strongly disagree with the suggestion that access arrangements are purely a bilateral matter for trading venues and CCPs. Trading members and clearing members need to update their IT systems, operational, legal and risk management practises within the same 6-9 month timeframes as the venues themselves. It is critical for systemic risk and market stability reasons that their interests also be a ground for denial of access. Trading members and clearing members may also have a more realistic assessment of the extent to which an access request is commercially compelling. An alternative approach, to avoid fears that such views could be used inappropriately by a CCP, is for the competent authority (rather than the

CCP itself) to be able to use this as a ground to deny access – if a regulator is satisfied that there is a significant undue risk relating to those who connect to or otherwise use the trading venue/CCP, then that should be sufficient on its own for a competent authority to deny access. We set out specific drafting below.

4. **"Wider negative impact on the market"**

We ask that ESMA clarify what it means by this phrase in Article 7(b) – what "negative impacts" are relevant and specifically which "market" is relevant?

5. **Proposed drafting changes**

Article 7

Section 2

Denial of access by a competent authority

Article 7

Conditions under which access will threaten the smooth and orderly functioning of markets or adversely affect systemic risk

(1) Granting access will threaten the smooth and orderly functioning of the markets or adversely affect systemic risk, apart from the situations identified in Regulation (EU) No 600/2014, where:

(a) one of the parties to the agreement is not meeting its legal obligations, or the competent authority reasonably determines that compliance with ~~would be unlikely to meet~~ its legal obligations as a consequence of granting access would be unlikely; or

(b) granting access would create significant undue risks for the CCP ~~or~~ , the trading venue, their respective members and clients of such members in a way that the competent authority reasonably determines would ~~may~~ have a wider negative impact on the market to the detriment of investors; ~~and~~

~~(c)~~ and, in either case, there is no remedial action that a party could take, in co-operation with the other party, which would allow the relevant party to meet its legal obligations with reasonable effort prior to the access arrangement being put in place according to Article 35(3) and 36(3) of Regulation (EU) No 600/2014.

(2) For the purposes of Article 7(1), "legal obligations" means the regulatory requirements applicable to the relevant party under applicable legislation and rules, including capital requirements and on-going compliance with regulatory authorisations and permissions.

<ESMA_QUESTION_CP_MIFID_151>

Q152. Do you agree with the elements of the draft RTS that cover the conditions under which access is granted? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_152>
Broadly, we agree with the proposals, subject to various drafting changes that we have set out our proposed draft changes at the bottom of this section of our response.

1. Article 8(1) would benefit from the following clarifications and additions:
   (a) The reference in Article 8(1)(c) to "transfer orders" should be clarified – we understand that ESMA intends that term to be construed in accordance with the Settlement Finality Directive;

   (b) Art 8(1)(e) **should be extended to cover market practices**, as well as relevant laws and regulations – neither party should be expected to derogate from widely accepted market practices as a condition to the access arrangement;

   (c) Art 8(1)(f)(i) should refer to the "**defaulting party**" rather than the "relevant party";

   (d) Art 8(1)(f)(ii) should be extended such that the access agreement is clear on **the impact of termination thereon on trades already cleared by the CCP** – this is clearly critical so as to ensure systematic integrity and market stability in the event of a termination of a key access arrangement;

   (e) **Terminating pursuant to Art 8(1)(f)(iv)** is a difficult decision to take in practice – to avoid a CCP capriciously seeking to terminate an access arrangement under this ground, the prior written consent of the competent authority of the CCP should be required;

   (f) A new Art 8(1)(f)(v) should be added to ensure that **the impact of sanctions, cyber-security breaches, changes in legislation and force majeure events should be catered for**. This is critically important, given the current EU-UE regulatory focus on cyber-security issues.

2. Article 8(2) would benefit from the following clarifications and additions:

   (a) The introductory provision in Article 8(2) refers to "*all* CCPs" but only refers to "*the* trading venue". It should cover **all trading venues and all CCPs** that are connected to one another.

3. Article 8(3) would benefit from the following:

   (a) The reference in Art 8(3)(a) to "**risk management standards**" would benefit from further clarification – the wording is very broad.

Proposed drafting changes

Title 2
Conditions under which access must be permitted

Article 8
Conditions under which access must be permitted

1. ~~All trading venues and all CCPs party~~ The relevant parties to an access arrangement in accordance with Articles 35 and 36 Regulation (EU) No 600/2014 shall agree on their respective rights and obligations, including the applicable law governing their relationships. The terms of the access arrangement shall:

(a) be clearly defined, transparent, valid and enforceable in all relevant jurisdictions;

(b) where applicable, specify how two or more CCPs with access to the same trading venue interact with one another;

(c) contain clear rules concerning the moment of entry of transfer orders (as such term is to be construed pursuant to EU Directive 98/26/EC, as amended by EU Directive 2009/44/EC) into relevant systems and the moment of irrevocability;

(d) not contain any provision that restricts or creates obstacles for the establishment or future extension of the access arrangement to other entities, other than on duly justified risk grounds;

(e) not impact on the compliance by the entities participating in the arrangement with the requirements to which they are subject under all relevant laws, regulations and market practices;

(f) contain rules regarding the termination of the access arrangements as a result of a breach of the terms thereof by any of the involved parties (unilateral termination upon notice not being permitted under any access arrangement), which should:

(i) be clear and transparent;

(ii) cater for termination in an orderly manner that does not unduly expose other entities that are part of the access arrangement to additional risks and cater for the impact of such termination on trades already cleared by the CCP, including clear and transparent arrangements for the management and orderly run-off of contracts and positions made under the access arrangements that were open at the point of termination;

(iii) ensure that termination is not triggered by minor breaches of the contract and that the defaulting ~~relevant~~ party is given a reasonable amount of time to remedy any breach that does not give rise to immediate termination;

(iv) allow the termination if risks increase in a way that would have justified denial of access in the first instance, subject to the prior written consent of the competent authority of the CCP;

(v) cater for the impact of sanctions, cyber-security breaches, changes in legislation and force majeure events;

(g) specify the contracts being subject to the access arrangement;

(h) specify the cover of the one-off and ongoing costs triggered by the access request; and

(i) cater appropriately for claims and liabilities stemming from the access arrangements.

2. The terms shall require that the trading venues and ~~all~~ CCPs party to the access arrangement put in place adequate policies, procedures and systems to ensure:

(a) timely, reliable and secure communication between the relevant entities;

(b) consultation where any change to ~~either~~ any such entity's operations is likely to have a material impact on the access arrangement or the risks to which the other entity is exposed;

(c) timely notification to the relevant party before a change is implemented, where the impact of a change is unlikely to be significant;

(d) resolution of disputes;

(e) identification, monitoring and management of the potential risks arising from the access arrangement;

(f) reception by the trading venue of relevant information in order to be able to fulfil ~~its~~ the trading venue's obligations regarding the monitoring of open interest, as appropriate; and

(g) acceptance by the CCP of delivery of physically settled commodities, if and as appropriate.

3. The relevant parties to the access arrangement shall ensure that:

(a) risk management standards are not adversely affected by granting access, in the judgment of the CCP's Risk Committee and the applicable competent authorities pursuant to the procedures referred to in Article 49 of Regulation (EU) No 648/2012;

(b) information provided in connection with the request for access, regardless of whether such information was provided during the applicable or following the granting of access, is kept up-to-date throughout the duration of the access arrangement, which includes an information about any material changes; and

(c) non-public and commercially sensitive information ~~including any information provided during the development phase of a financial instrument~~ is only to be used for the specific purpose for which it was conveyed ~~and~~, may only be acted upon for the specific purpose agreed by the entities and, unless otherwise agreed between the parties (or required in accordance with any legal or regulatory process), shall be kept confidential unless and until such information becomes public (other than by reason of the publication of such non-public or commercially sensitive information by the recipient thereof under the access arrangement).

<ESMA_QUESTION_CP_MIFID_152>

Q153. Do you agree with the elements of the draft RTS that cover fees? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_153>

Yes, save with respect to Article 9(1) and (2). We have set out our proposed draft changes at the bottom of this section of our response.

1. Articles 9(1) and 9(2) state that all clearing members (and in Article 9(1), where applicable, their clients) must be charged the same *schedule* of fees.

   We agree with the requirement whereby the same *schedule* of fees is to be used for all clearing members. Crucially, Article 35(6)(b) of MiFIR states that it is the fees *relating to access* (i.e. the access by one trading venue to the CCP rather than another) that must be non-discriminatory. That is not the same as saying that *all* fees charged to all clearing members must be the same in *all* circumstances.

   In short, the simple requirement is that the CCP cannot discriminate in its schedule of fees based upon the execution venue of the cleared trade.

   Volume discounts to clearing members are an illustration of the circumstances in which it may be appropriate for a CCP to charge different fees to different clearing members, *provided that* in the standardized schedule of fees it is made clear by the CCP precisely how a clearing member becomes eligible for such discounted fees as a result of the volume of financial instruments that it is clearing via that CCP service.

2. Article 9(4) be amended to clarify:

   (a) whether the fee schedules referred to in that Article must be publicly available (e.g. on the CCP's website) or whether it is sufficient to merely make them readily available to its members***;*** and

   (b) that the fees charged must be "capable of being determined precisely" rather than "predictable". We understand that what ESMA is driving at with the phase "that fees charged are predictable" is that ESMA want to ensure that the CCP makes sufficiently granular disclosure of fees so that a third party (e.g. a potential clearing member, or a trading venue seeking access, as applicable) can determine the *precise* amount of fees that will apply to it.

3. Article 10(1) be amended to clarify how "similar" financial instruments should be determined.

Proposed drafting changes

Article 9

Article 9

Non-discriminatory and transparent clearing fees charged by CCPs

1. A CCP shall only charge fees for clearing transactions executed on a trading venue to which it has granted access on the basis of objective criteria, applicable to all clearing members and, where relevant, clients. Fees shall not depend on the trading venue where the transaction takes place.

2. A CCP shall make all clearing members and, where relevant, clients subject to the same schedule of fees relating to access and rebates and not just a subset of them.

3. A CCP shall only charge fees to a trading venue in relation to access on the basis of objective criteria. The same fees and rebates shall apply for all trading venues accessing the CCP with regard to the same or similar financial instruments, regardless of the relationship with the CCP, unless a different basis can be objectively justified.

4. A CCP shall ensure that the fee schedules referred to in paragraphs 1, 2 and 3 are easily accessible to its members, adequately identified per service provided and sufficiently granular in order to ensure that fees charged are ~~predictable~~ ascertainable.

5. For the purpose of this Article, relevant fees are fees charged to cover both one-off and ongoing costs.

Article 10

Article 10

Non-discriminatory and transparent fees charged by trading venues

1. A trading venue shall only charge fees in relation to access on the basis of objective criteria. The same fees and rebates shall apply to all CCPs accessing the trading venue with regard to the same or similar financial instruments, unless a different basis can be objectively justified.

2. A trading venue shall ensure that the fee schedules referred to in paragraph 1 are easily accessible, adequately identified per service provided and sufficiently granular in order to ensure that the fees charged are ~~predictable~~ ascertainable.

3. This Article applies to all fees related to access, including those that are charged to cover one-off and ongoing costs.

<ESMA_QUESTION_CP_MIFID_153>

Q154. Do you agree with the proposed draft RTS? Please indicate which are the main costs and benefits that do you envisage in case of implementation of the proposal.

<ESMA_QUESTION_CP_MIFID_154>
We understand that this question is limited to Articles 11-13 of RTS 24. ***We disagree with ESMA's proposals in these areas.*** We have set out our proposed draft changes at the bottom of this section of our response.

In our response of last summer to the Discussion Paper, we advocated in favour of only identical contracts being deemed economically equivalent. We understand and appreciate that ESMA are keen to ensure that CCPs do not avoid the intent of Articles 12 and 13 by making a small change to a contract term, such that they cease to be identical and therefore the margin and netting provisions of this RTS are evaded. Our revised proposals below seek to mitigate that concern.

1. Economic equivalence – with emphasis on *"economic"*

We disagree with the proposed RTS with respect to the breadth of how economic equivalence is proposed to be determined pursuant to Article 11(1) – we do not consider that the determination of economic equivalence by reference to EMIR authorisation categories was reasonably within the contemplation of the European Commission/Parliament/Council of Ministers during the trilogue process – had it been so, economic equivalence would have been defined by reference to EMIR authorisation categories in the level 1 text. The determination should be made on economic grounds, not by reference to regulatory constructs such as EMIR authorisation categories. The term "economically equivalent" is a widely understood concept in financial markets, albeit that there is no single widely accepted definition thereof.

The draft proposal does not attempt to consider whether financial instruments are or are not ***economically*** equivalent. The reasonable expectation of the European Commission/Parliament/Council of Ministers when requiring reference to economic equivalence in these provisions must surely have been that the level 2 text would contain a definition of economic equivalence based on objectively demonstrable, ***economic***, rationale - the fact that two contracts are in the same EMIR category is not an *economic* assessment, it is merely a legal one, based on the regulatory construct of EMIR.

We further note that the definition of "economically equivalent" in Article 11 of RTS 24 and the discussion in recital (11) to not match the statement made by ESMA in paragraph 4.3.72 of the Consultation Paper that it the *CCPs* should have discretion to determine economic equivalence. We note that it would also be desirable to have a certain minimum degree of harmonisation in the EU regarding the determination of economic equivalence of contracts for netting, so such definition from ESMA would be useful. FIA Europe's amendments seek to achieve this outcome.

2. **FIA Europe's recommendation for another way to determine economic equivalence, based on ESMA precedent text under EMIR**

We encourage ESMA to look favorably upon our recommendation for an alternative approach – we recommend that ESMA determine economic equivalence along the lines of the precedent already set by ESMA/the European Commission under EMIR through Article

27(1) of Commission Delegated Regulation No. 153/2013 (which relates to cross-product margining at CCPs and is referred to in Article 13 of RTS 24), such that _economic equivalence means that the two instruments being compared are "significantly and reliably correlated, or based on equivalent statistical parameters of dependence, with the price risk of one another"._

To ensure a sufficiently high degree of correlation, we suggest that "significantly" be construed such that the price risk of the two instruments being compared are at least 90% correlated over the given period. We do not consider that the assessment period over which one determines such correlation needs to be defined in the regulation – it should be sufficient that whatever time period is chosen, that 90%+ correlation proves "reliable". Regarding new products, we suggest a simulation of pricing be undertaken in order to determine the likely levels of correlation.

This proposal would then tie-in Articles 11 and 12 of RTS 24 with Article 13 of RTS 24, which already refers to Article 27 of that Commission Delegated Regulation.

As with Article 27(2) of that Commission Delegated Regulation, ESMA may also consider stating that such correlation or an equivalence statistical parameter of dependence, between two or more financial instruments cleared should be shown to be reliable over the applicable lookback period and demonstrates resilience during stressed hypothetical scenarios.

If ESMA does not agree with the 90% figure proposed above, we nonetheless ask that ESMA does not also reject our core suggestion that economic equivalence be determined by reference to significant and reliably correlated price risks. The 90% figure can be refined if needs be, whilst keeping the correlation test.

3. **Collateral and margining requirements**

We consider that there has been unnecessary emphasis on Article 11(2) and as a result the requirements of MiFIR Article 35(6)(e) have not been reflected in the draft RTS. In its proposals, ESMA suggests that _the same_ collateral requirements and margin methodologies must be applied to economically equivalent contracts. Crucially, that is not what the level 1 text says: Article 35(6)(e) of MiFIR states that "ESMA shall develop draft regulatory technical standards to specify…the conditions for _non-discriminatory treatment_ in terms of how contracts traded on that trading venue are treated in terms of collateral requirements…of economically equivalent contracts".

The focus in the level 1 text is therefore on the collateral/margining treatment being "non-discriminatory", i.e. the CCP must not discriminate against one trading venue in favour of another. That is *very* different from saying that the way it treats the contracts traded on each trading venue for which it clears must be the *same*.

Two simple examples of where a difference of an approach may be appropriate are:

(a) a CCP that clears a deliverable commodities contract may receive an access request to clear a contract with a very similar specification, except for the method of settlement, e.g. that it would be cash settled rather than physically settled. The collateral and margin requirements would not be the same – specifically, they would differ insofar as the collateral and margin requirements relating to the delivery process are non-discriminatory, i.e. the same collateral and margin levels prior to entry of the settlement/delivery mechanism, with different requirements thereafter; and

(b) a CCP that clears a DAX futures contract may receive an access request to clear a very similar contract, but with half the notional size (a "DAX Mini"). It would be inappropriate for the CCP to charge the *same* margin – it should instead be stipulated that the CCP's margin requirements should be non-discriminatory, e.g. half the margin level of the DAX futures contract.

The key thing the CCP must ensure is simply that if it does margin/collateralize contracts traded on two different trading venues in different ways, such difference must not be *discriminatory*.

Requiring the *same* collateral treatment of economically equivalent contracts goes further than the level 1 text.

FIA Europe's members consider that not only should such margin and collateral methodologies be non-discriminatory, but they should also be transparent.

4. **Netting of economically equivalent contracts**

(a) As with Article 11(2), we do not believe that the requirements of MiFIR Article 35(6)(e) have been accurately reflected in Article 12(1) of RTS 24. In its proposals, ESMA suggests that economically equivalent contracts *must* be netted, unless such process is legally unenforceable. Crucially, that is not what the level 1 text says: Article 35(6)(e) of MiFIR states that "ESMA shall develop draft regulatory technical standards to specify…the conditions for *non-discriminatory treatment* in terms of how contracts traded on that trading venue are treated in terms of…netting of economically equivalent contracts".

The focus in the level 1 text is therefore on the netting process being "non-discriminatory", i.e. the CCP must not discriminate against one trading venue in favour of another. That is very different from saying that the way a CCP nets the contracts traded on each trading venue for which it clears must be the *same*. The key thing the CCP must ensure is simply that when applying netting to economically equivalent contracts, it must not be *discriminatory*.

Netting should only be required where it is enforceable (in the case of close-out netting) for regulatory capital purposes under CRDIV/CRR and (in the case of payment netting and close-out netting for balance sheet netting purposes) under IAS 32. This mirrors the level 1 text requirement in MiFIR Article 35(1)(a) for non-discriminatory netting procedures of a CCP "*based on the applicable insolvency law*".

CRD IV/CRR and IAS 32 netting opinions both have to consider the enforceability of close out netting pursuant to applicable insolvency law:

(i) in the case of CRD IV/CRR opinions, in order to receive a positive opinion, close out netting must be confirmed as being valid, binding and enforceable on the default (including but not limited to insolvency) of your *counterparty*; and

(ii) in the case of IAS 32 opinions, they go further in that in order to receive a positive opinion for balance sheet netting purposes:

(x) close out netting must be confirmed as being valid, binding and enforceable upon the default (including but not limited to insolvency) of *either* party; *and*

(y) pre-default payment netting must be valid, binding and enforceable.

Examples of when use of different netting techniques could be considered non-discriminatory include the two examples given above with respect to collateralization methodologies (DAX mini contracts and cash vs. physically settled contracts).
FIA Europe's members consider that not only should such netting processes be non-discriminatory, but they should also be transparent.

(b) Article 12(2) should be amended to provide the maximum amount of netting available – it is possible that one form of netting is legally enforceable (e.g. close out netting) whilst another (e.g. pre-default payment netting) is not – it is also possible that the extent of availability of different types of netting vary by product in certain jurisdictions. We assume ESMA would want CCPs to be able to provide such netting as is available.

(c) ESMA's proposed drafting of Article 12(3) is misleading in its suggestion that only economically equivalent contracts *excluded* from netting would be subject to the review of the Risk Committee and the Article 49 EMIR procedure. The drafting of Article 12(3) has the wrong emphasis: *regardless* of whether or not a given contract is netted or not netted with other contracts by such CCP, and *regardless* of whether such contracts are or are not economically equivalent, the netting process of the CCP will be subject to the review of the CCP's Risk Committee and the Article 49 EMIR procedure in the event of significant changes thereto. This Article 12(3) should merely be a "for the avoidance of doubt"-style statement of that fact.

5. **Basis risk**

We are not aware of the term "basis risk" being defined in any primary or secondary EU legislation and respectfully suggest that it is best not to seek to do so.

We note the reference to "basis risk" in Article 12(2) and its proposed definition in Article 12(4). We do not consider that the proposed definition fully and accurately captures all the ingredients that go into the concept of basis risk – rather than seek to define the concept and risk missing the key point that ESMA is looking to capture, we suggest that Article 12(2) retain the reference to "basis risk" but that such term not be defined (accordingly, the proposed Article 12(4) should be deleted).

6. Cross-margining of correlated contracts

As with Article 12 of RTS 24, we do not believe that Article 13 accurately reflects Article 35(6)(e) of MiFIR. The requirement is for cross-margining to be *non-discriminatory*.

7. Proposed drafting changes

Recital 11

(11) Pursuant to Regulation (EU) No. 648/2012, a CCP wishing to extend its business to additional services or activities not covered by the initial authorisation should submit a request for an extension of authorisation. An extension of authorisation is needed where a CCP intends to offer clearing services on financial instruments with a different risk profile or that have material differences from the CCP's existing product set. ~~When a contract traded on a trading venue to which a CCP has granted access is covered by the scope of the CCP's current authorisation, such a~~ A contract is to be considered as economically equivalent to the contracts already cleared by the CCP if such contracts are significantly and reliably correlated, or based on equivalent statistical parameter of dependence, with the price risk of other contracts cleared by such CCP.

Article 11

Title 3

Conditions for non-discriminatory treatment of contracts

Article 11

Non-discriminatory treatment of collateral methodologies and margining requirements of economically equivalent contracts

1. A CCP shall consider economically equivalent all contracts traded on the trading venue to which it has granted access~~, which are covered by the CCPs' initial authorisation referred to in Article 14 of Regulation (EU) No. 648/2012, or by any subsequent extension of authorisation referred to in Article 15 of Regulation (EU) No. 648/2012~~ if such contracts are significantly and reliably correlated, or based on equivalent statistical parameter of dependence, with the price risk of other contracts cleared by such CCP.

2. The CCP shall apply to economically equivalent contracts referred to in paragraph 1 non-discriminatory and transparent ~~the same~~ margin and collateral methodologies, irrespective of where the contracts are executed. A CCP may introduce changes to margin or collateral models or parameters regarding the clearing of economically equivalent contracts referred to in paragraph 1, in order to mitigate the respective risk factors of that trading venue or the contracts traded thereon. ~~These~~ Any ~~changes shall be considered as~~ significant changes to margin or collateral models or parameters that shall be subject to a review by the Risk Committee of the CCP and be subject to the review procedure referred to in Article 49 of Regulation (EU) No 648/2012.

3. For the purposes of Article 11(1) above, “significantly” means that the price risk of the two contracts being assessed is correlated by 90% or more.

Article 12

Article 12

Non-discriminatory treatment of ~~N~~netting of economically equivalent contracts

1. A CCP shall apply non-discriminatory netting processes to economically equivalent contracts referred to in paragraph 1 of Article 11~~ the same netting processes~~, irrespective of where the contracts were executed.~~,~~ A CCP shall not be required to net two contracts (whether or not such contracts are economically equivalent) unless ~~provided that~~ the applied netting process is valid, binding and enforceable in compliance with Directive 98/26/EC of the European Parliament ~~and~~; of the Council on settlement finality in payment and securities settlement systems; the relevant applicable insolvency laws; for regulatory capital purposes and, where applicable, balance sheet netting purposes.

2. Where the CCP considers that the legal risk or the basis risk related to ~~a~~the particular netting processes applied to an economically equivalent contract traded on different trading venues is not sufficiently mitigated, the CCP may exclude such contracts from ~~that~~ those particular netting processes.

3. ~~Where, in accordance with paragraph 2 above, a CCP excludes from netting economically equivalent contracts traded on different trading venues, this shall be considered as a significant change to its netting process that~~ Any significant changes to the netting processes applied by a CCP shall be subject to review by the Risk Committee of the CCP and be subject to the review procedure referred to in Article 49 of Regulation (EU) No 648/2012.

4. ~~For the purpose of this Article “basis risk” means the risk arising from less than perfectly correlated movements between two or more assets or contracts cleared by the CCP.~~Nothing in this Article 12 shall prevent a CCP from applying one or more of the remaining netting processes (or collateral or margining requirements under Article 11) to an economically equivalent contract where the CCP has determined under Article 12(2) to exclude such contracts from one particular netting process.

Article 13

Article 13

Non-discriminatory treatment of ~~C~~cross-margining of correlated contracts (Portfolio margining)

Where a CCP calculates margins with respect to portfolio margining of financial instruments in accordance with Article 41 of Regulation (EU) No 648/2012 and Article 27 of Regulation (EU) No 153/2013, the CCP shall act in a non-discriminatory manner when applying ~~apply~~ its portfolio margining approach to all relevant correlated contracts irrespective of where the contracts are executed.
<ESMA_QUESTION_CP_MIFID_154>

Q155. Do you agree with the elements of the draft RTS specified in Annex X that cover notification procedures? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_155>

Yes, we agree with such elements. We recommend the following amendments to address some questions that remain unaddressed in the current drafting:

1. Neither Article 15(1) of RTS 24 nor Article 39(5) of MiFIR specify how long the relevant competent authorities have to approve a transitional arrangement – if ESMA considers that it has views to clarify the same, we would welcome this issue being clarified in Article 15(1) of RTS 24.

2. We request that ESMA update Article 15(1) to confirm when and where details of the decision to approve/deny a request for approval of a transitional arrangement will be published, as such a decision impacts not only the CCP but also its clearing members and clients. The last sentence of the second paragraph of Article 35(5) of MiFIR is silent on this. Accordingly, as currently drafted, we know how quickly ESMA and the CCP college is notified by the relevant competent authorities of the decision, but do not know how quickly ESMA will publish that decision under Article 35(5) of MiFIR.

3. Article 12(2)(b) should be deleted as it is not necessary – ESMA already knows (and has made public on its website) the date of the CCP's authorisation or recognition, as set out in ESMA's public register.

<ESMA_QUESTION_CP_MIFID_155>

Q156. Do you agree with the elements of the draft RTS specified in [Annex X] that cover the calculation of notional amount? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_156>

We note that ESMA has the ability in Article 19(3) to interrupt the assessment period and that this could be used to defer the end of the assessment period indefinitely. To avoid market uncertainty resulting from an open-ended assessment period, we would welcome a long-stop date by which time the assessment period must end.

<ESMA_QUESTION_CP_MIFID_156>

Q157. Do you agree with the elements of the draft RTS that cover relevant benchmark information? If not, please explain why and, where possible, propose an alternative approach. In particular, how could information requirements reflect the different nature and characteristics of benchmarks?

<ESMA_QUESTION_CP_MIFID_157>

Broadly, we agree with the proposals. We have set out our proposed draft changes at the bottom of this section of our response.

We note that ESMA have not adopted our comment from last summer's Discussion Paper consultation that it is important to specify what recourse a trading venue or CCP has if the person with the proprietary rights in the benchmark refuses to provide to the trading venue/CCP such information as it reasonably considers necessary pursuant to Article 20(1). In order for an access arrangement to work, it may be necessary for a venue to obtain a licence – if the person with proprietary rights in the benchmark feels that there are no consequences if it fails to licence information reasonably requirement, then the intent of the provisions risk being frustrated.

Article 20(8) should be amended to state that the proprietary owner of the benchmark does not need to provide publicly available information, *provided that such information is reliable and provided in a timely manner*.

To ensure the rights of the proprietary owner of the benchmark are adequately protected, a new Article 20(9) should state that "A person with proprietary rights to a benchmark is not required to provide a trading venue or CCP with confidential information if such information is not already provided to users of the benchmark or where such information is not required for the purposes of execution or clearing."

Article 21(2)(b) should be extended to cover the weightings given to each constituent of the benchmark – this is a critical feature of any benchmark.

Article 21(2)(j) should be update to make clear that any material changes to the benchmark will be notified to the licensors *in advance*. It is manifestly in everyone's interest to minimise disruption by ensuring that any changes to the benchmark are notified to all users in sufficient time to update their systems accordingly.

So that the licensor has the contact details of the relevant persons running the benchmark, it is important that a new Article 21(2)(k) be added, to confirm that "the name and contact details of the operator of the benchmark" should be specified in the agreement and updated from time to time as applicable.

Proposed drafting changes

Article 20(8)

8. ~~If a~~ A person with proprietary rights to a benchmark ~~can show that certain information is available publicly or through other commercial means to a trading venue or CCP, provided such information is reliable and timely, it~~ does not need to supply that information through licensing to that trading venue or CCP~~:~~ if such person with proprietary rights can show that such information is available publicly or through other commercial means to a trading venue or CCP, provided such information is reliable and timely.

New Article 20(9)

9. A person with proprietary rights to a benchmark is not required to provide a trading venue or CCP with confidential information if such information is not already provided to users of the benchmark or where such information is not required for the purposes of execution or clearing.

Article 21(2)

2. In respect of composition and methodology, the information provided shall allow the trading venue or CCP to understand how each benchmark value is developed, the actual methodology used to make benchmark's values and the rationale for adopting a particular methodology. Subject to the provisions in Article 20 and unless such information is not needed for trading or clearing purposes, relevant information in respect of composition and methodology shall at least include:

(a) definitions of key terms;

(b) all criteria and procedures used to develop the benchmark, including input selection, the mix of inputs used to derive the benchmark, the procedures and practices that control the exercise of discretion, priority given to certain data types, the weightings of the benchmark's constituents, minimum data needed to determine a benchmark, any models or extrapolation methods, and the methodology used to determine the benchmark's value;

(c) the procedures used to calculate the benchmark in periods of market stress or disruption, or when inputs are temporarily unavailable, such as when inputs are suspended or closed;

(d) the hours during which the benchmark is calculated;

(e) the procedures which govern the benchmarks rebalancing methodology and the resulting weightings of the constituents of the benchmark;

(f) the procedures for dealing with error reports, including when a revision of a benchmark would be applicable;

(g) information regarding the frequency for any internal reviews and approvals of the composition and methodology. Where applicable, information regarding the procedures and frequency for external review of the composition and methodology;

(h) the circumstances and procedures under which the person with proprietary rights to that benchmark will consult with the trading venue or CCP that uses the benchmark, as appropriate;

(i) the identification of potential limitations of the benchmark, including its operation in illiquid or fragmented markets and the possible concentration of inputs;

(j) procedures for making changes to the composition and methodology~~;and~~, details of any change thereof and procedures for notifying the trading venue or CCP in advance of such changes; and

(k) the name and contact details of the operator of the benchmark.

<ESMA_QUESTION_CP_MIFID_157>

Q158. Do you agree with the elements of the draft RTS that cover licensing conditions? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_158>
Yes. We have the minor drafting comments and have set out our proposed draft changes at the bottom of this section of our response.

1. Article 22(4) should clarify that conditions shall be granted on an arms-length basis.

2. Article 22(7)(c) should be conformed to Article 22(7)(b) and should either say "both parties" (per Article 22(7)(b)) or Article 22(7)(b) should be amended to refer to "all parties";

3. We ask that ESMA clarify Article 22(7)(c) further by more clearly defining what is meant by a "fluid communication channel"

Proposed drafting changes

Article 22(4)

(4) The conditions shall be granted on arms-length, fair, reasonable and non-discriminatory terms. A person with proprietary rights to a benchmark shall set the same rights and obligations for the licensees within the same category, including where the person with proprietary rights to a benchmark and a trading venue or CCP are connected by close links. The person with proprietary rights to a benchmark shall ensure that the conditions for licensing agreements and the specific content of the agreement do not contain any provision that restricts or creates obstacles for the establishment or future extension of the access arrangement to other entities or mandate the use of a designated CCP, where derivatives constructed on the benchmark would have to be mandatorily cleared, or in any other way hinder the rights under Articles 35 and 36 of Regulation (EU) 600/2014.

Article 22(7)

7. The licensing agreement shall require that the person with proprietary rights to a benchmark and the trading venue or CCP put in place adequate policies, procedures and systems, including in relation to relevant conditions referred to in paragraph 5, to ensure:

(a) a prompt implementation of the service since its request according to a prearranged schedule;

(b) all information provided by both parties be kept up-to-date throughout the duration of the access arrangement, and that each party informs the other about any material changes, including information that could have a reputational impact;

(c) ~~a fluent~~ an agreed and established communication channel between both ~~all~~ parties that is timely, reliable and secure during the lifetime of the licence agreement;

(d) consultation where any change to either entity's operations is likely to have a material impact on the licence agreement or on the risks to which the other entity is exposed;

(e) the provision of information and the relevant instructions to transmit and use it through the technical means agreed;

(f) disclosure of any modifications to the technical means agreed to the trading venue or CCP as soon as possible before they are implemented;

(g) notification to the relevant party within a reasonable notice period before any change to either entity's operations is implemented, where the impact of a change is unlikely to be significant;

(h) the provision of up-to-date information to persons with proprietary rights to a benchmark regarding the dissemination, if redistribution is allowed, of information to clearing members of CCPs and participants of trading venues; and

(i) resolution of disputes and termination of the agreement occurs in an orderly manner according to the identified circumstances.

<ESMA_QUESTION_CP_MIFID_158>

Q159. Do you agree with the elements of the draft RTS that cover new benchmarks? If not, please explain why and, where possible, propose an alternative approach.

<ESMA_QUESTION_CP_MIFID_159>

As specified in our response last Summer, we recommend that an objective qualitative criterion also form a part of the assessment of novelty, such that a benchmark shall be considered new if it is "of a different quality or is perceived differently by market participants from existing benchmarks already in the market *and is treated as such*."

The existing comparative approach specified in the draft may be too narrow to capture all instances of novelty.

We also suggest the deletion of Article 23(2)(e): most benchmarks in a family will have the same or similar methodologies. Accordingly, methodologies are not determinative of novelty.

Proposed drafting changes

Deletion of Article 23(2)(e):

~~(e) The methodologies of each relevant benchmark are the same, or relatively similar.~~

New Article 23(2)(f)

(f) it is not of a different quality and is not perceived differently by market participants from existing benchmarks already in the market and is not treated as such.

<ESMA_QUESTION_CP_MIFID_159>

6. Requirements applying on and to trading venues

Q160. Do you agree with the attached draft technical standard on admission to trading?

<ESMA_QUESTION_CP_MIFID_160>
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Q161. In particular, do you agree with the arrangements proposed by ESMA for verifying compliance by issuers with obligations under Union law?

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Q162. Do you agree with the arrangements proposed by ESMA for facilitating access to information published under Union law for members and participants of a regulated market?

<ESMA_QUESTION_CP_MIFID_162>
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Q163. Do you agree with the proposed RTS? What and how should it be changed?

<ESMA_QUESTION_CP_MIFID_163>
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Q164. Do you agree with the approach of providing an exhaustive list of details that the MTF/OTF should fulfil?

<ESMA_QUESTION_CP_MIFID_164>
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Q165. Do you agree with the proposed list? Are there any other factors that should be considered?

<ESMA_QUESTION_CP_MIFID_165>
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Q166. Do you think that there should be one standard format to provide the information to the competent authority? Do you agree with the proposed format?

<ESMA_QUESTION_CP_MIFID_166>
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Q167. Do you think that there should be one standard format to notify to ESMA the authorisation of an investment firm or market operator as an MTF or an OTF? Do you agree with the proposed format?

<ESMA_QUESTION_CP_MIFID_167>
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7. Commodity derivatives

Q168. Do you agree with the approach suggested by ESMA in relation to the overall application of the thresholds? If you do not agree please provide reasons.

<ESMA_QUESTION_CP_MIFID_168>

1. Market impact

We are concerned about the macroeconomic impact that ESMA's proposals will have, if implemented. As ESMA itself acknowledges, there are a number of secondary effects on firms inaugurated into the scope of MiFID II, due to its interaction with other EU legislation (page 507 of the Consultation Paper). Further, ESMA has not been able to quantify the effects of the proposals as "no data is available to run a simulation with different threshold levels" (Annex A to the Consultation Paper, page 394). It is therefore difficult to predict with certainty the post-2017 landscape of commodity markets resulting from the interplay between the proposals and firms' strategic responses to them. This uncertainty poses a degree of risk to commodity markets, the wider economy and market participants, which some participants may manage by exiting EU markets.

ESMA's proposals would see the vast majority of commodity trading firms being regulated, subject them to detailed oversight by financial regulators and force them to comply with onerous and costly rules on licensing requirements, clearing, margining, capital and liquidity adequacy. These obligations trigger a cascade of material impacts on commodity markets, commodity consumers and the real economy, which may conflict with the European Commission EUR 315 billion investment plan (published on 26 November 2014: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014DC0903&from=EN) to create growth and jobs within the EU market. One of the main strands of the investment plan is to make Europe more attractive to investment and to remove regulatory bottlenecks.

However, the combination of (a) the proposed thresholds and capture of a wide range of market participants, including commercial business (e.g. suppliers in a group in which another entity exceeds one of the thresholds), (b) uncertainty around the calculation of capital employed for risk reducing transactions (please see our response to Question 175 and 181) and (c) the implementation timing issue raised in Question 182, may cause some commodity firms to exit the market or move outside of the EU. Such moves would lead to less liquidity in the EU market, which in turn means less competition based on fewer market participants, resulting in higher prices for end-consumers. This is not so much linked to having to obtain a MiFID II license but rather related to the additional consequences arising from a MiFID II authorisation. For example, MiFID II licensed commodity firms may be treated as financial counterparties under EMIR, resulting in them not being able to make use of the hedging exemption (whereas for the purposes of the threshold calculation, hedge transactions are deducted). They will have to apply minimum capital requirements to their business. Unlike financial institutions, commodity traders and energy companies do not have access to central bank liquidity to enable them to meet liquidity requirements that will be imposed under CRD IV as a result of such firms being covered by MiFID II.

Entities also likely to be captured by the currently proposed thresholds are those engaging in intermediary activities in the EU, i.e. those between producers of a commodity and the end-user. If MiFID II, and consequently EMIR and CRD IV, are applied to those firms, some of them are considering a move outside of the EU. We believe this is a risk to an efficient market because the intermediary market is important in the commodity space. Producers are using it to hedge their risks such as those arising from volatility in commodity prices, interest rates linked to the financing of their production and credit risk related to their customers. Intermediaries offer to take on a risk where, in what is very common, the producer and consumer do not have the same opinion on price and pricing methodology.

For example:

> Producer sells to bank, bank passes risk to other bank, other bank sells to intermediary, and intermediary sells to consumer. The transaction may be physical or financial, in whole or in part, but the end position is not held by a speculator.

In addition, producer and consumer negotiating directly could also lead to increased inflexibility for the consumer (e.g., the producer can dictate its terms and price as the consumer will have no intermediary source to buy from). One reason intermediaries exist and are required in the EU commodity market is that they offer risk management or pricing flexibility that a consumer or producer cannot otherwise obtain.

For example:

> A refiner wants to buy physical oil in 3 months' time at a fixed price today. It is very unlikely that a supplier will agree to sell a fixed price 3 months forward due to volatile commodity prices and the fact that three months are a long time in the oil business – for example, 3 months ago oil was at $86/bbl. As producer and consumer cannot lock in prices like that they will choose to deal at a floating price at time of delivery. Then they will have to go to the risk management providers to try and lock in sale/purchase prices and this is where intermediaries come into play.

If the intermediary and speculative commodity market is moving away from the EU based on regulatory and resulting capital constraints, then producers of commodities will encounter difficulties in hedging within EU Markets and market disruption may occur, which in turn may have a detrimental impact on liquidity in EU markets. It will also result in producing and manufacturing entities having to bear increased risks (price volatility, interest, currency risks and credit risks) and they will have to factor those risks into the prices of their products. As a result, prices of commodities such as electricity or gas or even food may rise substantially for end-consumers in the EU market.

We understand ESMA intends to capture all non-financial entities that are engaging in commodity derivatives for purposes other than hedging. However, outside of the hedging scope, market participants that may also be captured by MiFID II are consumers and producers, such as manufacturing companies who produce for the retail space (car manufacturers, food companies, farmers, just to name a few). In paragraph 38 on page 515 of the Consultation Paper, ESMA points out that transactions considered as reducing risks directly relating to commercial activity shall reduce the calculation of capital employed for eligible activity and the volume of trading activity. However, commercial activity itself may now be subject to MiFID II. This is the result of a combination of (a) the new scope and definitions of commodity derivatives in Annex I C6 and C7 to MiFID II as proposed in the Final Technical Advice issued by ESMA in December 2014, (b) the changes to Art. 38 of Commission Regulation (EC) No 1287/2006, particularly the deletion of the words "expressly stated ” from Art.38 (1)(a)(ii) and (iii) as proposed in the Final Technical Advice issued by ESMA in December 2014, and (c) the narrow definition of commercial purpose in Art. 38. Those changes may bring commercial supply contracts into the scope of MiFID II, for example, where a manufacturing company is entering into forward supply contracts for metal to ensure they can produce cars in a few months’ time, or a bakery chain buying forward grain to ensure supply of flour to produce their products. When setting the threshold levels, we encourage ESMA to take into account that those market participants may be captured by MiFID II.

In its Cost & Benefits Analysis (Annex B to the Consultation Paper), ESMA does not generally consider the impact of the draft RTS on persons using the exemption or denied the exemption. ESMA argues that as persons currently exempted from MiFID I do not have to notify national competent authorities, it cannot identify persons likely to use the exemption or otherwise be affected by the exemption. The analysis makes no reference at all to commodity producers or consumers transacting with persons using the exemption or denied the exemption. There is also no analysis of the impact of the proposed thresholds in section 7.1 of Annex B.

We also point out that market participants in financial derivatives other than commodities and emission allowances, for example equities derivatives, can make use of the exemption in Art. 2.1(d) for proprietary trading, irrespective of whether such trading is done as hedging or is purely speculative. We have difficulties understanding why commodities are treated differently from any other assets class and ask ESMA to provide some clarity.

Summary of potential market impact:

- *Conflict with European Commission policy and Capital Markets Union:* Removing liquidity from the commodity markets will lead to fewer market participants, less opportunities to hedge positions, resulting in higher risk levels, higher prices for end-consumers and loss of jobs within the EU market which will in turn harm the European Commission’s attempts to create jobs and growth pursuant to European Commission President Juncker’s investment plan.
- *Impact on the wholesale energy markets:* The potential impact may conflict with the political aims of the 3rd Energy Package and the Single European Energy Market. Illiquid wholesale markets reduce market competition and efficiency in the production and retail markets. Energy prices for consumers and industry will increase as a result. Increased risk, constrained investment capital and poor market price signals may also have an impact on investment, production and consumption decisions and weaken the security of energy supplies for consumers.
- *Liquidity:* Despite the need for increased liquidity in many European energy and commodity markets (e.g. as desired by Ofgem in the UK power market or as required to diversify supplies in the European Gas market) liquidity may dry out as a result of market participants relocating. A fall in liquidity will significantly increase the cost of risk management for commodities companies and massively reduce opportunities for commodity risk management by industrial customers.
- *Trading activity:* may, wherever possible, be routed via other international markets to avoid disproportionate licensing and capital costs. Trading may also migrate to purely bilateral, physical markets and products.

- *Relocation of capital:* Utilities may have to reallocate capital within their businesses to meet the capital and liquidity ratios for their trading unit. This will "trap" liquidity in the trading unit or force consolidation of asset (generation) businesses with trading businesses in order to utilise the liquidity. Consequently, this would see financial authorities regulating nuclear plants, coal plants and lignite mines etc. to oversee a minority trading business while simultaneously impacting the ability of commodity regulators' needs for effective business separation.
- *Small and medium sized firms:* Commodity firms may exit the market due to significant compliance and prudential capital and liquidity requirements. Larger firms may curtail or close their EU trading activity in the light of increased compliance and prudential capital costs.
- *Regulation:* Commodity markets are already regulated, transparent and subject to the same high standards of conduct and integrity under REMIT, EMIR and the Market Abuse regime.
- *Implementation issues:* As set out in more detail in our response to Question 182 below, low thresholds together with the need to have a MiFID II licence in place by 3rd January 2017, unless a firm can establish that they are below the thresholds, based on data which will only be available after 31 December 2016, our members are not aware of any market participant that can take the risk not to apply for a MiFID II licence. As a result, the currently proposed exemption will be of little practical use to market participants.

For our response on the threshold levels, we refer to Questions 173 and 179.

2. Access of third-country firms to ancillary exemption

Access of non EU-firms to EU markets is not harmonised under MiFID I. It is left to the discretion of a National Competent Authority, subject to their general obligations under EU laws and provided that national law does not result in more favourable treatment than that given to EU entities. The practical reality of this is that non-EU entities are currently subject to a regulatory regime that is fragmented in terms of access to EU markets.

RTS 28 Chapter I Article 1 (e) and Recital (9) seem to suggest that the ancillary exemption is only available to (a) EU entities and (b) third country entities with a branch in the EU. There is no basis to support an approach which discriminates against firms with no EU branch, and doing so could lead to local jurisdictional issues and an unintended shift in liquidity between markets. It is unclear if ESMA intentionally left out non-EU entities that do not have an EU branch or if this was unintended.

(1) In fact MiFIR Recitals (41)-(44) acknowledge the current issues and set the basis for the provisions of Part VIII in respect of the third country entity ("TCE") providing investment services or activities within the Union without a branch. Even when such services or activities are provided to eligible counterparties of per se professionals, an equivalence decision will be required as well as registration with ESMA and cooperation arrangements with the third country regulator. Given the likely time lapse until equivalence decisions can be made, the transitional provision in Article 54 is important in allowing TCFs to continue to provide services and activities in Member States, in accordance with national regimes until three years after the adoption by the Commission of a decision in relation to the relevant third country in accordance. However, the benefit of this will be destroyed unless such firms can in practice rely on

exemptions in Article 2 of MiFID II which are in principle applicable to them. As indicated above, TCEs must currently rely on exemptions to access EU Member States counterparties and clients, and those exemptions being a combination of MiFID I and/or national exemptions. However, TCEs which are not authorised in a MS and currently relying on Article 2(1)(i) or (k) to access that MS may wish to rely on Article 2(1)(j) of MiFID II from January 2017 until the transitional arrangements under Article 54 of MiFIR expires in relation to that firm's home country.

(2) There is a risk of a shift in liquidity. For example, if a TCE without a branch in an EU country trades with a German entity, such TCE would have to comply with German licensing law and obtain a MiFID authorisation. The TCE would not be able to apply for an exemption from MiFID II under ancillary activities. As a result, third country entities may move their trading activity and liquidity outside of EU, e.g. to Asian markets to avoid having to establish an EU branch in order to be able to make use of the ancillary exemption. Whilst our members recognise that ESMA wishes to reduce speculative trading on EU markets, the very low thresholds and the lack of availability of the ancillary exemption to third country entities without a branch in the EU increases the risk of EU and third country participants moving their trading activity (speculative as well as hedging) outside of the EU. Reduced liquidity and effectiveness of EU markets would be the result and EU exchanges in particular would struggle with the decreased levels of liquidity which we believe to be contrary to EU goals to promote growth and investment.

Recommendation: We recommend giving third country entities without a branch in the EU the opportunity to apply for the ancillary exemption:

RTS 28 Proposed drafting change **Recital (9)**
…If an entity situated in a third country undertakes ancillary activities in the European Union and wishes to benefit from the exemption it should make the notification to the competent authority of the Member State where its branch is situated, or, if it does not have a branch in a Member State, of the Member State in which the majority of its trading activity takes place.

RTS 28 Proposed drafting change **Article 1**
For the purpose of this Regulation the following definitions shall apply: (e) "relevant national competent authority" means the national competent authority of the jurisdiction of the place of incorporation of the person making use of the exemption under Article 2(1) (j) of Directive 2014/65/EU or the national competent authority of the Member State where its branch is situated or where its trading activity takes place if the person making use of that exemption is situated in a third country.

<ESMA_QUESTION_CP_MIFID_168>

Q169. Do you agree with ESMA's approach to include non-EU activities with regard to the scope of the main business?

<ESMA_QUESTION_CP_MIFID_169>
We are supportive of this approach.
<ESMA_QUESTION_CP_MIFID_169>

Q170. Do you consider the revised method of calculation for the first test (i.e. capital employed for ancillary activity relative to capital employed for main business) as being appropriate? Please provide reasons if you do not agree with the revised approach.

<ESMA_QUESTION_CP_MIFID_170>
The revised method is welcomed by our members, in particular the deduction of privileged transactions from the calculation of capital employed for the first test and from the trading activity for the second test.

It was noted that there is no definition for "capital employed" although there is a definition for "capital" in RTS 28.

Please note our comments on the definition of "capital" in response to Question 175.

We have some difficulty understanding what ESMA means by its description of the numerator at the end of page 513. It would appear from this description that whether capital employed for a particular transaction should be included or excluded depends on various permutations of whether the transaction was executed for a client, whether the client is a financial or non-financial, and whether the transaction was "intermediated" or "non-intermediated". Under such an approach, firms would have to set up various scenarios based on different combinations of the above factors to determine whether the capital employed for a particular transaction should be included or excluded. We do not believe such an extremely complex and resource-intensive approach is one that Article 2.1(j)(i) and Recital 25 in combination is intended to bring about. Rather, we consider that the exclusion of "persons who deal on own account when executing client orders" in Art 2.1(j) (i) is intended to mean that such persons are precluded from using exemption (j), and the Recital 25 scenario is meant to be an indicative, but not exclusive, scenario of when a person seeking to rely on exemption (j) can evidence that they are not "executing client orders".
<ESMA_QUESTION_CP_MIFID_170>

Q171. With regard to trading activity undertaken by a MiFID licensed subsidiary of the group, do you agree that this activity should be deducted from the ancillary activity (i.e. the numerator)?

<ESMA_QUESTION_CP_MIFID_171>
We agree with this approach.

We also consider that activity undertaken by a subsidiary of the group that can invoke any other MiFID II Article 2 exemption in its own right should also be deducted from the numerator.

We ask ESMA to consider a non-financial group who calculates that they employ (a) 4.5% of their capital for own account dealing in commodity derivatives, and (b) 0.6% for own account dealing in EUAs/EUA derivatives. Even if (b) is only for EU-ETS compliance purposes, and even if it was through a subsidiary that could invoke the MiFID 2.1(e) exemption in its own right, (b) does not qualify as privileged transactions under the (j) exemption. So the group as a whole is tipped over the threshold of 5% simply because of the marginal addition of trading conducted for EU-ETS compliance. As such the larger the carbon footprint of the emitting assets of the group, the higher the marginal contribution carbon compliance trading will make to the group's threshold position. This places groups operating "dirtier" assets at a disadvantage, which makes the (j) exemption a climate change tool as well as financial supervision tool, and should therefore be referred to climate-change policy-makers for consideration.

Recommendation: We urge ESMA to allow activity undertaken by subsidiaries of groups that can invoke other MiFID Article 2 exemptions to be deducted from the numerator.

RTS 28 Proposed drafting change **Recital 3**
The criteria for establishing when an activity is to be considered to be ancillary to the main business at a group level shall exclude privileged transactions, capital employed for trading activity undertaken by an entity of the group that holds a licence in accordance with Article 5 of Directive 2014/65/EU, and capital employed for any other activity exempt under Directive 2014/65/EU such as, without limitations, dealing in emission allowances in compliance with obligations under Directive 2003/87/EC (Article 2(1)(e) of Directive 2014/65/EU). Such privileged transactions include intra-group transactions as referred to in Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ~~53~~ that serve group-wide liquidity or risk management purposes; transactions in derivatives which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity and transactions in commodity derivatives, emission allowances entered into to fulfil obligations to provide liquidity on a trading venue where such obligations are required by regulatory authorities in accordance with Union law or national laws, regulations and administrative provisions, or by trading venues.,

RTS 28 Proposed drafting change **Article 3**
(1)…Capital employed for trading activity undertaken by an entity of the group that holds a license in accordance with Article 5 of Directive 2014/65/EU shall not be considered when calculating the capital employed for the eligible activity. Capital employed for trading activity undertaken by an entity of the group which is exempt under Directive 2014/65/EU such as, without limitations, dealing in emission allowances in compliance with obligations under Directive 2003/87/EC (Article 2(1)(e) of Directive 2014/65/EU) shall not be considered when calculating the capital employed for the eligible activity.

RTS 28 Proposed drafting change Article 4
(1)…The volume of trading activity undertaken by an entity of the group that holds a license in accordance with Article 5 of Directive 2014/65/EU shall not be considered when calculating the size of the trading in the eligible activity. Capital employed for trading activity undertaken by an entity of the group which is exempt under Directive 2014/65/EU such as, without limitations, dealing in emission allowances in compliance with obligations under Directive 2003/87/EC (Article 2(1) (e) of Directive 2014/65/EU) shall not be considered when calculating the capital employed for the eligible activity. The volume shall be measured using the gross notional value of contracts.

<ESMA_QUESTION_CP_MIFID_171>

Q172. ESMA suggests that in relation to the ancillary activity (numerator) the calculation should be done on the basis of the group rather than on the basis of the person. What are the advantages or disadvantages in relation to this approach? Do you think that it would be preferable to do the calculation on the basis of the person? Please provide reasons. (Please note that altering the suggested approach may also have an impact on the threshold suggested further below).

<ESMA_QUESTION_CP_MIFID_172>

Article 3(1) of the draft RTS calls for capital employed to be calculated as “the sum of capital employed…… by the group in the European Union”. For a group comprising of separate legal entities such as incorporated companies, capital would be held, and employed, by such entities. For such a group, we would read “capital employed…. by the group in the European Union” as capital employed by all the entities of the group which are incorporated or otherwise domiciled in a Member State of the European Union.

ESMA’s objective does not seem entirely clear with regards to the consequences of only one entity engaging in eligible activities within a group exceeding one of the thresholds. RTS 28 in its current form could be read to mean that, following a breach of the trading activity or capital test by one entity within a group, every other currently unregulated entity within such group will be required to obtain a MiFID II license, regardless of whether such other entities (a) are only engaging in privileged transactions, (b) are in the EU or a third country, or (c) where the entity is in a third country, whether that third country has been assessed as equivalent. A subsidiary of a group that only undertakes the activities permitted under the (j) exemption would still not be able to use the (j) exemption if the main business of the global group does not fulfil the ancillary criteria. The consequence would be that firms with affiliates whose only MiFID activity is to enter into intra-group transactions for the purposes of risk management, or a firm that undertakes only commercial non-MiFID activity, would have to obtain a licence for such affiliate and be subject to the full suite of regulation. This outcome seems disproportionate and could not have been intended by the co-legislators of MiFID II. Please see the below table as example.

Metals Group consisting of				
	Subsidiary A	Subsidiary B	Subsidiary C	Subsidiary D
Business Activity	• Mine extracting palladium • Sells extracted metal to B as well as the external market (often on a forward delivery basis) • Enters into intra-group transactions with C to manage its risks	• Manufacturing plant • Uses palladium bought from A and external sources to produce catalytic converters for car exhausts • Enters into intra-group transactions with C to manage its risks	• Risk management for the group • Enters into transactions with the external market to hedge exposure of A and B • Does **some speculation**	• Risk management for the group • Enters into transactions with the external market to hedge exposure of A and B (or E +F, being another mine and another manufacturing plant) • Does **some speculation**
Capital Employed for MiFID II activity on a **Person Level**	**4%** after deduction of intra-group as privileged transactions, based on physical metal forward sale contracts potentially falling under the new C7 if an OTF or other trading venue decides to offer a similar contract	**0%** after deduction of intra-group as privileged transactions	**10%**	**4%**
MiFID II licence	**Not required**	**Not required**	**Required**	**Not required**
Capital Employed test for MiFID II activity on a **Group Level** following deduction of risk reducing transactions	**8%**			
MiFID II licence	**Required**	**Required**	**Required**	**Required**

Recommendation: We recommend amending RTS 28 to clarify that only the person(s) exceeding the thresholds will need to be MiFID licensed, whereas MiFID II shall not apply to those entities in a group that are undertaking privileged or non-MiFID II activities. The level 1 text seems to support this as the exemption in Art. 2(1) (j) is available on a person rather than a group level

RTS 28 Proposed drafting change **Recital 6**
In relation to the first threshold determining the extent to which ancillary activity constitutes a minority of activities at a group level, the capital employed for carrying out the ancillary activity in the European Union relative to the capital employed for the main business should be considered…The ancillary activity should be determined by taking together all ancillary activities undertaken in the European Union on the basis of the group excluding privileged transactions in the European Union on the basis of the group. Capital employed for trading activity undertaken by a MiFID authorised entity of the group should be excluded when determining the ancillary activity. The capital employed for carrying out eligible activity should be calculated on the basis of unaudited balance sheets and financial statements. With regards to the capital employed for risk reducing transactions, such capital shall be calculated on the basis of working capital.

RTS 28 New proposed drafting **Article 1 (insert after paragraph (a))**
"in the EU" means, for a group comprising of separate legal entities, all entities in the group which are incorporated or otherwise domiciled in the European Union" and "trading activity undertaken in the European Union means, any trading activity subject to the reporting obligation under Article 9 of EMIR;

RTS 28 Proposed drafting change **Article 1**
iv. "main business" means the overall activity of a group, including activity undertaken

in third countries;

RTS 28 New proposed drafting
Article 3 (insert after paragraph 2)
(3) Directive 2014/65/EU shall only apply to such persons in the group that undertake eligible activities above the threshold that are not privileged transactions.

<ESMA_QUESTION_CP_MIFID_172>

Q173. Do you consider that a threshold of 5% in relation to the first test is appropriate? Please provide reasons and alternative proposals if you do not agree.

<ESMA_QUESTION_CP_MIFID_173>

FIA Europe has a broad membership, which means that for certain questions there are differing views – where that is the case, we have set out both points of view.

Some of our members note that MiFID II includes an exemption for commodity trading activity which is “ancillary” to a company’s main corporate business. The exemption was designed to avoid imposing the significant burden and cost of financial regulation on corporates for the sole reason of corporates using regulated financial markets. In defining ancillary activity, ESMA proposes that commodity trading activity will only be exempt if the capital employed in this activity stays below 5% of a company’s total capital employed and if a firm’s market share in individual European commodity markets stays below 0.5%. It is unclear, to some of our members, how ESMA arrived at a significantly lower figure since ESMA states in 7.1 (37) on page 515 of the Consultation Paper that the majority of respondents supported a threshold close to 50%. The mandate given to ESMA and as set out in Recital 20 to MiFID II states that only "dealing in financial instruments in a disproportionate manner" shall be compared with the level of investment in the main business.

Volatility in commodity prices and error margin

Some of our members point out that the very low threshold does not leave any room for calculation errors. A large number of commodity transactions are now considered commodity derivatives, therefore thresholds need to be adjusted to allow producers and non-financial entities to trade and continue their business.

Some of our members further point out that the proposed threshold levels do not cater for volatile commodity prices. Commodity prices are more volatile than prices in other markets, such as interest rates or currencies. This was evidenced just recently by a substantial drop in oil prices. Had the oil price spiked instead, then many commodity firms, which would not normally be caught by MiFID II because they are only trading commodities in an ancillary manner, would be caught by the low threshold as more capital will need to be employed to deal with volatile prices and participants will need to increase their risk management provisions.

We include below an example, where a firm may have a non-risk reducing Brent position with varying Brent prices (e.g. this could be a speculative position but equally so a position taken in relation to a supply contract with delivery to producers or consumers). This is a useful example given we have seen Brent drop from over $104 to below $50 in the last 5 months. Obviously a price drop can help the calculation of capital employed, but the reverse where Brent rises could just as easily occur.

	Brent = $50	Brent = $75	Brent = $100
Capital For MiFID Activity	$ 30,000,000	$ 45,000,000	$60,000,000
Global Capital of the Firm	$ 1,000,000,000	$1,000,000,000	$1,000,000,000
Percentage of Capital for MiFID Activity	3.00%	4.50%	6.00%

The above concern also exists where a firm's global capital is measured in one currency (i.e. Euro or GB, depending in which EU jurisdiction a firm is located) and the contracts such firm trades are in another (many commodity contracts are traded in USD). The simplified example below depicts this.

	GBP/USD = 1.40	GBP/USD = 1.50	GBP/USD = 1.60
Capital For MiFID Activity (contract traded in GBP)	£33,000,000	£33,000,000	£33,000,000
Capital For MiFID Activity (converted to USD)	$46,200,000	$49,500,000	$52,800,000
Global Capital of the Firm (measured in USD)	$ 1,000,000,000	$1,000,000,000	$1,000,000,000
Percentage of Capital for MiFID Activity	4.62%	4.95%	5.28%

When combining the two examples above, small movements against an entity in both a commodity price and FX rate could easily put someone in breach of the limit with no change in their activity/position.

Recommendation: Some of our members recommend that ESMA considers adopting fluid thresholds to be adapted to the market as and when more market data becomes available, starting with a higher threshold in 2017 that may be lowered over time, similar to the concept of the "step-down" approach adopted by the CTFC to allow markets and their participants to adapt and evolve at a more measured pace, and reduce the risk of large-scale market disruption, liquidity flight, and regulatory arbitrage.

Some members support ESMA's view that firms engaging in activities similar to regulated activities carried out by financial institutions should be regulated. However, those members recognise that a negative consequence of such regulation may be an adverse impact on liquidity, as set out in response to Question 168. Further, those members recognise that the capital treatment for financial institutions may not be appropriate for non-banking entities.

Other members prefer a fixed percentage rather than fluid thresholds, with a threshold of at least 15%. Those members are concerned that the current proposed threshold will not achieve a level playing field between financial and non-financial counterparties and state that imposing the same obligations on different types of businesses does not level the playing field; it simply makes the field unplayable.
<ESMA_QUESTION_CP_MIFID_173>

Q174. Do you agree with ESMA's intention to use an accounting capital measure?

<ESMA_QUESTION_CP_MIFID_174>
We agree with this approach.
<ESMA_QUESTION_CP_MIFID_174>

Q175. Do you agree that the term capital should encompass equity, current debt and non-current debt? If you see a need for further clarification of the term capital, please provide concrete suggestions.

<ESMA_QUESTION_CP_MIFID_175>
Some members have requested further clarity whether, when measuring capital employed for trading activities on the basis of the group for the purposes of calculating the threshold, margin payments will need to be added which could increase the capital figure substantially, especially considering rising margin costs.

The draft RTS defines "capital" as capital encompassing total equity, current debt and non-current debt as calculated from balance sheets and financial statements. It also calls for the monthly calculations to be performed. As firms generally only have their financial statements audited annually, we presume that the monthly calculations will not have to be performed on audited accounts.

The proposed definition does not take into account provisions. Commodity firms, particularly those in the energy sector, are required to have certain provisions in place, e.g. to cover costs for de-commissioning of an oil platform when it is no longer in use. Those costs form part of the business and should thus be taken into account in the definition of capital.

Whilst our membership supports the possibility to deduct capital employed for Privileged Transactions from the threshold calculations, we point out that the definition of capital in RTS 28 Chapter I Article 1 (d) cannot be used for this purpose, because, whilst by looking at the reporting under EMIR, it may be possible to determine which transactions are hedging transactions and thus privileged, it is not possible to calculate capital employed for such hedging transactions on the basis of "total equity, current debt and non-current debt as calculated from balance sheets and financial statements" as this amount is not visible when using those accounting terms.

Instead, some of our members propose to use a separate definition of "working capital" for the purposes of calculating capital employed for "risk reducing transactions" as defined in

RTS 28, Chapter 1, Article 1 paragraph (c) (ii). This calculation should be based on the aggregate of:

(i) Mark to market values for uncleared OTC risk reducing transactions;

(ii) Accounts receivables and accounts payables (netted) in respect of risk reducing transactions; and

(iii) Initial margin posted or received for exchange traded and/or cleared risk reducing transactions.

Recommendation: We recommend amending the definition of capital for the purposes of calculating capital employed for risk reducing transactions as set out above.

RTS 28 Proposed drafting change

Article 3

(1) For each person wishing to use the exemption in Art. 2(1)(j), the capital employed for carrying out the eligible activity shall be calculated by deducting from the sum of the capital employed for eligible activity by the group in the European Union the sum of the working capital employed for privileged transactions by the group ~~in the European Union~~…

RTS 28 Proposed drafting change

Article 1

For the purpose of this Regulation the following definitions shall apply:

(d)"capital" means capital encompassing total equity, provisions, current debt and non-current debt as calculated from unaudited balance sheets and financial statements;

<ESMA_QUESTION_CP_MIFID_175>

Q176. Do you agree with the proposal to use the gross notional value of contracts? Please provide reasons if you do not agree.

<ESMA_QUESTION_CP_MIFID_176>

We agree with this approach, provided that the gross notional value is used both as nominator and denominator. However, our members point out that whilst the notional amount is a reportable field under EMIR, the gross notional value is not. We ask ESMA to clarify how it will ensure that this data is available.

Some members also suggest that ESMA consider a test based on a fixed volume-based market size indicator as opposed to the current market share approach. This would make it easier for market participants to assess their position as they would need to consider only one 'moving' number, i.e. their own trading activity (numerator), while the overall market size value (denominator) is stable. Compared to using gross notional value, a volume-based approach displays the further advantage of being robust against swings in market size due to commodity price and exchange rate volatility, which may lead firms to fall on and off the exemption regime depending on these external factors.

<ESMA_QUESTION_CP_MIFID_176>

Q177. Do you agree that the calculation in relation to the size of the trading activity (numerator) should be done on the basis of the group rather than on the basis of the

person? (Please note that that altering the suggested approach may also have an impact on the threshold suggested further below)

<ESMA_QUESTION_CP_MIFID_177>

ESMA suggests in paragraph 61 on page 522 of the Consultation Paper that "the calculation for the size of the trading activity in the EU of the person seeking the exemption (numerator) and the size of the overall market activity in the relevant asset class in the EU (denominator) should be undertaken on the basis of TR data".

As the Trade Repositories would only contain data submitted by persons who are subject to the reporting obligation under Article 9 of EMIR, we concluded that, where Article 4(1) of the draft RTS calls for the size of the trading activity to be calculated as "the overall trading activity…… of the group in the European Union", this would comprise of trading activities of entities in the group which are subject to the reporting obligation under Article 9 of EMIR. On this basis, the calculation would be a group-wide calculation (much like with the EMIR calculation except that the scope would only include EU counterparties), and if the 0.5% threshold is breached, every entity in the group that undertakes eligible activities would have to take up a MiFID II licence, regardless of whether such other entities (a) are only engaging in privileged or non-MiFID transactions, (b) are in the EU or a third country, or (c) where the entity is in a third country, whether that third country has been assessed as equivalent. A subsidiary of a group that only undertakes the activities permitted under the (j) exemption would still not be able to use the (j) exemption if the main business of the global group does not fulfil the ancillary criteria. The consequence would be that firms with affiliates whose only MiFID II activity is to enter into intra-group transactions for the purposes of risk management, or a firm that undertakes only commercial non-MiFID activity, would have to obtain a licence for such affiliate and be subject to the full suite of regulation. Please see the below table as example:

	Metals Group consisting of			
	Subsidiary A	Subsidiary B	Subsidiary C	Subsidiary D
Business Activity	•Business consists of a mine extracting palladium and other metals • Sells extracted metal to B as well as the external market (often on a forward delivery basis) • Enters into intra-group transactions with C to manage its risks	• Manufacturing plant • Uses palladium bought from A and external sources to produce catalytic converters for car exhausts • Enters into intra-group transactions with C to manage its risks	• Risk management for the group • Enters into transactions with the external market to hedge exposure of A and B • Does **some speculation**	• Risk management for the group • Enters into transactions with the external market to hedge exposure of A and B (or E +F, being another mine and another manufacturing plant) • Does **some speculation**
Trading Activity on **Person Level** in metals compared with overall activity in EU following deduction of risk reducing transactions	**0.4%** after deduction of intra-group as privileged transactions, based on physical metal forward sale contracts potentially falling under the new C7 if an OTF or other trading venue decides to offer a similar contract	**0%** after deduction of intra-group as privileged transactions	**0.60%**	**0.40%**
MiFID II licence	**Not required**	**Not required**	**Required**	**Not required**
Trading Activity in metals on a **Group Level** compared with overall activity in EU following deduction of risk reducing transactions	**0.55%**			
MiFID II licence	**Required**	**Required**	**Required**	**Required**

This outcome seems disproportionate and conflicts with paragraph 32 on page 512 of the Consultation Paper which states that ESMA is of the view that a group is able to establish a subsidiary in which all MiFID II activities are bundled. In turn, this leads to the conclusion that other entities in the same group will not need to be licensed if they do not undertake MiFID II activity in excess of the threshold levels.

Recommendation: We recommend amending RTS 28 to state that only the person(s) exceeding the thresholds will need to be MiFID II licensed, whereas MiFID II shall not apply to those entities in a group that are undertaking privileged or non-MiFID II activities.

RTS 28 New proposed drafting
Article 4 (Insert after paragraph 3)
(4) Directive 2014/65/EU shall only apply to such persons in the group that undertake eligible activities above the threshold that are not privileged transactions.

<ESMA_QUESTION_CP_MIFID_177>

Q178. Do you agree with the introduction of a separate asset class for commodities referred to in Section C 10 of Annex I and subsuming freight under this new asset class?

<ESMA_QUESTION_CP_MIFID_178>

Our members are concerned by the granularity of the commodity classes. The risk of creating many classes is that in a small market such as emissions allowances, an entity with a high amount of carbon compliance obligations would easily exceed the thresholds. Several commodities particularly in the energy market are co-related and one underlying product hedged with a different product. For example, a power plant may hedge its exposure with emission allowances. Such co-relation should be taken into account when creating the commodity classes.

Recommendation: Based on the above, we recommend to regroup commodities into the following classes:

(i) Metals (including freight related to Metals)
(ii) Oil and oil products (including freight related to oil and oil products)
(iii) Energy (coal, gas, power, emission allowances and climatic variables) (including freight related to coal, gas, power and emission allowances)
(iv) Agricultural products (including freight related to agricultural products)

ESMA recognised in the Consultation Paper (page 520, paragraph 52) that freight is ancillary to the trading of other commodities and that it should not be considered a separate asset class. We agree with this statement. However, we believe freight should not be included with Annex I C10 products as there is no link between freight and such products. Instead, freight should be added as ancillary activity to the main business in the underlying commodity. This view is supported by the fact that there is data available from the exchanges, showing how freight is allocated between the different commodity classes.

Our members also believe that Annex I C10 should not be categorised as its own class of commodities. Whilst there is a recognised “metals” or “energy” market there is no “C10” market as such, and grouping together climatic variables with freight rates or inflation rates creates artificial markets. C10 includes so called “exotic derivatives” with underlying such as climatic variables, inflation rates, and official economic statistics. C10 also includes “other derivative contracts relating to assets, rights, obligations, indices and measures” with the characteristics of other derivative financial instruments. The precise scope of this asset class is unclear. Members question whether it will be possible to publish data for trading activity in the EU for products in C10. Considering the small number of market participants in some of the C10 products, establishing a C10 asset class may cause a small firm to be caught by MiFID II just because they are the only market participant trading a more exotic C10 contract.

In addition, we point out that a firm that is essentially a peripheral player in commodities, well below the threshold of impact on a market, would need to be licensed because of a dominant position or requirement in a tiny market, for example palladium or climatic variables, despite being invisible in all other markets. This seems an odd outcome.

The provision is silent on responsibility for the calculation of denominators for the commodity asset classes. The reference to trade repositories does not distinguish between those authorised by ESMA under EMIR and those recognised as equivalent to such trade repositories.

Recommendation: We strongly recommend to re-categorise commodities as set out above, to ensure products that are linked are within the same group, and to avoid creating an artificial commodity class such as a C10 group with very limited market participants.

RTS 28 Proposed drafting change **Recital 7**
The overall market size should be determined on the basis of trading activity undertaken in the EU and in relation to different asset classes, including metals (including freight related to metals), oil and oil products (including freight related to oil and oil products), energy (coal, gas, power, emission allowances and climatic variables (including freight related to coal, gas, power and emission allowances)) and agricultural products (including freight related to agricultural products)…. Where a person operates simultaneously in different asset classes and exceeds the threshold in relation to one asset class, it should be subject to Directive 2014/65/EU for all commodity asset classes. In order to ensure that all persons wishing to invoke the exemption in Art.2(1)(j) use consistent data, ESMA shall calculate and publish on a monthly basis the size of the overall trading activity in the European Union for each of the commodity classes set out under Article 2(b) of this Regulation.

RTS 28 Proposed drafting change **Article 2**
(b) if the size of the trading activity (i)…asset classes: 1. Metals; (including freight related to metals); 2. Oil and oil products; (including freight related to oil and oil products); 3. Energy (coal, gas, power, emission allowances and climatic variables) (including freight related to coal, gas, power and emission allowances); 4. Agricultural products; (including freight related to agricultural products); or…

<ESMA_QUESTION_CP_MIFID_178>

Q179. Do you agree with the threshold of 0.5% proposed by ESMA for all asset classes? If you do not agree please provide reasons and alternative proposals.

<ESMA_QUESTION_CP_MIFID_179>
FIA Europe has a broad membership, which means that for certain questions there are differing views – where that is the case, we have set out both points of view.

It appears to be ESMA's intention to capture all non-financial entities that are engaging in non-hedging commodity derivatives. We refer to our response to Question 168 for an analysis of the potential market impact, shift in liquidity, and the impact on end-user prices.

Some members believe the threshold to be too low. It is not clear to those members, which set of data ESMA used to arrive at a 0.5 % threshold. Without any market data for the denominator available, individual members are not able to assess whether they would be below the threshold or whether they would exceed it and by how much. As a result, firms are unable to assess whether they would breach this limit or not. Further, without that data, it is not possible to conduct a meaningful quantitative assessment and provide specific examples of firms that would or would not breach this limit.

Some members state that at this low level the exemption is likely to exist on paper but entities will not be able to make use of it, particularly if taking into account the implementation issues raised under Question 182. Some members point out that if the threshold is set at 0.5% even pure hedging companies, which do not engage in any speculative activity, as well as some producers and manufacturers entering into supply contracts that may be caught by the widened scope of the definition of commodity derivatives in C7 or Annex I, may exceed the threshold. A 0.5% threshold assumes that a firm should be smaller than the 1/200th of the market (or the 200th firm in conditions of perfect competition) in order to qualify for the exemption. This is not realistic as commodity markets tend to have far less active players.

Some members further note that the 0.5% test is based on a denominator which ESMA suggests "should be undertaken on the basis of TR data". It is possible that a substantial portion of the activity in each of the commodity classes identified by Article 2(b) of the draft RTS are not reportable under EMIR Article 9 (e.g. because the relevant market participant does not have reporting obligations under EMIR) which means such market data is not taken into account in the TR data, and therefore that firms whose trading activity is less than 0.5% of the total market in the EU may be above 0.5% of trading activity reported to the TR.

Some of our members note that under the current proposal of a threshold based on the percentage of trading activity, a person's position below or above the threshold is dependent on the trading activity of competitors. If other market participants exit certain markets or reduce their trading activity, then a person may suddenly exceed the trading activity threshold despite not having increased their activity levels. This risk is higher the lower the thresholds are set for a particular commodity class. A group could cross the threshold based purely on the location and activity of competitor firms, disadvantaging the EU versus other jurisdictions.

Recommendation: Some of our members urge ESMA to increase the threshold levels in order to make the exemption available to smaller market participants, and ask ESMA to consider introducing different threshold levels for the different commodity classes.

One member proposes that ESMA uses absolute figures for each asset class based on gross notional value of transactions entered into by market participants for the trading activity test, instead of a percentage figure, which ESMA could review those absolute threshold levels on an annual or three year basis. The member states that absolute figures would provide more clarity for market participants with regards to whether they are above or below the threshold and are not dependent on data being available for the trading activity in the EU or the activity levels of other market participants.

Another member asks ESMA to consider, that instead of setting a firm percentage the regulator is given discretion to set the percentage individually per market and that 0.5% is only a minimum level. This will provide the regulator with flexibility to adjust the threshold upwards should the described situation arise and the percentage for a given market is bringing more firms than anticipated above the threshold.

Other members support ESMA's view that firms active in activities similar to regulated activities carried out by financial institutions should be regulated. However, those members recognise that a negative consequence of such regulation may be an adverse impact on liquidity, as set out in response to Question 168. Further, those members recognise that the capital treatment for financial institutions may not be appropriate for non-banking entities.

We further recommend providing market data for firms to be able to assess whether or not they are likely covered by MiFID II to allow them to develop contingency plans. Our member firms do not have access to data in trade repositories, so this will need to be provided separately. In order to ensure that all persons wishing to invoke exemption (j) use consistent data, some members suggest that ESMA calculates, and publishes, a monthly measure of the size of the overall market trading activity in the European Union for each of the commodity classes set out under Article 2(b) of the draft RTS, based on data drawn from the trade repositories that it supervises, as the denominator for the "size of trading activity" test.

RTS 28 Proposed drafting change **Article 2 (insert as new paragraph at the end)** "The values in sub-paragraph (i) and (ii) of art. 2(b) can be reviewed and updated by ESMA every [X] years following a consultation with national competent authorities and market participants to reflect changes in the size of the overall market trading activity undertaken in the EU."

<ESMA_QUESTION_CP_MIFID_179>

Q180. Do you think that the introduction of a de minimis threshold on the basis of a limited scope as described above is useful?

<ESMA_QUESTION_CP_MIFID_180>
It is difficult to assess the usefulness of such test without available data in terms of the size of the market.

Some of our members point out that the threshold level is set so low, that even small or medium firms that are purely hedging and do not undertake any speculative activity are at risk of being unable to make use of this exemption. Those members further note that the calculation of market share is very complex and for this reason small firms may not be able to apply the test. Any calculation errors will have an immediate impact and most likely bring the entity above the de- minimis threshold. Thus, some of our members recommend that the threshold percentage should be flexible, with 0.5% as the minimum level rather than a constant level and that the de-minimis test should be set at 50% of the level of the threshold test rather than specifying 0.25% in the regulation.

Recommendation: If ESMA wishes to retain this test, it will need to be added to RTS 28 as it is not currently mentioned.
<ESMA_QUESTION_CP_MIFID_180>

Q181. Do you agree with the conclusions drawn by ESMA in relation to the privileged transactions?

<ESMA_QUESTION_CP_MIFID_181>
In principal, we are supportive of this approach and we agree with the inclusion of OTC and non-OTC derivatives in the definition of hedging transactions.

However, ESMA relies on the definition of intra-group transactions in Article 3 of EMIR but at present such definition is only partially activated and it will change once ESMA publishes the equivalence standards. In the absence of such equivalence assessments currently and uncertainty over when such assessments might eventually be made, we would consider it more appropriate to define an “intragroup” transaction be defined as a transaction between two counterparties belonging to the same group, with group being defined as ESMA sets out on paragraph 22, page 510 of the CP (i.e. as under the Accounting Directive). Otherwise, in recognition of the possibility that such assessments may not be in place before 2017, we urge that provisions be made in the technical standards for a transitional regime.

We also point out that many commodity market participants are global firms with subsidiaries or branches located in several jurisdictions, many of them outside of the EU. Market participants need clarity whether intra-group transactions with such subsidiaries and branches can be taken into account for the purposes of the deduction as privileged transaction. If firms were not allowed to deduct such intra-group transactions, the calculation of the thresholds would be altered significantly and market participants may need to be licensed under MiFID II even though the only transactions they are entering into are intra-group transactions with for example a parent company in the US. This would be a significant problem for firms operating global commercial operations such as energy exploration and production who need to hedge their commercial risk on a global basis. This is supported by paragraph 38 on page 515 of the Consultation Paper where ESMA states that privileged transactions shall be deducted from the ancillary activities, without limiting such deduction to transactions within the EU. However, Article 3 and 4 of RTS 28 do seem to limit privileged transactions to those in the EU.

There is no clarity whether ESMA would follow the EMIR approach when determining what is a hedge, but as there is no other guidance members envisage they would calculate it in a similar manner. However, the ESMA Questions and Answers to the Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR), in Question 10 (c) (3), may present problems for firms. For example, a firm may hedge the majority of their financial activity with all financial activity across the group and transferred via internal OTC transactions into a single entity which aggregates all positions into a single portfolio and then trades that portfolio into the external market. Once the portfolio is aggregated, it is difficult to segregate what represents hedging and what represents speculation. To do so would require major restructure of entities, systems and procedures. In relation to EMIR reporting and clearing, the cost of such a restructuring was deemed greater than the cost associated with just treating the whole portfolio as speculative. Further, the EMIR definition of hedging is being adopted by MIFID II and the implications of not having a workable definition of hedging for MIFID II purposes are much more significant. Members noted that in jurisdictions such as Canada, the regulators have clarified that "there will be situations where an end-user may qualify for the [hedging] exemption even where some of the trades could be interpreted as not being a hedge, as long as there is a reasonable commercial basis to conclude that such trades were intended to be part of the end-user's hedging strategy". Therefore, the relevant hedging exemption would be available even if some part of the portfolio represented speculative derivatives transactions. Would ESMA be able to provide further clarity on this point and confirm that the guidance in Question 10 (c) (3) shall not apply to the concept of privileged transactions under MiFID II, please?

Recommendation: Please provide clarification that intra-group transactions can be taken into account irrespective of whether they were entered into with a EU subsidiary/branch or a subsidiary/branch of a group located outside of the EU. Our members further urge ESMA to remove in Article 3 and 4 of RTS 28 the reference to "in the European Union" in relation to privileged transactions.

RTS 28 Proposed drafting change Recital 4
…Therefore, this Regulation should also take into account non OTC-derivatives in relation to transactions that are deemed to be objectively measurable as reducing risks directly related to commercial activity or treasury financing activity. Considering that commodity markets are global in nature, in relation to intra-group transactions referred to in Article 3 of Regulation (EU) No 648/2012 that serve group-wide liquidity or risk management purposes, this Regulation should take into account intra-group transactions irrespective of whether such entities are established or located within the EU or elsewhere.

RTS 28 Proposed drafting change Article 1
(c)"privileged transactions" means (i) intra-group transactions as referred to in Article 3 of Regulation (EU) No 648/2012 that serve group-wide liquidity or risk management purposes, taking into account transactions between group entities established or located outside of the EU;

RTS 28 Proposed drafting change Article 4
(1) For each person wishing to use the exemption in Art. 2(1)(j), the size of the trading activity shall be calculated by deducting from the volume of the overall trading activity of the group in the European Union the sum of the volume of the privileged transactions undertaken by the group ~~in the European Union~~.

<ESMA_QUESTION_CP_MIFID_181>

Q182. Do you agree with ESMA's conclusions in relation to the period for the calculation of the thresholds? Do you agree with the calculation approach in the initial period suggested by ESMA? If you do not agree, please provide reasons and alternative proposals.

<ESMA_QUESTION_CP_MIFID_182>

The intention in 2017 to use average data for 2016 is very difficult to achieve for member firms. Average data for 2016 will only be available once 2016 has come to an end, i.e. on 2 January 2017 (since 1 January 2017 is a bank holiday in most if not all EU jurisdictions). MiFID II applies from 3 January 2017. This means market participants have just 1 day to apply the capital test and the market share test to evaluate whether they will be covered by MiFID II or are able to apply for an exemption. It will be impossible to calculate an entity's market share without data relating to the whole EU market, which again will only be available after 2016 has come to a close and such date is unlikely immediately available on 2 January 2017. RTS 28 and ESMA's analysis in the Consultation Paper are silent on when a person is expected to have all data available for the 2016 calculation. If an entity discovers that authorisation is required then it is normal (certainly in the UK) that when submitting the application the company has all the systems, policies and procedures in place, although the capital increase can be subject to authorisation being granted. Upgrading the non-regulated firm to a regulated firm status will be a substantial and potentially costly exercise which can take well over 6 months.

The main focus for ESMA, the EC and national competent authorities should be to make available to market participants robust time series data on overall market trading activity per asset class for a period of at least six months prior to 1 January 2016 as the relative position of a firm vs the market from this date on will have a material impact on the qualification for an exemption after 3 January 2017. The data provided should be based on a well-defined methodology, which is published and consulted upon by ESMA or the EC as a matter of urgency. Trade Repositories (TRs) are best placed to supply this data provided that the issue of interoperability between different TRs is solved rapidly. Individual firms may struggle to draw the required information at a reasonable effort. There are currently six active trade repositories in the Union, and typically a company will only be directly connected to one of them. To draw on repository data again is a useful idea, however the only institution coming to mind with access to all repository data seems to be ESMA. The test can only be feasible if everyone is using the same data base, and that it cannot be the responsibility of market participants to collect the relevant data from different sources, including the effort to integrate that data. We believe it can only be ESMA's responsibility to provide the figures for overall market trading activity in the relevant commodity classes. Otherwise the resulting calculations will hardly be comparable; as it is highly unlikely every company will be using the identical denominator for the calculation. The error ratio will be much lower if only one institution is providing the market activity numbers, and it would be much more cost effective. Last, not least, we assume that ESMA is interested in gaining such an overview for EMIR purposes anyway.

Even if firms were able to submit an application for registration under MiFID II on 2 January 2017, national competent authorities will still have a six month period during which to consider the application. A firm conducting regulated business without appropriate authorisation is committing a criminal offence in the UK and any contracts entered into by such firm are voidable under English law. As a result, until a firm has obtained relevant regulatory approval, it would have to seize all trading activity to avoid criminal liability of its directors. In order to ensure continuity of trading, a currently unlicensed firm could apply for MiFID I authorisation before the 3 January 2017 deadline but it this may result in firms becoming regulated that are actually below the threshold once data becomes available, which cannot have been the intention of ESMA.

Taking into account the low thresholds and the lack of available data, at present all market participants will have to assume that they will be covered by MiFID II and thus develop a contingency plan to deal with the additional administrative and capital burden arising from MiFID II, EMIR and CRD IV. This results in the proposed capital and trading thresholds effectively being zero as there are no market participants that are able to confirm that they will remain exempt after 3 January 2017.

Our members support a three year calculation period. However, if the first calculation in January 2017 relies on the average date of 12 rather than 36 months, then entities may exceed the thresholds due to market swings or price spikes within 2016. Commodity prices are volatile (e.g. see the current situation on oil prices) and using a 12 month average is not sufficient to allow for the threshold tests to provide fair results. Over a 36 month period price spikes and market swings are much more equilibrated. We also point out that some firms enter into hedging programs at specific times of the year. If such firm initiates a hedging program for a forward period such that they breach the trading activity threshold of 0.5%, at other times they would be below the threshold.

Recommendation: We recognise that ESMA is reluctant to move the date for the first assessment and that the level 1 text does not provide for a phase-in. Therefore, we recommend considering a fluid threshold approach, taking into account the difficulties set out above and the fact that no market participant will be able to rely on the ancillary exemption on 3 January 2017 due to lack of market data until 31 December 2016. Instead of applying the proposed thresholds from 3 January 2017, some of our members propose to use higher thresholds for 2017 which can then be reduced in 2018 and further reduced in 2019 once sufficient market data is available. This would prevent entities being caught due to lack of data, calculation errors and market swings whilst ensuring that those market participants who do trade in a disproportionate manner are still covered by MiFID II, in line with Recital 20 of Directive 2014/65/EU. In addition, in order to avoid a firm having to stop trading while waiting for its application for authorisation to be approved by the national competent authority, we propose to consider a deemed authorisation approach. In other words, where a firm had submitted a valid application for authorisation they would be deemed as authorised for a period of up to 12 months.

<ESMA_QUESTION_CP_MIFID_182>

Q183. Do you have any comments on the proposed framework of the methodology for calculating position limits?

<ESMA_QUESTION_CP_MIFID_183>

Risk of real economy impact

In designing the framework for the calculation of position limits, consideration must be given to the impact on those organisations which utilise commodity derivatives to hedge the various business/commodity risks associated with their day to day business (e.g. manufacturers, end users and corporate treasurers).

FIA Europe members are concerned that the proposed regime may lead to market disruption to the extent that liquidity is reduced either due to liquidity providers having less scope to provide key intermediation hedging to their clients, notably end users of commodities.

In particular, we call for caution about the metric used to set the baseline limit. A large majority of FIA Europe members are concerned by the narrow definition of OTC economically equivalent contracts.

In our view, the position regime should be calibrated to ensure that it avoids disruption to the market/real economy. We highlight that commodity derivatives markets are global by nature. Market participants need to hedge their risk across multiple contracts (both OTC and on-venue). The EU position limits regime should therefore allow netting on a broad basis in order to accurately reflect:

- the global position given it is common for EU risk to be hedged with contracts traded on third country venues, i.e. the real risk exposure; our members would caution against extra-territorial application of EU position limits to third-country venue contracts because it could lead to conflicting rules and requirements applying to the same position;

- the reality that end users (e.g. manufacturers, airlines, refiners) require financial institutions to provide hedging instruments to manage price risk for their physical commodity consumption and/or production. Refiners and airlines, for example, depend on financial institutions to assume basis risk in order to hedge their specific grade of fuel oil (e.g. 0.1 Gasoil Rotterdam) used for their commercial activities because these institutions commonly offset this exposure with more liquid exchange traded benchmarks (e.g. gasoil futures). In addition this dynamic allows financial institutions to aggregate bespoke interests in a diverse client base resulting in an aggregated central pool of liquidity which is highly correlated. The liquidity pool is created by aggregating a highly correlated set of bespoke interest in a commodity type for example, an airline buys an OTC swap from a financial institution referencing Jet Rotterdam which the financial institution immediately hedges with gasoil futures. The next day a refiner sells a swap to a financial institution referencing Gasoil 0.1 FOB Med which is not entirely the same as Jet Rotterdam but it is highly correlated and therefore that second trade provides a hedge for the first at which point the financial institution can terminate the gasoil futures which provide a temporary hedge until the various OTC flows can be matched. European refiner capacity is around 11m bbl a day. If refiners hedge 20% of that that's 2.2mbd so 66m bbl a month – a comparative analysis of those numbers can be made with the deliverable volumes on IP gas oil.

These end user entities rely upon the flexibility of financial entities acting as liquidity providers for hedging intermediation to allow them to manage their exact price risk. In order to ensure the availability of hedging instruments and to prevent liquidity pools from shrinking or dissipating, it is critical (in the absence of a pass through hedge exemption) that any positions which the financial institution executes to reduce the risk of that end user hedge can be netted. As demonstrated above, it is vital that hedges that may be non-MiFID instruments or do not currently fall within the EEOTC definition, (e.g. as described above the different trades) can be taken into account in determining a person's net exposure or at the very least that the limits are established at appropriate levels to reflect the fact that futures positions used by financial institutions to hedge end user OTC risk reducing trades will not benefit from a pass through exemption; and

- The fact that fabricators and manufacturers look to financial institutions or trading houses for the supply of physical commodities (e.g. metal fabricators) and that these financial institutions or trading houses will hedge these physically settled forwards (e.g. non-MiFID financial instruments) with on venue commodity derivatives. To the extent that physical positions remain ineligible for netting, the risk position will not be accurately reflected and the limit will be reached quicker than if netting of OTC physical positions was permitted. In addition, if physical positions cannot be netted, then this may lead to hedges for such physical OTC transactions migrating off-exchange.

Deliverable Supply

The EU framework is to establish baseline limits for both spot and other month by reference to deliverable supply as defined in RTS 29 (i.e. deliverable supply means what is used either as settlement for, or a pricing reference to, that commodity derivative). Before market participants are able to opine on the appropriateness of the baseline figure of 25% the industry would need:

(i) ESMA to publish the methodology for calculating deliverable supply. We believe the proposed deliverable supply definition in Recital (5) and Article 1(2) of the RTS could be interpreted to mean overall trading interest in the commodity derivative whether for pricing purposes i.e. cash settled commodity derivatives or physical settlement. Alternatively, the definition of deliverable supply (if based on the Article 3 deliverable supply adjustment factor) may be interpreted as the total physical supply of a commodity that meets the delivery specifications of a futures contract. Taking the ICE Brent contract for the spot month and other month as an example, on the first interpretation, deliverable supply could be very low whereas if based on the standard market definition, it would be much higher;

Furthermore, in our view, limits should be established for the (i) spot month based on deliverable supply, and (ii) other months (i.e. aggregate limit) based on estimate of open interest, subject to a de minimis threshold. Please see our response to question 184 for further details.

In the event that deliverable supply means the quantity of the underlying physical commodity then we propose that deliverable supply should only be used to establish the spot month limit and that other month limits should be established based on open interest, which we believe to be a more suitable metric. Further, given the broad scope of commodity derivatives for which position limits will need to be established, it is critical that open interest is defined as overall outstanding trading interest in the commodity derivative instead of the traditional exchange based definition of open interest. Article 4 appears to capture the concept that open interest should reflect overall outstanding trading interest in other financial instruments (e.g. OTC contracts). However, we need to ensure that “other financial instruments with the same underlying commodity markets” includes underliers which are correlated to the exchange based benchmark e.g. crude oil and refined petroleum products;

(ii) estimates to be provided of deliverable supply for (at minimum) the key commodity benchmarks. Without estimates of deliverable supply, the industry will be unable to determine with any certainty if the baseline figure is overly restrictive or appropriate. It is clear for some commodities that it will be very challenging to source data to determine deliverable supply, for example, other than London Gold warrants, physically settled gold (some of which may be in scope, e.g. physically settled forwards and options traded on venue) is predominately traded OTC (i.e. there is no exchange traded contract and only a small portion of OTC is cleared on exchange). Therefore, deliverable supply estimates on which limits are to be based will need to be sourced from OTC data which is not publicly available. Another example is refined petroleum products which can be sourced anywhere in the world, which may make it very difficult to obtain access to the relevant data in order to achieve a credible estimate of deliverable supply. Further, if a broader definition of deliverable supply applies, the overall outstanding market interest derived from OTC swaps etc. may be difficult to source; and

(iii) clarity to be provided as to how the adjustment mechanism will work in relation to the factors proposed, in particular, deliverable supply and open interest. For example, paragraph 28 of the Consultation Paper provides that the greater the volume of open interest the greater the position limit. However, if the baseline figure is low due to no available deliverable supply data, the regulator is only able to increase the limit by a maximum of 15%. Accordingly, it is critical that ESMA identify the markets for which it would be difficult to obtain deliverable supply and to provide for further flexibility in the event open interest is the only reliable / available metric.

Contracts where there is no "deliverable supply" for the relevant underlying

The definition of "commodity derivatives" includes contracts which relate to commodities referred to in Section C(10) Annex 1 MiFID2. ESMA's technical advice to the Commission (page 422) indicates that those commodities will include factors which are not deliverable e.g. environmental variables such as weather factors and indices and other measures of prices or values. ESMA's proposals for setting position limits do not address how position limits should be set where there is no deliverable underlying. In our view, this should be addressed in a supplemental consultation. In addition, this highlights the need for ESMA to provide the methodology for the calculation of deliverable supply to determine the baseline where there is no deliverable supply for the relevant commodities.

Commodity derivatives in the form of listed warrants or similar instruments

The definition of "commodity derivatives" includes transferable securities covered by Article 4(1)(44)(c) MiFID2, such as cash-settled warrants relating to commodities or underlying covered by section C(10). It is not clear how ESMA envisages that the methodology for setting position limits will be adapted in cases where the commodity derivative takes the form of a warrant listed or traded on a securities trading venue. For example, it is unlikely that trading venues for such warrants will calculate the deliverable supply as contemplated by the recitals to draft RTS 29. It may also be more difficult to determine the "spot month" when a range of similar warrants trade on a particular venue.

ESMA should clarify that the definition of "commodity derivative" does not include:

- warrants that are physically settled by delivery of the underlying commodity or other deliverable since Article 4(1)(44)(c) MiFID2 only covers instruments "giving rise to a cash settlement" (or instruments exercisable into transferable securities); or

- shares or bonds or other forms of securitised debt, even if they embed derivatives relating to commodities or other underliers specified in Section C(10) Annex I MiFID2, because Article 4(1)(44)(c) MiFID2 is a residual category covering "other securities" i.e. securities not already covered in Article 4(1)(44)(a) or (b).

Territorial and personal scope of the position limits regime

It is not clear from the consultation paper what ESMA's views are on the territorial and personal scope of the position limits under Article 57. It is important that Member States take a common approach to the scope of application of these requirements. Accordingly, ESMA should indicate how Member States should apply the requirements.

ESMA states in paragraph 41 of its consultation paper that it regards the geographical scope of Article 57 as bounded within the EU and Article 5(3) of draft RTS 30 only envisages aggregation of positions with other positions held by other persons within the same group "in the European Union" to determine the final net position.

While Article 57(1) MiFID II refers to position limits applying to "a person", it should be read in the context of Article 1 MiFID II which sets the scope of the Directive. Article 1(1) provides that the Directive applies to, amongst others, investment firms and third country firms performing relevant activities through a branch in the EU and Article 1(6) provides that Articles 57 and 58 shall apply to a person exempt under Article 2. In addition, Article 1(3) indicates that the position limits apply to EU authorised credit institutions performing MiFID II regulated services and activities. Even though Article 1(3) does not refer to Article 57 or 58, position limits are imposed under Article 69(2)(p) by virtue of Article 57(11), and Article 1(3)(d) does refer to Article 69.

This suggests that the position limits under Article 57 are not intended to apply to persons outside the EU or to persons in the EU that are not "investment firms" within the definition in Article 4(1)(1) or exempt from the requirements that apply to investment firms under Article 2 (e.g. individuals that are not "undertakings").

Equivalence and Flexibility

In our view, given the global nature of the commodity markets, it is imperative that the regime is as consistent as possible with other existing regimes, (i.e. the US). FIA Europe members note that the US use open-interest as the metric for other months.

In addition, given the issues highlighted above, we believe it is necessary for the regime to be sufficiently flexible in terms of both the expression of limits and measure of the market size to adapt to market changes. We believe the mechanism proposed in which the NCA can adjust the baseline figure according to the factors proposed in Articles 2-8 of RTS 29 (e.g. the maturity of the commodity derivatives contracts, deliverable supply in the underlying commodity, the overall open interest, number and size of market participants and

characteristics of the underlying commodity) is an expression of the type of flexibility the market will require given the dynamic nature of the commodity markets. It is critical that participants understand the methodology for calculating deliverable supply in order to determine if the adjustment mechanism proposed builds in an appropriate level of flexibility including a possible de-minimis threshold below which the established position is not applied.
<ESMA_QUESTION_CP_MIFID_183>

Q184. Would a baseline of 25% of deliverable supply be suitable for all commodity derivatives to meet position limit objectives? For which commodity derivatives would 25% not be suitable and why? What baseline would be suitable and why?

<ESMA_QUESTION_CP_MIFID_184>
Deliverable supply

FIA Europe members take the view that ESMA's proposed 25% of deliverable supply baseline limit for spot-month contracts may be appropriate and support the flexibility granted to national regulators to adjust it by +/- 15%.

However, in order to come to a conclusive view, market participants (corporates, financial firms) need ESMA to (i) confirm its interpretation of the "deliverable supply" definition, including the methodology for calculating deliverable supply and (ii) provide estimates for deliverable supply (based on the relevant interpretation of the deliverable supply definition) on key benchmarks to assess whether the 25% is appropriate for all commodities and the adjustment mechanism will provide sufficient flexibility for national regulators.

In addition, limits should be established for (i) the spot month based on deliverable supply, and (ii) other months, on an estimate of open interest, subject to a de minimis threshold.

For other months' limits, a majority of FIA Europe members have stated that it will be challenging to obtain estimates of deliverable supply for other months' limits and that open interest is the most relevant metric. We note ESMA's concerns that the use of open interest for other months' limits may constrain legitimate business for contract months further along the curve. However, this could be addressed by introducing a de minimis threshold below which limits could not be set, thereby avoiding any constraints on contract growth.

In addition, as highlighted in response to Question 183, end user participants rely upon a centralised pool of liquidity for correlated underliers (e.g. refined petroleum products) as a key component of efficient end user hedging intermediation which allows such entities to manage their exact price risk related to the specific grade of fuel oil which they use in their commercial activities. Financial institutions aggregate bespoke interests in a diverse client base resulting in an aggregated central pool of liquidity which is highly correlated. This liquidity pool is created by aggregating a highly correlated set of bespoke interest in a commodity type, for example, an airline buys an OTC swap from a financial institution referencing Jet Rotterdam which the financial institution immediately hedges with gasoil futures which for the financial institution hedge the majority of the OTC risk. The next day a refiner sells a swap to the financial institution referencing Gasoil 0.1 FOB Med which isn't exactly the same as Jet Rotterdam but it is highly correlated and therefore that second trade provides a hedge for the first at which point the financial institution can terminate the gas oil futures which provide a temporary hedge until the various OTC flows can be matched.

The availability of this centralised pool of liquidity among correlated underliers is a key component of efficient end user hedging intermediation. If ESMA's vision of the population of underliers which are eligible for offset is too narrow then there is a risk that these correlations will be broken, impacting the provision of liquidity for end users, i.e. if financial institutions are restricted from netting the futures with this pool of instruments which reference these correlated underliers then financial institutions will be restricted in making that pool of liquidity available to end users. It is especially critical that these correlated underliers are eligible for netting because the degree of correlation is even tighter in the outer months.

Furthermore reference to deliverable supply raises the following points:

- How ESMA/ National regulators will measure the deliverable supply, including production and storage is very unclear, and notably, how they can access data from physical facilities not subject to financial supervision (e.g. oil refineries). Whereas it seems workable for some commodities (e.g. metals), it is raising significant challenges for other commodities, in particular when markets are global (e.g. oil, agriculture)

- What period will be considered as relevant for the measure of deliverable supply compared to the maturity of other month contracts is unclear as well as how ESMA/ National regulators will distinguish between storable/ no storable commodities, seasonal/ non seasonal commodities.

- What geographical spectrum is to be considered for the measure of the deliverable supply, i.e. European – Global, is unclear. Whereas some markets remain mostly national (e.g. natural gas and power), some others are global by nature (oil, agriculture).

In the light of all the operational challenges that would be ahead of market participants as well as regulators in the implementation of the position limits regime, a majority of FIA Europe members generally consider open interest as a better metric for other month contracts. As the open interest reflects all relevant market factors relating to the trading of the relevant contract (e.g. maturity, volatility, number and size of market participants) thereby ensuring limit flexibility to prevailing market conditions for the relevant underlying commodity.

Open Interest

We further point out that when market liquidity (i.e. trading activity) is too low, therefore open interest is constrained and as a result the limit becomes irrelevant, ESMA should consider a *de minimis* threshold. This threshold would be different depending on the market and we encourage ESMA/ NCAs to engage with trading venues and market participants to establish what is appropriate for each market. The threshold should be in end commodity units, which can be used by MTFs/ OTFs, but exchanges can translate into lots.

<u>We suggest the following amendments to RTS 29:</u>

Amendment to Recital 10:

"(10) The national competent authority of the trading venue for the commodity derivative will calculate a baseline position limit for the commodity derivative based on 25% of the deliverable supply for the spot-month contract or spot-month contracts to which the position limit shall apply. The baseline shall be specified in the number of lots of the relevant commodity derivative. The national competent authority of the trading venue for

commodity derivative will calculate a baseline limit on open interest for all other *month contracts subject to a de minimis threshold below which limits could not be set"*

Article 1 - The methodology for the calculation to be applied in establishing position limits

[…]

(2) The competent authority shall, for each commodity derivative traded on a trading venue for which it is the competent authority, or central competent authority as specified in Article x, determine a baseline figure on the basis of the deliverable supply *for spot month contracts and on the basis of open interest for non-spot month contracts* for that commodity derivative. The deliverable supply shall be that which is used either as settlement for, or a pricing reference to, that commodity derivative.

(3) The baseline figure *for spot month contracts* shall be 25% of the deliverable supply for the commodity derivative to which the position limit shall apply. The baseline figure shall be specified in the number of lots of the relevant commodity derivative with the definition of lot being the unit of quantity used by the trading venue on which the commodity derivative contract trades.

(4 – new)) The baseline figure for other *month contracts shall be X% of open interest.*

(5 – new) The competent authority will set a de minimis threshold for all contracts subject to position limits below which limits could not be set.

[…]

Article 3 - The deliverable supply in the underlying commodity

1. The competent authority, or central competent authority as specified in Article x, shall assess whether the deliverable supply in the underlying commodity is such that the baseline figure for the position limit for spot month contracts requires adjustment. The deliverable supply shall be that which is used either as settlement for, or a pricing reference to, a commodity derivative contract.

Article 4 - The overall open interest

1. The competent authority, or central competent authority as specified in Article x, shall assess whether the overall open interest in the commodity derivative and the overall open interest in other financial instruments with the same underlying commodity markets is such that the baseline figure for the position limit for spot month contracts requires adjustment. Any adjustment made to the baseline figure for the position limit shall be based on the principle that there is a commonality between the volume of overall open interest in the commodity derivative and the overall open interest in other financial instruments with the same underlying commodity markets and the level of the position limit so that the greater the volume of overall open interest, the higher the overall position limit.

Article 5 - The volatility of the relevant markets

The competent authority, or central competent authority as specified in Article x, shall assess whether the volatility of the relevant markets in the commodity derivative is such that the baseline figure for the position limit requires adjustment. Any adjustment made to the baseline figure for the position limit shall be based on the principle that there is a commonality between the level of volatility in the markets relevant to the commodity derivative and the level of the position limit so that the greater the level of volatility, the higher ~~lower~~ the overall position limit.

Article 6 - The number and size of market participants

The competent authority, or central competent authority as specified in Article x, shall assess whether the number and size of market participants that hold a position in the commodity derivative is such that the baseline figure for the position limit requires

adjustment. ~~*Any adjustment made to the baseline figure for the position limits shall be based on the principle that there is a commonality between the number and size of market participants that hold a position in the commodity derivative and the level of the position limit so that the greater the number of position holders, the lower the overall position limit*~~
<ESMA_QUESTION_CP_MIFID_184>

Q185. Would a maximum of 40% position limit be suitable for all commodity derivatives to meet position limit objectives. For which commodity derivatives would 40% not be suitable and why? What maximum position limit would be suitable and why?

<ESMA_QUESTION_CP_MIFID_185>
In the absence of clarity regarding the definition of 'deliverable supply' and estimates for deliverable supply we are unable to comment on whether a maximum position limit of 40% is appropriate.

As stated in response to Question 184 above, we advocate the introduction of a de minimis threshold, below which limits could not be set, thereby avoiding any constraints on contract growth. We believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. The position limits regime would only capture positions above a certain size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortion.

In our view consideration needs to be given to non-linear position changes which may occur as a result of option expirations for any contract i.e. options on futures expiring ahead of the corresponding future contract expiration.

It can be difficult to manage limits during the option expiration window and participants could find themselves over the limit and may not know what the delta will be until the future has expired. Under the CFTC regime, there is a 1 day grace period after option expiration to comply with the limit.
<ESMA_QUESTION_CP_MIFID_185>

Q186. Are +/- 15% parameters for altering the baseline position limit suitable for all commodity derivatives? For which commodity derivatives would such parameters not be suitable and why? What parameters would be suitable and why?

<ESMA_QUESTION_CP_MIFID_186>
Without the methodology for calculating deliverable supply, market participants cannot accurately assess whether the +/- 15% adjustment is suitable. It may be more appropriate to allow regulators some flexibility in the event a higher or lower adjustment is required, due to factors specific to the commodity asset class (such as open interest, number of market participants)

Giving recognition to the fact that unique circumstances may exist across the wide range of underliers which come within the scope of the position limit framework could be a useful concept although it is likely that this could be picked up through open interest if used as the metric for other months.
<ESMA_QUESTION_CP_MIFID_186>

Q187. Are +/- 15% parameters suitable for all the factors being considered? For which factors should such parameters be changed, what to, and why?

<ESMA_QUESTION_CP_MIFID_187>
We understand that ESMA has a statutory mandate to consider volatility. We further recognise that volatility may have a residual value in terms of reflecting illiquidity issues.

We highlight that if open interest is used to determine other month limits, the other factors become incidental. This is because open interest numbers would already factor in such matters as maturity of contracts, volatility, number and size of participants and characteristics of underlying commodity markets.
<ESMA_QUESTION_CP_MIFID_187>

Q188. Do you consider the methodology for setting the spot month position limit should differ in any way from the methodology for setting the other months position limit? If so, in what way?

<ESMA_QUESTION_CP_MIFID_188>
Yes. Deliverable supply is the correct metric for spot month contracts.

For cash settled spot-month contracts, deliverable supply may be the correct metric for setting the cash spot month limit. In addition, we acknowledge the logic for ESMA's conclusion in para. 21 of the Consultation Paper that the limit for the spot month should generally be lower than the other months limits given that other months limits will apply to multiple expiries. However, we note that the bulk of trading activity occurs in the spot month or at least the first couple of contract expirations (this is especially the case in oil contracts, where 50% of open interest sits in the first three contract months and the remaining 50% of open interest accounts for the other expirations). In addition this may differ depending on the type of commodity contract. Therefore market participants would need to give further consideration to this proposition when the measure of deliverable supply and open interest has been clarified by ESMA.

For other months' limit, as mentioned under question 184, we propose to introduce a de minimis threshold, below which limits could not be set, thereby avoiding any constraints on contract growth. We believe that that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. The position limits regime would only capture positions above a certain size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortion.

In relation to the use of open interest for other month limits on physically and cash settled other month contracts, as the MiFID II regime applies to a broader range of commodity derivatives than just futures derivatives and will include economically equivalent OTC contracts, it will be necessary for open interest to reflect the end commodity unit of OTC contract relating to the relevant on-venue contracts. Certain commodities may not have a related futures contract and competent authorities will need to estimate the deliverable supply or open interest based on notional amounts of swaps and other relevant OTC contracts (e.g. options and forwards). Open interest and deliverable supply data should be available via trade repositories as a result of EMIR reporting.

We further note, that some commodities are durable and can be stored indefinitely and some cannot; thus for some commodities, deliverable supply should include stock levels (i.e. surplus production stored from a prior period). Further, estimated deliverable supply should include the quantity of commodity, including volume in storage that is available for sale on a spot basis at the contract's delivery points.

We believe that ESMA and/ or national regulators should include an obligation on RMs/MTFs and OTFs to provide data to ESMA/ regulators in order to ensure sufficient data is available to set position limits. This would address ESMA's concern that they may not receive relevant data from trading venues (RMs, MTFs and OTFs) on open interest.
<ESMA_QUESTION_CP_MIFID_188>

Q189. How do you suggest establishing a methodology that balances providing greater flexibility for new and illiquid contracts whilst still providing a level of constraint in a clear and quantifiable way? What limit would you consider as appropriate per product class? Could the assessment of whether a contract is illiquid, triggering a potential wider limit, be based on the technical standard ESMA is proposing for non-equity transparency?

<ESMA_QUESTION_CP_MIFID_189>
FIA Europe members believe that ESMA should 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 is to take each new or illiquid contract separately and consider a reasonable multiple of the current transaction size after a defined period of trading.

New contracts often are illiquid/ immature initially and may be used by a small number of market participants. In order to accommodate the demand for hedging and develop a robust, established market, it may be necessary to permit a small number of market participants to represent a relatively large share of the (small) market. Concerns regarding market abuse can be adequately addressed through enhanced reporting and surveillance, as necessary.

We propose introducing a de minimis threshold until a new contract is established, below which limits could not be set, thereby avoiding constraints on contract growth.

If liquidity in a contract is not present, then that is a clear indicator that trading activity in the contract is either irrelevant or not sufficiently significant to need to limit it. In such case, the risk of distortion should therefore be considered as irrelevant. As stated in response to question 184 above, we advocate the introduction of a de minimis threshold, below which limits could not be set, thereby avoiding any constraints on contract growth. We believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. The position limits regime would only capture position above a certain size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortions.
<ESMA_QUESTION_CP_MIFID_189>

Q190. What wider factors should competent authorities consider for specific commodity markets for adjusting the level of deliverable supply calculated by trading venues?

<ESMA_QUESTION_CP_MIFID_190>
FIA Europe members believe that the seasonal supply outages in the physical market, the perishability of deliverable materials and the capacity constraints (with regard to transportation and delivery) should be taken into account under the "characteristics of the underlying" factor.

We reiterate that the absence of accurate data on production and storage of some commodities should be reflected in the consideration related to the characteristics of the underlying commodity market.

Whilst estimated deliverable supply is the appropriate baseline for setting spot month limits, we believe that open interest is the appropriate metric for all other contracts, and that this metric would take into account all relevant factors particular to the relevant commodity contract: it would then not be necessary to provide for an adjustment mechanism driven by an exhaustive list of factors.

It is critical that deliverable supply or open interest calculations for other months' limits allow for the inclusion of correlated underliers (e.g. refined petroleum products such as jet ara, jet rott, gasoil fob 0.1).

These correlated underliers use the commodity derivative as a hedge. Therefore, it would be inaccurate not to recognise these underliers for the purposes of calculating deliverable supply and / or open interest.
<ESMA_QUESTION_CP_MIFID_190>

Q191. What are the specific features of certain commodity derivatives which might impact on deliverable supply?

<ESMA_QUESTION_CP_MIFID_191>
See response to question 190.
<ESMA_QUESTION_CP_MIFID_191>

Q192. How should 'less-liquid' be considered and defined in the context of position limits and meeting the position limit objectives?

<ESMA_QUESTION_CP_MIFID_192>
See responses to questions 189 and 184.

We point out that the test for liquidity should be a 'high hurdle' because commodity derivative markets are globally dispersed, seasonal and often fragmented between venues.
<ESMA_QUESTION_CP_MIFID_192>

Q193. What participation features in specific commodity markets around the organisation, structure, or behaviour should competent authorities take into account?

<ESMA_QUESTION_CP_MIFID_193>
FIA Europe members believe that where a product is traded by a small number of participants, ESMA should seek to understand the composition of market participants before determining the position limit. For example, a market with ten active participants may have two sellers and eight buyers, or just one risk management provider amongst nine participants seeking risk management services. In such markets, a single position limit may have a disproportionate impact on some of the participants.

Appropriate recognition of legitimate offsets (via definition of EEOTC contracts) is a key component of efficient end user hedging intermediation for liquidity providers. In addition, risk monitoring entities within financial institutions have aligned their monitoring and reporting architecture with this dynamic (i.e. offsetting correlated underliers with exchange based benchmarks as the instruments are seen as broadly fungible) and this same architecture should serve as a model / broad framework for regulators when trying to accomplish or identify these correlations for the purpose of establishing netting rules for the position limits regime.

As stated in our response to question 184, we advocate the introduction of a de minimis threshold is established, below which limits could not be set, thereby avoiding constraints on contract growth.

We believe that a de minimis threshold could be set per contract and calibrated (following a public consultation) to ensure that the position limits are only established for contracts once the de minimis threshold is reached. The position limits regime would only capture position above a certain size which could potentially impact the orderly pricing and settlement conditions of that market or which may lead to market distortions.

We particularly question ESMA's assertion that overall position limits should move inversely against the number of market participants. We suggest that the greater the number of participants in a given market segment, the lower the chances of a single actor having a dominant or otherwise inappropriate position. Therefore, the logic proposed by ESMA for new or illiquid markets should, equally, apply to established markets.
<ESMA_QUESTION_CP_MIFID_193>

Q194. How could the calculation methodology enable competent authorities to more accurately take into account specific factors or characteristics of commodity derivatives, their underlying markets and commodities?

<ESMA_QUESTION_CP_MIFID_194>
We broadly agree with the principles proposed by ESMA to enable the competent authority to adjust the limits. However, we believe that ESMA's assumption that position limits should move up in direct proportion to the flexibility of the relevant commodity market is incorrect. The reverse is likely to be true, in the sense that the more restricted a market (in terms of few points of delivery, geographic specificity, and seasonality …) the greater the tolerance for inadvertent large positions that needs to be built into the calibration.

We further believe that ESMA's assumption that position limits should be adjusted downwards in volatile market conditions is incorrect. In volatile markets there is an increase in demand for price risk management services from financial institutions and other liquidity providers. Restricting the ability of price risk management providers to offer these services in volatile markets will have an adverse impact on end users.

We believe that open interest would factor in the relevant characteristics or specific factors relating to a particular commodity market.
<ESMA_QUESTION_CP_MIFID_194>

Q195. For what time period can a contract be considered as "new" and therefore benefit from higher position limits?

<ESMA_QUESTION_CP_MIFID_195>
See our response to questions 184 and 198.

We believe that NCAs should have discretion on a case-by-case basis to take a view on the relative maturity of a contract after its commencement.
<ESMA_QUESTION_CP_MIFID_195>

Q196. Should the application of less-liquid parameters be based on the age of the commodity derivative or the ongoing liquidity of that contract.

<ESMA_QUESTION_CP_MIFID_196>
No. FIA Europe members underline that the age is irrelevant as a contract may never reach trading levels which are sufficiently high to result in the need for a position limit to be applied. We feel that the case by case approach is the best. Please see our responses to questions 184 and 189.
<ESMA_QUESTION_CP_MIFID_196>

Q197. Do you have any further comments regarding the above proposals on how the factors will be taken into account for the position limit calculation methodology?

<ESMA_QUESTION_CP_MIFID_197>
We ask that ESMA clarify how it interprets its definition of deliverable supply (i.e. that it is meant to be broader than just the amount of physical commodity sitting in a warehouse) and provides live data to test the proposed baseline / adjustment percentages against.

Furthermore, we highlight that the frequency and timing of limit revisions is critical for monitoring a well-functioning market. From a practical perspective, position limits should not be changed more frequently than annually with a minimum 6 months compliance window.
<ESMA_QUESTION_CP_MIFID_197>

Q198. Do you agree with ESMA's proposal to not include asset-class specific elements in the methodology?

<ESMA_QUESTION_CP_MIFID_198>
Yes. We agree with ESMA that the methodology should provide competent authorities with sufficient scope to take into account the specificities of the different markets without incorporating asset-class specific elements in the methodology.

It is critical that open interest is used as the metric for other month limits as open interest will factor in asset specific elements relevant to the particular commodity in question.
<ESMA_QUESTION_CP_MIFID_198>

Q199. How are the seven factors (listed under Article 57(3)(a) to (g) and discussed above) currently taken into account in the setting and management of existing position limits?

<ESMA_QUESTION_CP_MIFID_199>
FIA Europe members highlight that the seven factors listed under Article 57(3)(a) to (g) are all relevant but suggest that open interest for other month limits is the universal metric which is collectively reflective of all of them. In addition, differentiation between asset classes would be reflected through open interest and which, in our view, is the more appropriate metric for other months.
<ESMA_QUESTION_CP_MIFID_199>

Q200. Do you agree with the proposed draft RTS regarding risk reducing positions?

<ESMA_QUESTION_CP_MIFID_200>
We request that ESMA consider exempting arbitrage positions (simultaneous purchase and sale of identical or equivalent commodity futures contracts or other instruments across two or more regulated markets) from the position limits.
<ESMA_QUESTION_CP_MIFID_200>

Q201. Do you have any comments regarding ESMA's proposal regarding what is a non-financial entity?

<ESMA_QUESTION_CP_MIFID_201>
We agree that the term "non-financial entity" should be understood to cover persons that are not either:

- persons who are regulated under the various EU directives or regulations regulating financial entities; or

- persons who would be regulated under those directives or regulations if they were established in the EU.

We consider that the definition should be read in this way even if the territorial and personal scope of Article 57 is limited to EU persons. There is a risk that the positions of non-EU non-financial entities may need to be aggregated with the positions of a parent undertaking in the EU. The non-EU entity or its EU parent on its behalf should be able to obtain the benefit of the exemption for risk reducing positions.
<ESMA_QUESTION_CP_MIFID_201>

Q202. Do you agree with the proposed draft RTS regarding the aggregation of a person's positions?

<ESMA_QUESTION_CP_MIFID_202>
Exception to aggregation

MiFID II (article 57.1) states that the limits apply to "*the net position which a person can hold at all times*" and clarifies that the limits "*shall be set on the basis of all positions held by a person and those held on its behalf at an aggregate group level*".

Whilst we understand that the level 1 text does not allow disaggregation of positions within the same legal entity, we strongly believe that the definition of what qualifies as a position held on behalf of this legal entity does allow disaggregation based on independence of decision.

Accordingly, we believe that the basis for disaggregation proposed by ESMA in RTS 30 (Art. 2(2), i.e.: where positions are held by an intermediary on behalf of a client) is unduly restrictive. ESMA should allow disaggregation of independently managed businesses to which legal mandatory information barriers already apply (e.g. asset management businesses). These businesses are separated from principal trading businesses by a firewall (which may make it impossible to aggregate due to lack of access to the relevant data)/information barriers designed to ensure no exchange of information can occur between these businesses or no control can be asserted by one business over the other. It is critical that Article 2(2) is expanded to provide for disaggregation on this basis. In our view, any other interpretation would conflict with the independence requirements set out in European legislation (for example UCITS, AIFMD) and ignore the reality of such businesses.

Furthermore, we do not believe that positions should be aggregated with other entities of the group where such entities are not included in the same fully consolidated accounting group. This is consistent with Article 3(1) of EMIR. Accordingly, we therefore propose that Article 5(3) is amended as follows:

"*The positions of a person in a commodity derivative… shall be aggregated with the net positions in that commodity derivative held by other persons within the same group which are included in the same consolidation on a full basis as such person*"

Furthermore, whilst we welcome Article 2(2) of draft RTS 30, which provides that positions that are held by an intermediary on behalf of a client shall not count towards that intermediary's own position limits regardless of whether for reasons of market practice, operational structure or legal framework, the positions are held by the intermediary as principal. However, we note that in Europe the principal-to-principal model is used for exchange traded derivatives which means that, as a matter of market practice, positions that are held by an intermediary on behalf of a client will be held as principal. We therefore request that the reference to "regardless of whether" in Article 2(2) is amended to provide further clarity that for exchange traded derivatives such arrangements should not be construed narrowly as an exception, but are in fact market practice in Europe.

In addition, we would welcome clarity regarding the rules on aggregation for fund structures. We note that ESMA and the Commission have accepted, in the context of the draft RTS on the clearing obligation in respect of interest rate derivatives (published on 29 January 2015) and the RTS on minimum margining requirements, that independent investment funds should not be aggregated at group level for the purpose of the relevant thresholds. We encourage ESMA to provide similar clarity in the context of aggregation of position limits for investment fund structures (i.e. that the thresholds shall be determined at an individual fund level and not on a group basis).

Pro rata consolidation

We note that a 100% consolidation, rather than a pro rata consolidation, is likely to lead to double counting of positions. We do not believe that it is appropriate to attribute control twice for the same position. We urge ESMA to consider that a 100% consolidation provides an opportunity for participants in a 50-50 joint venture to each receive 100% netting benefit from a position held in the joint venture.

Parent company holds no positions in commodity derivatives traded on a trading venue

We believe the effect of ESMA's proposals is that where a parent or ultimate holding company itself holds no positions in commodity derivatives traded on a trading venue or economically equivalent OTC contracts, that entity will not be subject to aggregation rules, notwithstanding positions may be held by one or more subsidiary undertakings of that entity.

In paragraph 19 of Section 7.3 of the Consultation Paper, ESMA states that the aggregation will comprise of the positions of a person together with those of any wholly or partly owned subsidiaries of that entity but 'aggregation with the positions of fellow subsidiaries of a mutual parent or ultimate holding company' is not required. It follows, therefore, that the parent or ultimate holding company should not have to aggregate its positions with those of its subsidiaries where it holds no positions in commodity derivatives traded on a trading venue or economically equivalent OTC contracts itself as otherwise this could result in the position limits applying on an aggregated basis between the positions of fellow subsidiaries of that mutual parent or ultimate holding company which would be inconsistent with the position as set out in Section 7.3, paragraph 19 of the Consultation Paper.

Accordingly, we would welcome further clarification in the RTS that the position limit regime is only applicable where the relevant person holds positions in commodity derivatives and, accordingly, a parent or ultimate holding company that holds no positions in commodity derivatives is not required to aggregate the positions of its subsidiaries.

We accordingly suggest the following amendments to the RTS 30:

Recital (8): *Article 57(1) of Directive 2014/65/EU requires that position limits shall be set on the basis of all positions held by a person and those held on its behalf at an aggregate group level. Article 4(34) of Directive 2014/65/EU establishes the definition of group in Article 2(11) of Directive 2013/34/EU which refers to a group as a parent undertaking and all its subsidiary undertakings. The positions of a person which is a member of a group shall therefore be aggregated with the positions in commodity derivatives that it holds in its own name together with those of any wholly or partly owned subsidiary undertakings of that entity with the exception of positions to which legal mandatory information barriers apply under the EU legislation. Subject to this exception, ~~T~~the ~~whole~~ positions of the other entities within the group will be added to the person's positions~~, to simplify reporting and to reflect that a person which has effective control of an entity may use the full amount of that entity's position to support its activities~~.*

Article 2 - Determining when positions of a person are to be aggregated within a group

1. The positions of a person shall be aggregated within a group by aggregating the positions in commodity derivatives that the person holds in its own name (whether held directly by itself or on its behalf by third parties such as investment firms, under a client relationship) together with those of any subsidiary undertakings of that group, but not aggregating the positions of other subsidiary undertakings of a mutual parent or of any intermediate or ultimate holding company. Such aggregation shall be made on a whole position basis and not on a pro rata basis. A subsidiary undertaking means an undertaking that is controlled by a parent undertaking.

2. By exception to aggregation within the group between the position of a person and those of any subsidiary undertaking of that group as defined in article 2.1 of RTS 30, positions taken by subsidiaries to which legal mandatory information barriers apply shall not be aggregated with the positions of their parent undertaking.

3. The aggregation within the group between the position of a person and those of any subsidiary undertakings of that group as defined in article 2.1 of RTS 30 shall be in proportion to the capital held by the parent company.

<ESMA_QUESTION_CP_MIFID_202>

Q203. Do you agree with ESMA's proposal that a person's position in a commodity derivative should be aggregated on a 'whole' position basis with those that are under the beneficial ownership of the position holder? If not, please provide reasons.

<ESMA_QUESTION_CP_MIFID_203>

See our response to question 202.

It does not make sense to aggregate the positions held by funds managed by an asset management company with the positions held by its mother company on the basis that the mother company owns more than 50% of the capital of the asset management company. This approach conflicts with the regulation put in place by the EU to ensure independence of decision making and information in the asset management space.
<ESMA_QUESTION_CP_MIFID_203>

Q204. Do you agree with the proposed draft RTS regarding the criteria for determining whether a contract is an economically equivalent OTC contract?

<ESMA_QUESTION_CP_MIFID_204>
No.

The functioning of commodity derivatives markets makes it critical that the definition of economically equivalent OTC contracts (EEOTC) recognises the global nature of markets.

As we point out in our response to Question 207 below, narrow netting rules will restrict capacity for financial institutions (and other liquidity providers) to provide liquidity to real economy customers (e.g. commodity producers, suppliers and manufacturers) to execute their price risk management strategies and do not accurately reflect the net risk exposure of a counterparty.

In addition, we point out that although Recital 10 of Draft RTS 30 suggests that there would be a conclusive list of EEOTC contracts maintained by the competent authorities / ESMA, we believe producing such a list may be operationally unworkable given the large number of commodity derivative contracts and the dynamic nature of the market. Therefore, we believe that market participants should assess for themselves what constitutes an EEOTC contract and note that this approach has worked effectively in the context of EMIR trade reporting.
<ESMA_QUESTION_CP_MIFID_204>

Q205. Do you agree with the proposed draft RTS regarding the definition of same derivative contract?

<ESMA_QUESTION_CP_MIFID_205>
We agree that is a subset of economically equivalent and that a contract is “the same” if it is at least economically equivalent and in addition has other equivalent properties. However, we believe that the definition of ‘same contract’ should allow netting between long and short positions transacted on different broker platforms/ exchanges in effectively the same product.
<ESMA_QUESTION_CP_MIFID_205>

Q206. Do you agree with the proposed draft RTS regarding the definition of significant volume for the purpose of article 57(6)?

<ESMA_QUESTION_CP_MIFID_206>
FIA Europe members do not believe that the ‘3 lot’ rule is appropriate as it is not material enough to be disturbed on a daily basis by relatively minor market activity.
<ESMA_QUESTION_CP_MIFID_206>

Q207. Do you agree with the proposed draft RTS regarding the aggregation and netting of OTC and on-venue commodity derivatives?

<ESMA_QUESTION_CP_MIFID_207>
No.

FIA Europe members believe that the inability to net non-MiFID instruments with MiFID instruments will make the calculation of positions simply inaccurate as the position will not reflect the real risk exposure of markets participants. We note that the term “economically equivalent OTC contracts” is not defined in the Level 1 text and so, in our view, there is scope for ESMA to interpret this term broadly.

We question that the level 1 text does not allow netting between contracts traded on EU venues and contracts traded on third country venues. The recognition of third-country venues is a critical feature of the European financial legislation (EMIR as well as MiFID) and it seems arbitrary to state that for the purpose of netting, Article 57 is bound at European level.

As noted in our response to Question 183, consideration must be given to the netting treatment of OTC contracts to ensure that in calculating the net position of an entity that entity is able to net OTC instruments which are closely correlated to on-venue contracts. We view this as critical to financial institutions to continue to provide efficient end user hedging intermediation.

Non-financial entities require financial institutions to provide hedging instruments to manage price risk in respect of their physical commodity consumption and/or production. Refiners and airlines, for example, depend on financial institutions to offer OTC derivative contracts to hedge their specific grade of fuel oil (e.g. Jet Rotterdam) as the alternative would be to hedge with on-venue contracts (e.g. gas oil futures) which would involve assuming unwanted basis risk. These financial institutions commonly offset the OTC derivative exposure with exchange traded contracts (e.g. gas oil futures) as the OTC derivatives are closely correlated to the futures. In addition, this dynamic allows financial institutions to aggregate bespoke interests in a diverse client base resulting in a highly correlated centralised pool of liquidity which provides an efficient source of hedging intermediation for non-financial entities. However, to ensure financial entities can continue to offer this, it is critical (in the absence of a pass through hedge exemption) that these correlated OTC instruments continue to operate as legitimate offsets to the futures exposure assumed by financial institutions to deliver this source of liquidity to non-financial entities. Accordingly, we ask ESMA to clarify that exposures to such OTC swaps can be taken into account in determining the net position. Furthermore, it is critical that market participants can consider REMIT products and physical positions (which do not constitute MiFID instruments) and commodity index swaps as reducing the net position held in an on-venue commodity derivative.

As discussed above, these products are often used to hedge the risk of commodity derivatives. An inability to include them in calculating the net position will restrict the capacity for financial institutions to execute their price management strategies. For example, commodity index swaps are hedged through future positions.

An inability to offset cash settled commodity index swaps with the futures positions will limit the ability of financial institutions to write swaps for pension funds / asset managers etc. seeking to use such instruments to achieve diversification objectives. Accordingly, it is imperative that commodity index swaps and non-MiFID instruments will receive appropriate recognition as legitimate offsets under the position limits regime and we therefore believe it is necessary for ESMA to clarify that exposures to these non-MiFID instruments and commodity index swaps can be taken into account in determining a person’s net position.

<ESMA_QUESTION_CP_MIFID_207>

Q208. Do you agree with the proposed draft RTS regarding the procedure for the application for exemption from the Article 57 position limits regime?

<ESMA_QUESTION_CP_MIFID_208>
No.

FIA Europe members support an ex-post approval procedure, e.g. the firm notifies the competent authority but trades immediately without waiting for approval. It is of fundamental importance for entities to be able to effectively hedge positions – market participants cannot wait 30 days to do so. Commodity producers and suppliers particularly, raised serious concerns with the proposed approach in the draft RTS. There are some situations where a firm could be in a position that it needs to exceed the position limit on an ongoing basis for the purposes of commercial hedging. It is not always possible to precisely predict the amount by which the firm will need to exceed the limit at a future date as the commercial risk being hedged can fluctuate significantly day to day. The proposed approach appears to require a regular renewal of the exemption application in order to continue to do this.

We believe this approach will be extremely inefficient and impractical both for the firms and the competent authority. Exemptions should be applied for at the group aggregate level and based on historical and anticipated needs. It is critical that the process is relatively straightforward and efficient.

We suggest the following amendment to RTS 30:
*Article 6 - **Procedure for application of use of exemption from position limits***
[…]
2. The non-financial entity shall provide information demonstrating how the position is:

(a) related to the commercial activity of the non-financial entity; and

(b) reduces risk directly relating to that person's commercial activities.

3. The non-financial entity shall ~~apply~~ declare ~~to~~ the use of the exemption before it exceeds the limits set for the size of a position in that particular commodity derivative. A position under Article x (10) shall ~~not~~ be considered as exempt from the relevant position limit ~~if~~ unless the competent authority ~~has~~ does not approve the exemption.

4. A competent authority shall have up to 30 calendar days to approve an application under Article x (10) after the declaration made by the non-financial entity. The competent authority shall send a confirmation to the non-financial entity to approve or reject the application. Where the non-financial entity has not received a refusal, confirmation or request for more information from the competent authority within a period of 30 calendar days, ~~the person may use the exemption~~the exemption is considered granted.

<ESMA_QUESTION_CP_MIFID_208>

Q209. Do you agree with the proposed draft RTS regarding the aggregation and netting of OTC and on-venue commodity derivatives?

<ESMA_QUESTION_CP_MIFID_209>
We note this question is a repeat of question 207. We assume this question is instead meant to refer to pages 550 and 551 of the CP. If that's the case, we think the approach that ESMA

proposes is sensible. However, this is only likely to be relevant with a more workable and wider definition of what constitutes the 'same' commodity derivative, which we would favour.
<ESMA_QUESTION_CP_MIFID_209>

Q210. Do you agree with the reporting format for CoT reports?

<ESMA_QUESTION_CP_MIFID_210>
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Q211. Do you agree with the reporting format for the daily Position Reports?

<ESMA_QUESTION_CP_MIFID_211>
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Q212. What other reporting arrangements should ESMA consider specifying to facilitate position reporting arrangements?

<ESMA_QUESTION_CP_MIFID_212>
International consistency

FIA Europe members strongly encourage ESMA to consider a process for end-client reporting close to the one used in the US under the form 40 under the CFTC rules: the end-client can directly send the relevant information to the CFTC without passing through the chain of intermediaries, which protects client confidentiality vis à vis the intermediaries.

We point out that the end-client reporting provisions, if implemented in a manner that forces clients' information to pass through the whole chain of intermediaries, would conflict with national privacy laws in a number of jurisdictions and we typically experienced this issue when implementing the CFTC reporting rules of derivatives derived from the Dodd Frank Act.

Territorial and personal scope of position reporting

It will be important that Member States take a common approach on the scope of application of these requirements. Accordingly, ESMA should clarify the personal and territorial scope of the obligations that are laid down in Articles 58(2) and (3) and should indicate how Member States should apply the requirements.

Article 58(2) MiFID2 refers to reporting obligations applying to "investment firms" and Article 58(3) refers to reporting obligations applying to "members", "participants" and "clients" of EU trading venues.

However, Article 1 MiFID2 defines the scope of application of the provisions of the directive.

Article 1(1) provides that the Directive applies to, amongst others, investment firms and third country firms performing relevant activities through a branch in the EU and Article 1(6) provides that Articles 57 and 58 shall apply to a person exempt under Article 2.

Article 1(3) does not explicitly provide that position reporting requirements apply to EU authorised credit institutions performing MiFID2 regulated services and activities because it does not expressly refer to Article 57 or 58. However, competent authorities may apply position reporting to credit institutions by virtue of Article 69(1)(j) and Article 1(3)(d) does refer to Article 69 (compare Article 57(11) in relation to position limits).

Article 1 indicates that the position reporting requirements of Article 58(2) and (3) would only apply to:

- EU incorporated and authorised investment firms;
- EU incorporated and authorised credit institutions performing MiFID2 regulated services and activities; and
- EU persons that are "investment firms" as defined in Article 4(1)(1) MiFID2 but which are exempt from the requirements that apply to EU incorporated investment firms by virtue of Article 2,

but, in the case of Article 58(3), only if the undertaking is also a member, participant or client of an EU trading venue. Accordingly, the reporting requirements under Article 58(2) and (3) are not intended to apply to persons outside the EU or to persons in the EU that are not "investment firms" (e.g. individuals that are not "undertakings"), even if they are a member, participant or client of an EU trading venue and we therefore encourage ESMA to include an acknowledgment to this effect.

Scope of obligations of investment firms

An investment firm subject to position reporting under Articles 58(2) and (3) may have relationships with clients that do not involve contracts or interests within the scope of Article 58(2) and (3). The investment firm should only be required to obtain daily information for inclusion in a report required under Articles 58 (2) or (3) from a client with whom the investment firm has executed contracts within the scope of Articles 58(2) or (3), or for whom the investment firm currently holds positions in products within the scope of Articles 58(2) or (3) for the client (e.g. where the investment firm holds derivative warrants in custody for the client).

Reporting delay

FIA Europe members, for operational reasons, support that the reporting of positions is done for trade T no later than close of business T+1.

Accordingly, we suggest the following amendment to article 2 of ITS 31:

After **Article 2.1**, introduction of point 2 and 3 as follows:

“2. Investment firms shall produce the daily reporting of their position for trade day T no later than close of business T+1.

3. When the reporting by investment firms of their clients and the clients of those clients until the end client is reached breaches any existing privacy or confidentiality law in the country where the client or the investment is established, the end-client shall directly report its position to the competent authority of the country where he is established."

General comments

To ensure consistent application and implementation of the regime we believe it is necessary for ESMA to provide clarity on the following issues:

Annex I and Annex II: It is possible that an OTC contract may be economically equivalent to contracts traded on two or more venues (perhaps with different competent authorities). It is not clear whether it is expected that a position in those contracts should be reported separately to each relevant competent authority.

Annex II – field 4: The unique product identifier for warrants may be an ISIN rather than an Alternative Instrument Identifier. Accordingly, field 4 should reference an ISIN or, where the ISIN is not the industry method of identification, the Alternative Instrument Identifier.

Annex II – field 6: It should be made clear that the spot month is determined in the same way as for position limits. However, the methodology for determining spot months will need to be adapted to take account of the structure of OTC derivatives, warrants and emission allowances.

Annex II - field 7: For OTC derivatives, derivative warrants and emission allowances, the "number of contracts" may not be a meaningful measure (or possible to calculate). The notional amount, number of warrants, units of allowances, etc. may be more meaningful.

Annex II – field 9: It is not clear how to report if some but not all of the contracts being reported are risk reducing. The flag to indicate if a position is 'risk reducing' is linked to the flag on the client, as per EMIR. This assumes that a single client cannot have one position which is risk reducing and one which is not.
<ESMA_QUESTION_CP_MIFID_212>

8. Market data reporting

Q213. Which of the formats specified in paragraph 2 would pose you the most substantial implementation challenge from technical and compliance point of view for transaction and/or reference data reporting? Please explain.

<ESMA_QUESTION_CP_MIFID_213>
We would like to maintain a choice of formats for transaction reporting so that firms have the flexibility to report transactions to Approved Reporting Mechanisms (**ARMs**) in any format. If this were the case, we would anticipate that an industry preferred solution would, in effect, start to evolve once the new reporting requirements start to apply.

We believe it makes sense for the ARMs to use defined formats for the onward reporting to National Competent Authorities (**NCAs**) but, as noted above, these requirements should not be imposed on firms as well.
<ESMA_QUESTION_CP_MIFID_213>

Q214. Do you anticipate any difficulties with the proposed definition for a transaction and execution?

<ESMA_QUESTION_CP_MIFID_214>
As noted in our response to the May 2014 Discussion Paper, the definition of transaction means that, in ETD markets, each of the executing broker and the clearing broker will have a reporting obligation. It is therefore important to be clear about which events are reportable and by whom. Our understanding based on the Consultation Paper is that any events arising in the normal course of clearing and settlement are not reportable but that, where something happens that changes the position, this should be reported.

Our main concern relates to clearing brokers and how the exercise or assignment of options is to be reported and we would welcome some clarification on this point. This applies to American, European and other style options. Firms (executing brokers) will report the initial option purchase or sale as a transaction. Clearing brokers will also report the trade resulting from the option exercise or assignment as a separate transaction as indicated in paragraph 21 in Section 8.2 of the Consultation Paper. However, it is unclear whether clearing brokers are also required to report the increase or decrease in the original option position as discussed in paragraph 15 in Section 8.2.

We have put together some worked examples to illustrate what we understand is required. As you will see, it is not necessarily easy to follow the details of the option exercise from the reports that would be made or to see how they tie together. It is important to be aware that the report of the exercise as an increase or decrease would differ from the execution of a transaction in the market. For example, an exercise might involve different market participants acting in differing capacities from the original transaction – the party exercising the option is the clearing broker rather than the executing broker.

Please see worked examples attached in annex 1

<ESMA_QUESTION_CP_MIFID_214>

Q215. In your view, is there any other outcome or activity that should be excluded from the definition of transaction or execution? Please justify.

<ESMA_QUESTION_CP_MIFID_215>
Firstly, as noted in our response to the May 2014 Discussion Paper, the definition of transaction means that, in ETD markets, each of the executing broker and the clearing broker will have a reporting obligation. It is therefore important to be clear about which events are reportable and by whom. Our understanding based on the Consultation Paper is that any events arising in the normal course of clearing and settlement are not reportable but that, where something happens that changes the position, this should be reported.

Our main concern relates to clearing brokers and how the exercise or assignment of options is to be reported and we would welcome some clarification on this point. This applies to American, European and other style options. Firms (executing brokers) will report the initial option purchase or sale as a transaction. Clearing brokers will also report the trade resulting from the option exercise or assignment as a separate transaction as indicated in paragraph 21 in Section 8.2 of the Consultation Paper. However, it is unclear whether clearing brokers are also required to report the increase or decrease in the original option position as discussed in paragraph 15 in Section 8.2.

We have put together some worked examples to illustrate what we understand is required. As you will see, it is not necessarily easy to follow the details of the option exercise from the reports that would be made or to see how they tie together. It is important to be aware that the report of the exercise as an increase or decrease would differ from the execution of a transaction in the market. For example, an exercise might involve different market participants acting in differing capacities from the original transaction – the party exercising the option is the clearing broker rather than the executing broker.

Please see worked examples attached in Annex 1

Secondly, we welcome ESMA's decision to exclude (SFTs) from the scope of transaction reporting. However, firms would welcome more clarity on Article 3(3)(a) of draft RTS 32 as there is likely to be a difference in the timing of the implementation of MiFIR and the Securities Financing Transaction Regulation 2014/0017 (**COD**) (**SFTR**). Firms presume that it is not ESMA's intention for firms to report SFTs under MiFIR for the period between MiFIR implementation and SFTR implementation. In order to avoid any confusion, we urge the RTS to be more explicit and suggest Article 3(3)(a) to be redrafted to read as follows: 'Securities Financing Transactions provided they are subject to reporting under Regulation 2014/0017 (**COD**), the Securities Financing Transaction Regulation or expected to be once the obligations in that Regulation become effective.
<ESMA_QUESTION_CP_MIFID_215>

Q216. Do you foresee any difficulties with the suggested approach? Please justify.

<ESMA_QUESTION_CP_MIFID_216>
Whilst we recognise ESMA's intention to reduce the number of reporting parties, we believe that the proposed approach to defining when transmitting firms have successfully transmitted an order will be especially problematic for ETDs, potentially resulting in an increase rather

than a decrease in the number of reporting parties. In ETD markets, given the extended scope of MIFID II, reporting a contract may already involve more than one party. For example, in relation to the exercise of an option, the execution of the option would be reported by the executing broker and its exercise by the clearing broker as illustrated in the example set out in the response to Question 214.

We anticipate that commercial pressure will require firms executing client business to provide an infrastructure to support the transmission of orders. A client will require all firms with which they execute and clear business to offer a transmission arrangement to ensure that they have a complete reporting solution. Otherwise, where such conditions are not met by all of the client's service providers, the client will be required to build its own reporting infrastructure. In any event, a client will need to have reporting capability for situations where the transmission criteria are not met (e.g. where the client has been unable to provide all required transmission data on a timely basis), which might not always be within its control.

Firms are unlikely to confirm that their clients have not met the transmission criteria until towards the end of T+1 in order to give clients a chance to provide all the necessary information by that time. However, on the occasions where clients fail to do so and must therefore report themselves, clients will have very little time to submit the information to the ARM, even if they have it available. We therefore believe that there will be scenarios where the NCAs will not receive transaction reports within the deadlines imposed.

ESMA should note that these issues are likely to be exacerbated for buy side firms trading ETDs as they typically trade large volumes.

Finally we expect that the executing broker will need to build a capability to validate all client data to ensure completeness prior to submission to an ARM. This could lead to a fragmented service offering as not all industry participants will have the sufficient scale, technical and financial capability to do this and it may result in increased costs to end users.<ESMA_QUESTION_CP_MIFID_216>

Q217. Do you agree with ESMA's proposed approach to simplify transaction reporting? Please provide details of your reasons.

<ESMA_QUESTION_CP_MIFID_217>
Yes. We support this proposal for ETDs and appreciate the clarity that has been provided in the worked examples.
<ESMA_QUESTION_CP_MIFID_217>

Q218. We invite your comments on the proposed fields and population of the fields. Please provide specific references to the fields which you are discussing in your response.

<ESMA_QUESTION_CP_MIFID_218>
Please find our comments on the proposed reporting fields and how they should be populated below.

Fields 8 to 19 and 23 to 34: We have concerns at the amount of personal data to be included in the transaction reports. We believe that it would sufficient to identify natural persons by their national ID number given that these are unique to each individual and will enable the NCAs to find the additional information they require.

Fields 35 to 39: We understand that these fields apply to all types of asset classes and transactions.

Field 42: We do not have an issue with populating this field but we have a concern about the interpretation of “matched principal” as discussed in our response to Question 219 (copied below):

We understand that ESMA wants to identify trades that are entered into purely to facilitate client business. However, we do not think that the “matched principal” capacity is interpreted sufficiently broadly because the definition in Article 1(b) of draft RTS 32 does not take account of situations where a firm acts as a facilitator and makes no profit or loss as described but does not enter into both sides of the transaction simultaneously. Given that the definition is taken from Article 4(1)(38) of MiFID itself, we suggest that, in order to do this, the word "simultaneous" should be interpreted to include scenarios where the second side of the transaction is not necessarily allocated to the end beneficiary at the point of execution. We would welcome acknowledgement of this point in any Questions and Answers that ESMA might produce in respect of MiFID II and MiFIR.

Field 43: ESMA may wish to specify which convention is used for each type of contract. We recommend that ETDs should be reported in the manner in which they are commonly expressed and/ or traded on the relevant trading venue – i.e. by reference to the number of lots. This field would therefore be populated with a numerical figure for ETDs.

Field 44: ESMA may wish to specify which convention is used for each type of contract. We recommend that ETDs should be reported in the manner in which they are commonly expressed and/ or traded on the relevant trading venue – i.e. by reference to the number of lots. This field would therefore be populated with the letter “U” for ETDs.

Field 50: We interpret this field to relate to the cash flows associated with execution of the transaction. For ETDs this will have limited relevance but it will come into play for some ETDs such as premium paid options.

Field 51: We do not have any concerns with this field provided that a segment MIC is available for all trading venues and other markets.

Field 57: The taxonomy for this field does not work for products where the deliverable is not known at the time of execution and/or may come from a range of underlying assets such as a gilt future where the deliverable may be any of a range of gilts. We propose an additional value of “O” meaning “optional as will be determined at a future date following execution”. Please see also our response to Question 222 (copied below):

Yes, but we have some suggested improvements as set out in relation to Fields 57 and 58 in response to Question 218 (response for Field 57 copied below). Firms will use an ISIN where one is available as required. However, where the underlying deliverable asset is unknown at *the point of execution and the list of deliverables is subject to change after the actual execution (e.g. a gilt future where a new gilt might fall into the list of deliverable underlying assets), we propose introducing an additional code to be applied to enable firms to report this information for ETDs.*

Field 58: Please refer to our comments on Field 57. Where the underlying asset is not known at the point of execution (e.g. a gilt future), we propose an additional value such as "O" meaning "optional as will be determined at a future date following execution".

Without clarification, ESMA should expect that firms might report index names in different ways. For example, it could be S&P 500 or Standard and Poors 500. It should also be noted that the 25 alphanumerical characters for the index name may be insufficient.

Field 65: As under the reporting requirements for EMIR, we recommend that this field should not be populated with the option premium.

Field 67: We have a query related to our request for clarification in response to Question 214 (which is copied below). Should this field be reported as part of the report that shows the decrease in the option position after exercise of the option, assuming that firms are required to make such a report?

As noted in our response to the May 2014 Discussion Paper, the definition of transaction means that, in ETD markets, each of the executing broker and the clearing broker will have a reporting obligation. It is therefore important to be clear about which events are reportable and by whom. Our understanding based on the Consultation Paper is that any events arising in the normal course of clearing and settlement are not reportable but that, where something happens that changes the position, this should be reported.

Our main concern relates to clearing brokers and how the exercise or assignment of options is to be reported and we would welcome some clarification on this point. This applies to American, European and other style options. Firms (executing brokers) will report the initial option purchase or sale as a transaction. Clearing brokers will also report the trade resulting from the option exercise or assignment as a separate transaction as indicated in paragraph 21 in Section 8.2 of the Consultation Paper. However, it is unclear whether clearing brokers are also required to report the increase or decrease in the original option position as discussed in paragraph 15 in Section 8.2.

We have put together some worked examples to illustrate what we understand is required. As you will see, it is not necessarily easy to follow the details of the option exercise from the reports that would be made or to see how they tie together. It is important to be aware that the report of the exercise as an increase or decrease would differ from the execution of a transaction in the market. For example, an exercise might involve different market participants acting in differing capacities from the original transaction – the party exercising the option is the clearing broker rather than the executing broker.

Fields 68 to 69: We would like to raise a concern with ESMA's proposal to have traders identified by National ID numbers. We suggest that there are other more suitable items of identification that could be used and are already used within firms to identify individuals, for example the NCA's registration number. While we understand the need for a unique national ID number to be used for natural persons when they are clients, we do not think this is justified in the case of a trader working within a firm and already identified by the NCA via the registration number. A trader ID need not be identified more broadly. Moreover, a registration number is better than a personal ID, as it does not inherit the problem of people with dual nationalities

Field 76: Firms will need to be told which (if any) waiver is relevant by the trading venue in the transaction feed received on execution. See also our response to Question 220 (copied below):

We expect that these waiver flags will be provided in the transaction feed from the trading venues on execution. However, as firms will not be able to comply with their reporting obligations otherwise, we recommend that trading venues are required in RTS 32 to supply this data in an automated manner at the point that execution is confirmed (i.e. on a real time basis) by the trading venue. See also our comments on Field 76 in response to Question 218 (copied below).

Field 77: This does not apply to ETDs. As such, we would expect to populate this field with a null value.

Field 78: We understand that the indicators are those set out in draft RTS 9 Annex II Table 2. We think it would be sensible if they were either duplicated or cross referred to in RTS 32 Annex I.

Field 80: For transactions executed on a trading venue, Annex I Table 1 of RTS 32 provides that this number will be generated by the trading venue. Firms would like an additional field in which they can provide an internal reference number as well.

It should also be noted that for the transaction reference number generated by the trading venue, firms will need to be told the transaction reference number by the trading venue in the transaction feed received on execution.
<ESMA_QUESTION_CP_MIFID_218>

Q219. Do you agree with the proposed approach to flag trading capacities?

<ESMA_QUESTION_CP_MIFID_219>
We understand that ESMA wants to identify trades that are entered into purely to facilitate client business. However, we do not think that the “matched principal” capacity is interpreted sufficiently broadly because the definition in Article 1(b) of draft RTS 32 does not take account of situations where a firm acts as a facilitator and makes no profit or loss as described but does not enter into both sides of the transaction simultaneously. Given that the definition is taken from Article 4(1)(38) of MiFID itself, we suggest that, in order to do this, the word "simultaneous" should be interpreted to include scenarios where the second side of the transaction is not necessarily allocated to the end beneficiary at the point of execution. We would welcome acknowledgement of this point in any Questions and Answers that ESMA might produce in respect of MiFID II and MiFIR.

The conclusion to this issue also impacts on Field 42 of the proposed transaction reporting template. Our comment on that field in response to Question 218 is copied below:

Field 42: We do not have an issue with populating this field but we have a concern about the interpretation of “matched principal”.
<ESMA_QUESTION_CP_MIFID_219>

Q220. Do you foresee any problem with identifying the specific waiver(s) under which the trade took place in a transaction report? If so, please provide details

<ESMA_QUESTION_CP_MIFID_220>
We expect that these waiver flags will be provided in the transaction feed from the trading venues on execution. However, as firms will not be able to comply with their reporting obligations otherwise, we recommend that trading venues are required in RTS 32 to supply this data in an automated manner at the point that execution is confirmed (i.e. on a real time basis) by the trading venue. See also our comments on Field 76 in response to Question 218 (copied below):

Field 76: Firms will need to be told which (if any) waiver is relevant by the trading venue in the transaction feed received on execution.

<ESMA_QUESTION_CP_MIFID_220>

Q221. Do you agree with ESMA’s approach for deciding whether financial instruments based on baskets or indices are reportable?

<ESMA_QUESTION_CP_MIFID_221>
Yes. Given that Article 26(2)(c) of MiFIR includes financial instruments where the underlying is a basket or index composed of financial instruments traded on a trading venue, we agree with the approach of reporting a financial instrument on a basket as soon as one component of the basket is a financial instrument that is admitted to trading or traded on a trading venue as provided for in Article 11 of draft RTS 32.
<ESMA_QUESTION_CP_MIFID_221>

Q222. Do you agree with the proposed standards for identifying these instruments in the transaction reports?

<ESMA_QUESTION_CP_MIFID_222>
Yes, but we have some suggested improvements as set out in relation to Fields 57 and 58 in response to Question 218 (response for Field 57 copied below). Firms will use an ISIN where one is available as required. However, where the underlying deliverable asset is unknown at the point of execution and the list of deliverables is subject to change after the actual execution (e.g. a gilt future where a new gilt might fall into the list of deliverable underlying assets), we propose introducing an additional code to be applied to enable firms to report this information for ETDs.

Field 57: The taxonomy for this field does not work for products where the deliverable is not known at the time of execution and/ or may come from a range of underlying assets such as a gilt future where the deliverable may be any of a range of gilts. We propose an additional value of "O" meaning "optional as will be determined at a future date following execution".
<ESMA_QUESTION_CP_MIFID_222>

Q223. Do you foresee any difficulties applying the criteria to determine whether a branch is responsible for the specified activity? If so, do you have any alternative proposals?

<ESMA_QUESTION_CP_MIFID_223>
We have not identified any issues for ETD at this point.
<ESMA_QUESTION_CP_MIFID_223>

Q224. Do you anticipate any significant difficulties related to the implementation of LEI validation?

<ESMA_QUESTION_CP_MIFID_224>
Whilst legal entity identifiers (**LEIs**) are still being introduced, it should be noted that not all parties with a reporting obligation outside the EEA currently have an LEI. We would welcome ESMA's assistance in rolling this out this regime via the Regulatory Oversight Committee to parties with a reporting obligation outside the EEA.

A firm acting on behalf of clients should be expected to validate each client's LEI when it onboards the client and to conduct periodic reviews of the client's LEI thereafter. However, it should be made clear in RTS 32 that firms are <u>not</u> required to validate their clients' LEIs on a trade-by-trade basis, either before or after execution.

Responsibility for renewing LEIs sits squarely with the counterparty and firms reporting on their behalf should not be penalised for reporting lapsed LEIs provided they have validated their clients' LEIs as described above.
<ESMA_QUESTION_CP_MIFID_224>

Q225. Do you foresee any difficulties with the proposed requirements? Please elaborate.

<ESMA_QUESTION_CP_MIFID_225>
For ETDs, we have not identified any issues.
<ESMA_QUESTION_CP_MIFID_225>

Q226. Are there any cases other than the AGGREGATED scenario where the client ID information could not be submitted to the trading venue operator at the time of order submission? If yes, please elaborate.

<ESMA_QUESTION_CP_MIFID_226>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_226>

Q227. Do you agree with the proposed approach to flag liquidity provision activity?

<ESMA_QUESTION_CP_MIFID_227>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_227>

Q228. Do you foresee any difficulties with the proposed differentiation between electronic trading venues and voice trading venues for the purposes of time stamping? Do you believe that other criteria should be considered as a basis for differentiating between trading venues?

<ESMA_QUESTION_CP_MIFID_228>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_228>

Q229. Is the approach taken, particularly in relation to maintaining prices of implied orders, in line with industry practice? Please describe any differences?

<ESMA_QUESTION_CP_MIFID_229>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_229>

Q230. Do you agree on the proposed content and format for records of orders to be maintained proposed in this Consultation Paper? Please elaborate.

<ESMA_QUESTION_CP_MIFID_230>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_230>

Q231. In your view, are there additional key pieces of information that an investment firm that engages in a high-frequency algorithmic trading technique has to maintain to comply with its record-keeping obligations under Article 17 of MiFID II? Please elaborate.

<ESMA_QUESTION_CP_MIFID_231>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_231>

Q232. Do you agree with the proposed record-keeping period of five years?

<ESMA_QUESTION_CP_MIFID_232>
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<ESMA_QUESTION_CP_MIFID_232>

Q233. Do you agree with the proposed criteria for calibrating the level of accuracy required for the purpose of clock synchronisation? Please elaborate.

<ESMA_QUESTION_CP_MIFID_233>
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<ESMA_QUESTION_CP_MIFID_233>

Q234. Do you foresee any difficulties related to the requirement for members or participants of trading venues to ensure that they synchronise their clocks in a timely manner according to the same time accuracy applied by their trading venue? Please

elaborate and suggest alternative criteria to ensure the timely synchronisation of members or participants clocks to the accuracy applied by their trading venue as well as a possible calibration of the requirement for investment firms operating at a high latency.

<ESMA_QUESTION_CP_MIFID_234>
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<ESMA_QUESTION_CP_MIFID_234>

Q235. Do you agree with the proposed list of instrument reference data fields and population of the fields? Please provide specific references to the fields which you are discussing in your response.

<ESMA_QUESTION_CP_MIFID_235>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_235>

Q236. Do you agree with ESMA's proposal to submit a single instrument reference data full file once per day? Please explain.

<ESMA_QUESTION_CP_MIFID_236>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_236>

Q237. Do you agree that, where a specified list as defined in Article 2 [RTS on reference data] is not available for a given trading venue, instrument reference data is submitted when the first quote/order is placed or the first trade occurs on that venue? Please explain.

<ESMA_QUESTION_CP_MIFID_237>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_237>

Q238. Do you agree with ESMA proposed approach to the use of instrument code types? If not, please elaborate on the possible alternative solutions for identification of new financial instruments.

<ESMA_QUESTION_CP_MIFID_238>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_CP_MIFID_238>

9. Post-trading issues

Q239. What are your views on the pre-check to be performed by trading venues for orders related to derivative transactions subject to the clearing obligation and the proposed time frame?

<ESMA_QUESTION_CP_MIFID_239>

FIA Europe submits that the pre-trade checks to be performed by Trading Venues are not required in the ETD market as the intention of the MiFIR level 1 text is already met through the market's current structure. Article 29 (2) of MiFIR states that "*CCPs, Trading Venues and investment firms which act as clearing members….shall have in place effective systems, procedures and arrangement in relation to cleared derivatives to ensure that transactions in cleared derivatives are submitted and accepted for clearing as quickly as technologically practicable using automated systems*". Where binding contractual arrangements arise upon trade execution under the rulebooks of Trading Venues and CCPs this requirement is met. Also, the introduction of pre-trade checks would cause significant disruption to the ETD market. Therefore FIA Europe proposes that Article 3 of the draft RTS be amended so as to exclude from the pre-trade check requirement those orders that benefit from certainty of clearing upon trade execution through the binding contractual arrangements of the Trading Venue and CCP rulebooks.

We recognise the inherent differences between OTC and ETD markets and would therefore stress that this response is applicable for ETD only. For OTC we defer to ISDA to advise on the appropriate STP infrastructure for those markets.

Certainty of Clearing

To ensure market integrity and user confidence, ETD markets include rules to ensure that certainty of clearing is an in-built design feature. In a multilateral anonymous counterparty ETD market, the credit risk of counterparties is mitigated through the rulebooks of the Trading Venues and their associated CCPs, which set out membership standards, contractual arrangements, operational processes and technology infrastructure requirements for Trading Venue members and clearing members.

Trading Venues rules require that for every exchange member executing on the market there is a clearing member that is contractually obliged to stand behind the trade either as buyer or as seller of the contract. Under the contractual obligations of the CCP rules, these Trading Venue contracts are then discharged and are immediately replaced with a legally binding contract between the buying clearing member and the CCP on the one hand, and the selling clearing member and the CCP on the other.

The enforcement of standing data requirements by the technology platforms of the Trading Venue and the CCP (based upon the standard contract specifications of the Trading Venue) means that all orders submitted must meet the precise requirements of the contract specification in order to be accepted for execution. Any incorrect orders (for example, invalid exercise prices, expiry dates or tick values) are rejected by the Trading Venue at the point of order submission. As such, any transactions arising from the execution of such orders are in a format that will be accepted for clearing by the CCP. Robust, resilient and integrated high performance messaging interfaces between clearing members, Trading Venues and CCPs provide for the near real time transfer of transactions from the Trading Venue to the CCP and for the immediate re-transmission of such transactions to the relevant clearing members.

Included at the end of this response to Q239 are examples of current Trading Venue and CCP rules that highlight how these arrangements are facilitated in the relevant rules. These contractual arrangements of the Trading Venue and CCP ensure certainty of clearing of trades executed on the Trading Venue and meet the requirements of Article 29 (2) of MiFIR. FIA Europe therefore proposes that Article 3 of the draft RTS be amended so as to exclude from the pre-trade checks orders submitted for derivative contracts by those clearing members who are members of Trading Venues and their associated CCPs where *binding contractual obligations* arise between the Trading Venue members and their clearing members, and *consequently between the clearing members and the CCP immediately upon execution of the Trading Venue transaction.*

Market Disruption

Although ESMA has not undertaken a cost benefit analysis on the impact of requiring pre-trade client order level checks to be undertaken, it should be understood that this would cause a fundamental re-structuring of the ETD market infrastructure and negatively impact execution quality and service for end user clients. In order for client level credit limit checks to be undertaken, this would require a real-time interactive link between the CCP, the Trading Venue, the clearing member and the client, plus each Executing Broker and its clearing member (should that execution route still be viable) for the calculation of the impact of the trade upon the existing positions of the client and resultant margin requirement by the CCP and the transmission of this information to the other parties.

Currently asset managers and pension funds submit aggregated orders on behalf of multiple funds to Trading Venues requiring execution of such orders so as to obtain average prices / volume weighted average prices. They will use a number of different executing brokers to undertake this activity, determined by such factors as cost, quality of execution service, product expertise, market expertise and quality of research. For pre-trade checks to work in practice, the Trading Venue and the CCP would need to know the identity of each originating client for which the order is submitted and for the CCP to be able to identify the positions held by each such client. This would require asset managers and pension funds to fundamentally change the way in which their orders are submitted to Trading Venues and the way in which positions are held by CCPs. Such a change could potentially force such participants out of the European ETD market.

The impact of each individual order upon the margin requirement of the client and the impact upon the client’s limit would then need to be translated into a number of lots of that order that can be submitted for execution. In order to avoid the introduction of latency into the execution of such orders, where Trading Venues have already invested significant sums of money to reduce trade execution times down to milliseconds, Trading Venues, CCPs and clearing members would need to completely re-engineer the market infrastructure and face the seemingly impossible technology challenge of implementing pre-trade order limit checks with lower processing times than that of the Trading Venue's matching algorithm.

In the event of any delay or interruption of the transmission of this information between the parties, this could result in orders not being executed at all (with clients effectively being shut out of the market through no fault of their own) or orders being submitted for execution behind other members' orders and for such orders potentially to be executed at an inferior price than that which would have been available if they had been submitted with no delay.

The extent to which the obligations pursuant to Article 29(2) and draft RTS 37 apply to Trading Venues operated by firms located outside the EU and/or to non-EU CCPs that have been recognised under Article 25 EMIR should be clarified. It would also be helpful to define the scope of "clearing member" as this is not currently defined in the level 1 text.

The following extracts from the rules of Eurex Deutschland and its CCP, Eurex Clearing, ICE Futures Europe and its CCP, ICE Clear Europe, and Euronext Paris and its CCP, LCH.Clearnet SA are examples of the contractual arrangements that provide the certainty of clearing that is required by MiFIR Article 29 (2):

Conditions for Trading at Eurex Deutschland and Eurex Zürich

2.3 Binding Nature of Transactions

(1) Transactions that are concluded on Eurex Exchanges are consummated only between Eurex Clearing AG and an enterprise holding a Clearing License.

(2) If an Exchange Participant which is not itself authorised to participate in the clearing procedure (a "Non Clearing Member"), it may only effect transactions via the General Clearing Member or the affiliated Direct Clearing Member which performs the clearing of its transactions on the Eurex Exchanges. If an order or quote entered into the EDP system of the Eurex Exchanges by a Non-Clearing Member is matched with another order or quote, a transaction is effected between such Non Clearing Member and the General Clearing Member or the affiliated Direct Clearing Member, and a corresponding transaction is simultaneously effected between such General Clearing Member or the affiliated Direct Clearing Member and Eurex Clearing AG.

Clearing Conditions for Eurex Clearing AG

Chapter 1, Part 1

1.2.2 Conclusion of Transactions and Transfer of Transactions

Transactions pursuant to these Clearing Conditions will be concluded and may be transferred in accordance with this Number 1.2.2.

(1) Market Transactions

Market Transactions are concluded as follows:

(a) Whenever an order or quote entered into the trading systems of a Market by a Clearing Member is matched with another order or quote, in each case a Market Transaction with identical terms shall be concluded between Eurex Clearing AG and the relevant Clearing Member(s) (each hereinafter also an “executing Clearing Member”).

(b) Whenever an order or quote entered into the trading systems of a Market by a Non-Clearing Member is matched with another order or quote, in each case a Market Transaction with identical terms shall be concluded between Eurex Clearing AG and the relevant Clearing Member(s) and a corresponding Transaction shall be concluded simultaneously between such Non-Clearing Member (hereinafter also an “executing Non-Clearing Member”) and its Clearing Member.

ICE Futures Europe Regulations

Section F – Contracts

F.1.2 The following Rules apply to a Platform Trade that is matched between one Member and another Member (the "Counterparty") which may be the same Person as the first-mentioned Member pursuant to Rules F.1.3 and F.1.4. Pursuant to the Clearing House Rules, two Contracts arise at the time of such matching, which for the purposes of this Rule F.1 shall be called the ICE Futures Europe Matched Contracts.

F.1.3 The two ICE Futures Europe Matched Contracts arising in accordance with Rule F.1.2 shall be between the following parties:

(i) one Contract between the Clearing House and the following counterparty or counterparties acting as Buyer (the "First Leg Contract"):

(Own account Platform Trades of the Member)

(A) if the Member is a Clearing Member and is clearing a Platform Trade for its own account, the Member;

(B) if the Member (such Member, for the purposes of this Rule F.1, a "non-clearing Member") is entering into a Platform Trade for its own account and is not a Clearing Member or Sponsored Principal, (or, if it is a Clearing Member or Sponsored Principal, and has, by act or omission, established settings in the ICE Systems such that it will not clear the relevant Platform Trade in either such capacity) the Clearing Member that has been selected by the Member as Clearing Member for the Platform Trade ("Clearing Member A");

(C) if the Member is a Sponsored Principal and is entering into a Platform Trade for its own account, the Member, acting as Sponsored Principal ("Sponsored Principal A") and its Sponsor ("Sponsor A") on a joint basis as provided in the Clearing House Rules, provided that the Member has established settings in the ICE Systems to clear the relevant Platform Trade in such capacity;

(Client account Platform Trades of the Member)

(D) if the Member is a Clearing Member and is entering into a Platform Trade for the account of its client which is not a Sponsored Principal (or the client is a Sponsored Principal but has, by act or omission, established settings in the ICE Systems such that it is not acting in such capacity for the purpose of the relevant Platform Trade), the Member;

(E) if the Member (such Member or its client, for the purposes of this Rule F.1, a "non-clearing counterparty") is not a Clearing Member and is entering into a Platform Trade for the account of a client which is not a Sponsored Principal (or the client is a Sponsored Principal but has, by act or omission, established settings in the ICE Systems such that it is not acting in such capacity for the purpose of the relevant Platform Trade) the Clearing Member that has been selected by the Member as Clearing Member for the Platform Trade ("Clearing Member B"); and

(F) if the Member is a Clearing Member and is entering into a Platform Trade for the account of its client which is a Sponsored Principal and which has established settings in the ICE Systems such that it is acting as a Sponsored Principal for the purposes of the relevant Platform Trade, and the Member is the Sponsor of such Sponsored Principal, the Member, acting as Sponsor ("Sponsor B"), and the client, acting as Sponsored Principal ("Sponsored Principal B") on a joint basis as provided in the Clearing House Rules;

(G) if the Member is entering into the Platform Trade for the account of its client which is a Sponsored Principal and which has established settings in the ICE Systems such that it is acting in its capacity as a Sponsored Principal for the purpose of the relevant Platform Trade, and the Member is not the Sponsor of such Sponsored Principal (irrespective of whether the Member is a Clearing Member), such other Member, acting as Sponsor ("Sponsor C"), and the client (of both the Member and Sponsor C), acting as Sponsored Principal ("Sponsored Principal C") on a joint basis as provided in the Clearing House Rules; and

(ii) another Contract between the Clearing House and a counterparty or counterparties acting as Seller in the same way as set out in Rule F.1.3(i) above but with respect to the Counterparty (the "Second Leg Contract").

ICE Clear Europe Clearing Rules

Part 4 Clearing Mechanism

Rule 401 Formation of Contracts

(a) Subject to Rule 403 and Rule 404, two Contracts shall arise automatically, one between the Selling Counterparty and the Clearing House and the other between the Clearing House and the Buying Counterparty (or a single Contract shall arise between the Clearing House and a Buying Counterparty or Selling Counterparty where applicable in the case of Rule 401(a)(vi)), at the moment that:

(i) in the case of any ICE Endex Matched Transaction, ICE Futures Europe Matched Transaction, ICE Futures US Matched Transaction or Financials & Softs Matched Transaction, the relevant orders are matched on ICE Endex, ICE Futures Europe, ICE Futures US or LIFFE, as applicable;

(ii) [Not used.];

(iii) in the case of any ICE Endex Block Transaction, ICE Futures Europe Block Transaction, ICE Futures US Block Transaction or Financials & Softs Block Transaction: ICE Endex, ICE Futures Europe, ICE Futures US or LIFFE, as applicable, receives and has recorded on its system complete data in respect of the Transaction;

Euronext Paris

EURONEXT RULE BOOK – BOOK I
HARMONISED RULES

CHAPTER 2: EURONEXT MEMBERSHIP

2.5. CLEARING ARRANGEMENTS

2501 GENERAL CLEARING ARRANGEMENTS

2501A/1 Each Euronext Market Undertaking shall appoint a clearing house duly authorized and/or recognized by the relevant Competent Authority to clear Transactions unless otherwise specified in Book II.

2501A/2 Contractual relationships arising pursuant to the effecting and clearing of Transactions may be specified in Book II.

2501A/3 Pursuant to Rule 2501A/1, Transactions shall be cleared by LCH.Clearnet S.A., being the clearing house appointed for that purpose by the Relevant Euronext Market Undertaking.

2501/1 Any Member wishing to trade on the Euronext Markets other than as a customer of another Member must be party to a Clearing Agreement in respect of those Financial

Instruments which it is authorised to trade but which it is not authorised to clear.

2502 CLEARING AGREEMENTS

2502/1 Any Member wishing to trade other than as a customer of another Member shall enter into a Clearing Agreement which complies with any requirements imposed by or pursuant to the relevant Clearing Rule Book from time to time in force in respect of those Financial Instruments which it is not authorised to clear.

2502/2 In order to trade on a Euronext Market, each Member which is not a Clearing Member in respect of the Financial Instrument he is authorised to trade must have filed with the Relevant Euronext Market Undertaking (or have filed on his behalf) an unrevoked and valid Clearing Mandate, which may either be a copy of the Clearing Agreement entered into by such Member or written confirmation of the existence of such Clearing Agreement.

CHAPTER 5: TRADING RULES FOR DERIVATIVES

5303 ORDER EXECUTION

5303/3 All bids, offers and Transactions made through the Euronext Trading Platform workstation shall be binding on the Euronext Derivatives Member through whose Individual Trading Mnemonics such bids, offers or Transactions (as the case may be) are made.

5304 CONTRACTUAL RELATIONSHIPS

5304/1 Valid acceptance of a valid bid or offer shall make a Transaction between the members whose traders made the bid or offer and the acceptance.

EURONEXT RULE BOOK – BOOK II:

SPECIFIC RULES APPLICABLE TO THE FRENCH REGULATED MARKETS

PART II – RULES APPLICABLE TO MATIF AND MONEP

Article P/M 1.0
The MATIF ("Marché à Terme International de France") and the MONEP (Marché des Options Négociables de Paris) are two regulated markets, within the meaning of Article L.421-1 of the "Code Monétaire et Financier", which are operated by Euronext Paris.

As a result of an agreement, trades carried out on the MATIF and the MONEP are cleared and guaranteed by Banque Centrale de Compensation, hereafter LCH.CLEARNET, according to the conditions and limits specified by the operating rules of the clearing house LCH.CLEARNET.

Unless otherwise specified, the following provisions of this Book II of the Euronext Rule Book shall apply equally to both of these markets in addition or, where such is the case, by special dispensation to those of Book I.

LCH.Clearnet SA – Clearing Rule Book

TITLE I – GENERAL PROVISIONS & LEGAL FRAMEWORK
Chapter 3 LEGAL FRAMEWORK

Section 1.3.1 Status and Activity of LCH.Clearnet SA

B. Scope of Activity

Article 1.3.1.5
In accordance with this Clearing Rule Book, and for Transactions eligible to novation pursuant to Article 1.3.1.6 below, LCH.Clearnet SA registers Transactions, calculates Open Positions of its Clearing Members, and the associated risk, calls Margin to cover this risk, guarantees the proper settlement of positions as central counterparty, manages the default procedures, transmits settlement instructions to the settlement provider and performs all other functions specified by the Clearing Rules.

Article 1.3.1.6
Transactions executed on any Regulated Market or MTF, or executed or matched on any Trading & Matching Platform, may give rise to novation by LCH.Clearnet SA provided that the Financial Instruments in question comply with the following criteria:
- LCH.Clearnet SA has entered into an agreement, for the provision of Clearing Services in respect of the relevant Financial Instruments, with the Market Undertaking operating the Regulated Market, or the MTF or the operator of the Trading and Matching Platform on which the Financial Instruments are negotiated;

Section 1.3.2 General Clearing Principles

A. General

A.1. Novation and Irrevocability

Article 1.3.2.1
All Transactions complying with the criteria mentioned in Article 1.3.1.6 that are submitted to LCH.Clearnet SA, within the clearing hours as set out in a Notice are registered in the name of the Clearing Member. Upon registration, novation occurs. As a result of novation, LCH.Clearnet SA becomes counterparty to the Clearing Member and becomes therefore subject to the rights and subject to the obligations arising from the Transaction registered in the name of such Clearing Member.

Article 1.3.2.2
Any Transaction, received by LCH.Clearnet SA, from a Clearing Member, pursuant to Article 1.3.2.1 is deemed irrevocable in the sense of Article L 330 1 § III of the Financial and Monetary Code as soon as it is registered in the Clearing System in accordance with Article 3.1.1.1 and within the clearing hours as set-out in a Notice, without prejudice to the

exception foreseen in Article 3.3.1.3.

Article 1.3.2.3

Submission by Clearing Members of Transactions complying with the criteria mentioned in Article 1.3.1.6 signifies the acceptance by such Clearing Members of the novation.

TITLE III – CLEARING OPERATIONS

CHAPTER 1- REGISTRATION

Section 3.1.1 Registration of Transactions

Article 3.1.1.1

From the matching of the Transaction, LCH.Clearnet SA guarantees that the Transaction will be registered in the Clearing System forthwith, unless otherwise provided in a Notice.

LCH.Clearnet SA will not be held liable if a Transaction is not registered or is improperly registered in the Clearing System because of a third party's fault or Force Majeure.

A. Registration of Transactions Registered in the Cash & Derivatives Clearing System

Article 3.1.1.3

The Cash & Derivatives Clearing System, monitors Transactions on real time basis, and is a single system for processing Transactions carried out on markets operated by a Market Undertaking, in respect of both Securities and Derivatives Product Groups.

Article 3.1.1.4

Each Clearing Day, LCH.Clearnet SA registers in real time Transactions carried out in Securities & Derivatives Product Groups except for certain categories of Transactions set out in an Instruction.

LCH.Clearnet SA informs each Clearing Member of the Trade Legs registered in its name.

Proposed amendments to RTS 37 to reflect the contractual certainty of clearing - addition of a new recital 4 and additions to Article 3:

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

Having regard to Directive (EU) No 2014/65/EU [MiFID II] of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, and in particular Article 17(a) thereof.

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

Whereas:

(1) In order to manage operational risk, it is important to determine whether a derivative transaction can be cleared by a CCP at an early stage. It is therefore necessary to identify it in a clear manner.

(2) The information needed by the trading venue and the CCP to perform their tasks as set in this regulation should be pre-determined and clearly set in the documentation of the trading venue and CCP.

(3) It is more efficient for the market to determine whether a difficulty could occur in the post-trading process, at an early stage, and preferably before the transaction is entered into. Therefore, when the derivative transaction is entered into on a trading venue, the trading venue should get the clearing member limits for the clients and check them against the orders.

(4) It is not necessary for the clearing member to provide such limits or for the trading venue to check orders it receives against them when the rules of the trading venue and the CCP that clears the transaction resulting from such orders require that the CCP becomes the central counterparty to the buying and selling clearing members for each such transaction.

(~~4~~5) When a transaction is entered into electronically on a trading venue, its processing can be automated and therefore its processing time can be much shorter than when it is not. As a result the time for a trading venue to process a derivative transaction should be much shorter for electronically traded derivative transactions.

(~~5~~6) As the trading venue sends the information related to derivative transactions to the CCP in a pre-agreed electronic format for both the transactions entered into in an electronic and non-electronic manner, the CCP should not need a different timeframe for these transactions for deciding whether the transaction can be accepted for clearing or not.

(~~6~~7) When derivative transactions subject to the clearing obligation are not entered into on a trading venue but on a bilateral basis, the process is usually less automated. As a result, more time would be needed to transfer the information to the CCP.

(~~7~~8) In order to manage the credit risks related to derivative contracts that are not entered into on a trading venue, the CCP should allow the clearing member to review the transaction and decide whether to accept it. As the process between the CCP and the clearing member is usually automated, this process should require limited time.

(~~8~~9) When derivative contracts are cleared on a voluntary basis, they can be submitted for clearing at any time. At the point when they are submitted to the CCP, they do not differ from other derivative transactions and the same process as for those submitted to the clearing obligation should apply.

(~~9~~10) As the processing of a derivative transaction subject to the clearing obligation concluded electronically on a trading venue is very short, there should be no or extremely limited damage suffered by the counterparties whose transactions are rejected by a CCP and therefore these transactions should be considered void. As the timeframe is longer for other derivative contracts, the parties should know in advance how the transaction will be treated.

(1~~0~~1) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the European Commission.

(1~~1~~2) In accordance with Article 10 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council, the European Securities and Markets Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010."

"CHAPTER II

Straight through processing

Section 1

Derivative transactions mandatorily cleared and executed on a Trading Venue

Article 3

Pre-trade check

1. A clearing member shall provide to the trading venue the limits applicable to its clients that are entering into transactions referred to in Article 2 on that trading venue and update them on a regular basis.

2. A trading venue shall check that the amount of the order of the client is within the limit set by the clearing member for that client before the execution of the order.

3. The trading venue shall perform the check referred to in paragraph 2:

   (a) within 60 seconds from the receipt of the order when the order is entered into electronically;

   (b) within 10 minutes from the receipt of the order when the order is not entered into electronically

When the order is not within the limit, the trading venue shall inform the client and the clearing member on a real time basis when the order is entered into electronically, and within 5 minutes when the order is not entered into electronically.

4. When a trading venue is using the services of a service provider, it remains responsible for complying with paragraphs 2 and 3 of this Article.

5. Paragraphs 1 to 4 of this Article 3 shall not apply to a clearing member or a trading venue in respect of any order which is submitted to that trading venue by a member or participant of the trading venue or any client where, on execution of a transaction resulting from such order pursuant to the rules of the trading venue:

   (a) the rules of the trading venue require that each such member or participant which is not a clearing member of the CCP through which the transaction is cleared has a contractual arrangement with such a clearing member, under which the clearing member automatically becomes party to the transaction;

(b) the rules of the CCP through which such transaction is cleared provide that the transaction is cleared by the clearing member on each side of the transaction automatically becoming the counterparty to the CCP; and

(c) the rules of the trading venue provide for the immediate creation of equivalent transactions between the clearing member and the member or participant of the trading venue or its client, as the case may be.

6. For the purposes of Article 3(5):

(a) a member or participant of a trading venue is a person which is recognised as such by the trading venue and which is bound by the rules of that trading venue; and

(b) a client is a person which has a contractual arrangement with a member or participant of the trading venue permitting it to submit orders to the trading venue and providing that the member or participant will enter into an equivalent transaction to the transaction(s) created pursuant to the rules of the trading venue if the rules of the trading venue do not themselves create an equivalent transaction to which the client is party."

<ESMA_QUESTION_CP_MIFID_239>

Q240. What are your views on the categories of transactions and the proposed timeframe for submitting executed transactions to the CCP?

<ESMA_QUESTION_CP_MIFID_240>
FIA Europe's response is focused on ETD transactions that fall into the single category of "transactions executed electronically on a Trading Venue" where certainty of clearing upon trade execution is provided through the contractual arrangements of the rules of the Trading Venue and CCP.

Well-established ETD Trading Venues have invested a great deal of time and money in ensuring that their technology platforms are scaled so as to facilitate trade execution in milliseconds and to have appropriate capacity so as to transfer these transactions to the CCP in near real-time. However, the experience of our members has shown that, on occasion, there can be peaks in trading activity (e.g. in reaction to extreme world events / unexpected economic figures) where the number of trades executed exceeds the maximum planned message flow rate capacity of the Trading Venue, thus causing a back-log of trades to queue up for transmission to the CCP. It is FIA Europe's view that, in order to accommodate these occasional peaks in activity, the timeframe for submitting executed transactions to the CCP should be **an average of not more than 10 seconds** (measured over the Trading Venue's hours of trading) rather than within 10 seconds. It should be the responsibility of the relevant NCA to ensure that the Trading Venue and its CCP have sized their technology infrastructures and messaging interfaces so as to be able to meet this standard.

Proposed amendments to Article 4 of RTS 37:

“Article 4

Transfer of information

1. For transactions referred to in Article 2 executed electronically on a trading venue, the trading venue shall send the information related to the transaction to the CCP within an average of 10 seconds measured over the trading venue’s hours of trading on each trading day.

2. For transactions referred to in Article 2 that are not executed electronically on a trading venue, the trading venue shall send the information related to the transaction to the CCP within 10 minutes from the execution of the transaction.

3. The CCP shall accept or reject the clearing of a transaction referred to in paragraphs 1 or 2 within an average of 10 seconds following the receipt of the transmission from the trading venue measured over the trading venue’s hours of trading on each trading day and inform the clearing member and the trading venue on a real time basis.”

<ESMA_QUESTION_CP_MIFID_240>

Q241. What are your views on the proposal that the clearing member should receive the information related to the bilateral derivative contracts submitted for clearing and the timeframe?

<ESMA_QUESTION_CP_MIFID_241>
The response of FIA Europe is focused on the ETD markets and not the OTC bilateral trades subject to the clearing obligation in accordance with Article 4 of Regulation (EU) No 648/2012.
<ESMA_QUESTION_CP_MIFID_241>

Q242. What are your views on having a common timeframe for all categories of derivative transactions? Do you agree with the proposed timeframe?

<ESMA_QUESTION_CP_MIFID_242>
The response of FIA Europe is focused on the ETD markets and not the OTC bilateral trades subject to the clearing obligation in accordance with Article 4 of Regulation (EU) No 648/2012. For ETD markets in our response to Q240 we have proposed that, in order to accommodate peaks in trading activity, the timeframe for submitting executed transactions to the CCP should be **an average of not more than 10 seconds** (measured over the Trading Venue’s hours of trading) rather than within 10 seconds.
<ESMA_QUESTION_CP_MIFID_242>

Q243. What are your views on the proposed treatment of rejected transactions?

<ESMA_QUESTION_CP_MIFID_243>
For ETD transactions, given the certainty of clearing obtained through the contractual obligations that arise upon execution of a transaction, rejection of such transactions by the CCP does not arise in the normal course of activity. Given the anonymous multilateral counterparty model of ETD markets, where counterparties are not exposed to their undisclosed trading counterparty, the impact of rejection of matched transactions by the CCP relating to the creditworthiness of, for example, the selling clearing member would result in the transactions of those clearing members who were the buyer(s) of the transaction also being rejected, despite there being no issue with their part of the transaction. It is for this very reason that anonymous, multilateral counterparty Trading Venues and their CCPs have

rulebooks that provide certainty of clearing: the invalidation of seemingly good transactions for one counterparty would severely undermine the integrity of the market and cause a significant lack of confidence amongst its users.

In order to prevent adverse impacts on the integrity of the market and confidence of its users that transaction rejection would bring, the CCP relies upon immediate post-trade risk management of the transaction and will undertake regular, intra-day assessments of the impact of transactions upon the portfolio of positions held at the CCP by each clearing member to confirm the appropriate margin cover is held. If necessary, the CCP will make an intra-day call for additional margin or, in extremis, will require the clearing member to reduce its risk exposure by trading to close out part of its position. In turn, the clearing member undertakes the same regular margin cover / risk exposure calculations in respect of its exchange members and other clients across multiple markets and, if necessary, calls for additional intra-day margin or otherwise manages down the position through further trading in the market.

Notwithstanding the above, all Trading Venues and CCPs have provisions in their rules relating to the invalidation of transactions post registration with the CCP. For example, transactions arising as a result of market activity considered as disorderly by the Trading Venue (or its NCA) or a Trading Venue technology issue, such as a messaging infrastructure failure or a matching algorithm problem. In such circumstances, Trading Venue and CCP rules will determine the treatment of such transactions, which may include adjustment of the execution price of transactions, rather than the invalidation of such transactions.

In the event that ESMA considers that the invalidation of transactions post registration, rather than rejection pre-registration, be included within Article 7 of RTS 37, FIA Europe would ask ESMA to amend the RTS such that the rules of the Trading Venue and CCP should govern the treatment of these transactions.
<ESMA_QUESTION_CP_MIFID_243>

Q244. Do you agree with the proposed draft RTS? Do you believe it addresses the stakeholders concerns on the lack of indirect clearing services offering? If not, please provide detailed explanations on the reasons why a particular provision would limit such a development as well as possible alternatives.

<ESMA_QUESTION_CP_MIFID_244>
Introduction

FIA Europe is pleased to submit these comments with respect to the draft Regulatory Technical Standards on Indirect Clearing (the "**RTS**") in response to questions 244 and 245 of ESMA's Consultation Paper on MiFID II/MiFIR (ESMA/2014/1570) (the "**CP**"). For ease of review, we have structured our response as follows:

Part I – A description of our key concerns regarding the current draft of the RTS and a summary of the proposed solutions;

Part II – A proposed revised draft of the RTS (the "**Revised Draft RTS**") which addresses our concerns with the current draft RTS and seeks to provide a robust and workable indirect clearing regime for exchange traded derivatives ("**ETD**"); and

Part III – A commentary table setting out in detail the basis for each of the amendments we propose to make to the RTS.

Our comments are limited to the technical standards which will apply in respect of indirect clearing arrangements with regard to ETD. We understand that ESMA is also planning to give further consideration to the existing technical standards regarding indirect clearing arrangements for OTC derivatives (the "**EMIR RTS**"). We welcome this and believe that the proposed amendments in the Revised Draft RTS would address many of the issues with the EMIR RTS that have disincentivised firms from offering indirect clearing services for OTC derivatives in accordance with those rules. However, it is important to note that there are differences between ETD and OTC derivatives, which mean that certain amendments to the Revised Draft RTS would likely be necessary to render them suitable for indirect clearing of OTC derivatives. With respect to indirect clearing of OTC derivatives, we have had the opportunity to review the responses of the International Swaps and Derivatives Association, Inc., and fully support those comments.

Part I: Key Concerns

The ETD market is an established, well-functioning and generally highly liquid market involving standardised products and most ETD products are already centrally cleared. Indirect clearing arrangements (particularly clearing arrangements where a global clearing services provider clears its clients' trades on CCPs on which the global clearing services provider is not a direct clearing member, via other entities which are direct clearing members) already form a part of the market standard model for ETD business. We are strongly of the view that application of the RTS, as currently drafted, would jeopardise the regulatory objective of access to markets, limiting access for ETD end users to global ETD markets and thereby reducing liquidity and increasing market risk.

While we acknowledge and appreciate that ESMA has sought to address some of the concerns raised by market participants in respect of the EMIR RTS, we believe that certain features of the RTS are likely to impose obligations with which ETD market participants will be unable to comply and/or will cause undue market disruption. We believe that these issues are contributing factors to the absence of an offering of indirect clearing services for OTC derivatives. In particular, we highlight the following concerns and proposed solutions:

Jurisdictional scope and conflict of laws

It is important that the RTS include sensible scope parameters to ensure that they apply to indirect clearing arrangements with an appropriate EU nexus and that they will be workable in practice. In the interests of legal certainty, we encourage ESMA to include those scope parameters in the operative provisions of the RTS themselves, rather than in accompanying Q&A. In our view the purpose of the RTS is to provide protections to EU indirect clients clearing through EU CCPs and the scope of the RTS should be limited accordingly. We also ask ESMA to consider limiting the application of the RTS to EU clients, as many of the conflict of laws issues highlighted in Part III of our response could be avoided by such scope limitation.

We note that unless ESMA limits the scope to EU clients only, clients outside of the EU will need to comply with their local laws and that those local laws will not necessarily be compatible with the RTS. This could effectively prevent a large number of existing clients (including US clients) providing indirect clearing services. In this regard, we draw ESMA's attention to the responses of our affiliate, FIA, which focuses on the impact of the RTS on the ability of US Futures Commission Merchants (FCMs) to provide services to their clients and the conflict of law between the RTS and the US Bankruptcy Code. We have had the opportunity to review the FIA's response and fully support their comments and conclusions.

Default management process

We are suggesting drafting amendments to achieve the following:

- clarity that the clearing member ('CM') is only required to take steps to return assets to indirect clients that have selected gross omnibus segregated accounts ('GOSA' or 'gross OSA') and that there are circumstances in which a CM is not able or permitted to make a return of assets or liquidation proceeds directly to the indirect clients. Instead, in those circumstances the clearing member should have flexibility to adopt procedures that contemplate making a payment of the liquidation proceeds to the insolvent client for the account of its indirect clients.

- clarity that for net omnibus segregated accounts ('NOSA' or 'net OSA') clients, a CM is expected to have a robust procedure to liquidate the portfolio and return assets to the client for the account of the indirect clients. Note: EMIR Article 48(7).

- clarity that the client is only required to include in its agreement with the indirect client terms to facilitate the prompt return of the liquidation proceeds to indirect clients, if the indirect client has selected gross OSA.

Scalabilty and implementation challenges

Whilst in the Revised Draft RTS we have sought to provide a workable framework for indirect clearing arrangements in respect of ETD, we anticipate that the implementation of the requirements in the Revised Draft RTS will entail a number of operational and implementation challenges, which, together, could result in the widespread cessation of indirect clearing arrangements in light of the resultant operational, legal/re-papering, business, capital and compliance requirements.

The scale of the market upheaval – not least the requirement for clearing members and clients to repaper all indirect clearing arrangements (i.e. thousands of legal relationships) to accommodate the RTS – cannot be underestimated. Operational changes will also be significant: the RTS introduce a new type of GOSA account and impose requirements as to the functionality associated with such account (in particular in respect of excess margin). Accordingly, CCPs, clearing members and clients will need to develop systems and procedures to support this new account functionality which may differ from CCP to CCP. The implementation challenges are likely to be heightened further by the fact that the requirements are due to come into force from **3 January 2017,** impacting all existing indirect clearing arrangements. In our view this timeline is likely to pose very serious problems for market participants, many of which will be required to reconsider the feasibility of an indirect clearing offering.

Other issues

- In the Article 39 EMIR context, it has been extremely difficult for CMs to obtain responses from clients on the type of account they desire. It is likely to be even more difficult to obtain account choices in the indirect clearing context, particularly given that many clients in indirect clearing arrangements are non-EU entities and may not feel compelled to pursue indirect clients for responses. Our drafting suggests that in the absence of the indirect client's choice of account, notwithstanding the client's reasonable efforts, the client should be able to "default" indirect clients to net OSA.

- Risk management obligations imposed on the CM need to be workable, clear, fair and comparable with the risk management obligations imposed on CCPs.

- Clearing chains which involve entities that receive ETD clearing services from indirect clients ('longer chains') are not subject to the RTS and we sought clarification to that end in the RTS via a drafting amendment which also ensures that the first four parties in the chain must always comply with the RTS, even if the chain contains more than four parties.

Furthermore, we also expect further issues to arise as market participants seek to implement the requirements and that ESMA will need to provide guidance on these and other issues. On such issues, we are keen to continue a constructive dialogue with ESMA and to ensure that they are addressed in a consistent manner.

Finally, we note that Annex A of the CP does not provide a cost-benefit analysis of the requirements of the RTS. Both the RTS and our Revised Draft RTS impose a number of obligations on CCPs, clearing members, clients and are likely to require a number of changes to established ETD markets. Prior to the promulgation of the final draft RTS it is therefore imperative that a full cost-benefit analysis is published and that market participants are given the opportunity to discuss the analysis with ESMA.

PART II: Revised draft of the RTS

The changes that FIA Europe's members propose that ESMA make to the RTS are set out in Annex 1 to FIA Europe's response.

Part III: Commentary Table

Provision	**Summary of FIA Europe Amendment(s)**	**Explanation**
Recital 1	Clarify that indirect clearing arrangements outside the scope of the RTS are not prohibited	Our amendments to Article 1 propose sensible scope parameters for the RTS. The amendment to Recital 1 clarifies that indirect clearing arrangements that fall outside the suggested scope parameters (for example, indirect clearing arrangements on non-EU CCPs) are not subject to the requirements of the RTS, nor are they prohibited by the RTS.
Recital 5	1. Extend the Member State law "override" to default management provisions. 2. Remove the "prohibition" of certain third country arrangements	<u>1. Extension of Member State law "override"</u> We understand that Recital 5 was in part designed to ensure that the provisions of the RTS override any conflicting requirements in Member State law. The suggested addition of the words "the management of the default of a client and the return of liquidation proceeds to an indirect client" extends the scope of the purported override to cover the RTS default management provisions (currently it only covers the segregation requirements). The basis for this is that we believe legal conflicts are most likely to arise with respect to the default management

		provisions in the RTS, specifically those that contemplate the direct return of liquidation proceeds to an indirect client following a client default. Separately, we note that there are significant doubts as to the ability of Recital 5 to amend conflicting Member State law. It is unlikely that a Recital alone can create obligations and/or requirements in its own right and/or in the absence of an operative provision in the text of the Regulation. It is not clear that the Commission is empowered to include an operative provision of this type in the MiFIR RTS as its mandate is limited to "specifying the types of indirect clearing service arrangements...that meet the conditions referred to in [Article 30] paragraph 1" (permissible indirect clearing arrangements). If the Commission is unable to include an operative provision, it is doubtful that it can seek the same result with a Recital. In addition, MiFIR does not contain an operative provision which gives explicit effect to such an override. Article 30 of MiFIR refers to "permissible" indirect clearing arrangements. It does not impose a clear obligation on Member States to facilitate such indirect clearing arrangements nor any provisions overriding Member State law. By contrast, the operative provisions of EMIR (Article 48(7)) provide for certain outcomes which may not be permitted under national insolvency laws. Even then, however, there is legal uncertainty as to whether those national insolvency laws are overridden by Article 48(7). For this reason, many jurisdictions have taken the view that Article 48(7) alone is not sufficient to effect the necessary amendments to national insolvency laws and that national implementation measures are required. In the UK, for example, amendments to Part 7 of the Companies Act 1989 were made in order to provide the requisite insolvency protections required in relation to the EMIR requirements. <u>2. Removal of "prohibition" on certain third country arrangements</u> The draft RTS appear to prohibit arrangements involving non-EU clients and EU indirect clients, where the insolvency law applicable to the non-EU client is incompatible with the RTS. We understand that this was not the intention behind this part of Recital 5 and that ESMA does not seek to prohibit such arrangements, provided that relevant risks are clearly disclosed to indirect clients. We have duly clarified the Recital and introduced a corresponding operative provision in Article 5(6), requiring the client to make appropriate risk disclosures in these circumstances. Please see the discussion of our proposed amendment to Article 5(6), which provides an example of a third country jurisdiction (the United States)

		whose insolvency laws may conflict with certain aspects of the RTS.
Article 1	1. Limitation of scope of RTS to (a) EU CCPs and (b) EU indirect clients and (c) EU clients. 2. Clarification that the RTS apply solely to the first four parties in an indirect clearing arrangement (i.e. CCP, clearing member, client, indirect client).	<u>1. Scope parameters</u> It is important that the RTS include sensible scope parameters to ensure that (i) they apply to indirect clearing arrangements with an appropriate EU nexus; and (ii) they will be workable in practice. In the interests of legal certainty, we would encourage ESMA to include those scope parameters in the operative provisions of the RTS themselves, rather than in accompanying Q&A. The clearest and most effective way to achieve the above objectives would be to limit the application of the RTS to arrangements involving exclusively EU parties. The greater the extent to which the RTS can be limited to EU parties, the more likely it is that parties subject to the RTS can comply with the requirements therein. The inclusion of the "override" mechanism in Recital 5 appears to acknowledge the likelihood that the RTS will create conflicts of law. We would expect such conflicts to be most likely to arise with respect to third countries (such as, the United States), which cannot be addressed through an override mechanism such as that included in Recital 5. If such third country arrangements are not carved out of the scope of the RTS, it is likely that they would be regarded as "non-compliant" and may therefore be required to cease, thereby depriving access to clearing for many end users. We do not believe that this was ESMA's intention. As a minimum, we suggest that the scope of the RTS is limited to indirect clearing arrangements involving (i) CCPs established in the European Union and (ii) indirect clients established in the European Union. We also ask ESMA to consider limiting the application of the RTS to EU clients. <u>(a) Limitation to EU CCPs</u> We propose to limit the RTS to EU CCPs (achieved through our proposed amendment to the definition of "indirect clearing arrangement") on the following bases: - Consistency with MiFIR: Article 30(1) MiFIR states that indirect clearing arrangements are permissible provided that the assets and positions of the counterparty benefit from protection with "equivalent effect" to that referred to in EMIR Articles 39 and 48. ESMA EMIR Q&A CCP Q8(j) has clarified that the requirements of EMIR Article 39 apply only to EMIR authorized CCPs. - Policy rationale and enforcement: we consider it important from a policy and enforcement perspective that the RTS are given a sufficient EU nexus and do not purport to regulate arrangements relating to non-EU CCPs.

		<u>(b) Limitation to EU indirect clients</u> We propose to limit the RTS to indirect clients established in the EU (covering entities incorporated in the EU and not, for instance, EU branches of non-EU firms) on the following bases: - ESMA's mandate under MiFIR: ESMA is directed to develop RTS "ensuring consistency" with the provisions under the EMIR RTS. EMIR Q&A OTC Q18 limits the scope of the EMIR RTS to entities subject to the EMIR clearing obligation, which has limited application to non-EU end clients. Therefore the proposed limitation in scope to EU indirect clients would ensure consistency with the EMIR RTS. - We believe the rules are ultimately aimed at providing protection for EU end users. Support for this view can be seen in Recital 5, which refers expressly to indirect clearing arrangements involving non-EU clients and EU indirect clients. The absence of a reference to non-EU indirect clients in Recital 5 suggests that the RTS are not aimed at regulating arrangements involving non-EU indirect clients. - It would be difficult to articulate a coherent policy rationale for regulating essentially non-EU clearing chains where the only EU nexus is the EU CCP, which itself could be a US Derivatives Clearing Organisation (for example: ICE Clear Europe – US FCM – US client – Brazilian indirect client). <u>(c) Limitation to EU clients</u> We also ask ESMA to consider limiting the RTS to EU clients. The rationale set out above with respect to the limitation to EU indirect clients applies equally in respect of a limitation to EU clients. We also note that many of the conflicts of law issues expected to arise (and render significant indirect clearing activity non-compliant) are likely to relate to the insolvency law applicable to the client. While Recital 5 is able to address these conflicts in respect of EU clients (though note our concerns in this regard, set out above), the RTS are not able to address conflicts arising in third countries. Accordingly, the RTS are significantly more likely to be workable in practice and avoid disruption to (and potentially cessation of) global, cross-border indirect clearing arrangements if their application is limited to EU clients. Additional disclosure requirements could be introduced to ensure that EU indirect clients receiving indirect clearing services from non-EU clients are made sufficiently aware of the attendant risks and of the additional protections that could

		be available by clearing through an EU client. 2. Arrangements with more than four parties ("longer chains") We understand from the definition of "indirect clearing arrangement" that the RTS regulate indirect clearing arrangements with four parties and that arrangements with more than four parties are not within the scope of the RTS. Such arrangements are not prohibited by the RTS and in our view constitute ETD contracts at each stage in the chain, which are ultimately traded on exchange and cleared. We have sought to make this clearer in the definition of "indirect clearing arrangements". To address the risk that the RTS could be avoided altogether by the inclusion of additional parties into clearing chains, our suggested amendment provides that the first four parties in any indirect clearing arrangement must always comply with the RTS, even if the chain contains more than four parties.
Article 2(1)	Clarification that clearing member may offer indirect clearing services to certain clients only	The proposed amendment clarifies that a clearing member may decide to facilitate indirect clearing services for some, but not all, of its clients, subject to reasonable commercial terms (which must be publicly disclosed under Article 4(1)). A clearing member might deem certain clients to be suitable to support indirect clearing (from a risk perspective, for example) and others not. While we do not expect this amendment to be controversial, we believe it is important to clarify that clearing members have the ability to exercise contractual freedom in this manner.
Article 2(2)	Expansion of requirement to consult with clearing member on contractual terms	We believe the reference to "aspects that can impact the operations of the clearing member" may not be sufficiently broad to capture other key areas where the clearing member will require consultation on the contractual terms between the client and the indirect client to ensure it is able to comply with the RTS. For example, the clearing member may need to be consulted on the manner in which it receives information from the client relating to the risks from indirect clearing arrangements with particular indirect clients in order to fulfil its obligations under Article 4(8). Our suggested amendment ensures that there will be an appropriate dialogue between key parties before indirect clearing arrangements are entered into.
Article 4(2)(b)	Clarification regarding record keeping	Clarification. It is a very common market practice for entities in the clearing chain to apply a valuation percentage or 'haircut' to (non-cash) margin to manage market risk arising out of assets provided as collateral. The draft RTS do not explicitly address this scenario and, for the avoidance of doubt, we are suggesting amendments which clarify the value of collateral that needs to be passed up to the CCP with respect to GOSA indirect clients. In our drafting amendment we are proposing to clarify that the clearing member obligation to pass on the collateral value

		attributable to a GOSA indirect client *excludes* the value of collateral that is calculated as a difference between collateral value before applying haircut and collateral value after applying haircut. When meeting an (initial) margin call from the CCP in non-cash collateral, the CM would need to post to the CCP sufficient securities to compensate for the haircut on the value of the securities imposed by the CCP. In turn, the CM and the client will apply haircuts to the securities that they call from the client/indirect client so that the collateral value (post haircut) received is at least equivalent to those posted to the CCP. If the CM and or the client apply a higher haircut, then there is a mismatch between the collateral value required by the CCP and the higher amount received by the CM and we do not consider this as "excess margin" which is required to be passed on to the CCP. The minimum amount which will always get passed to the CCP will be the CCP margin requirement – i.e. the collateral value taking into account the CCP haircut – because this is the only way the CM can meet the CCP margin requirement. The question of collateral value and haircut should not be confused with the question of "excess margin" which is explained in reference to our proposed amendment to Article 4(4).
Article 4(3)	Clarification regarding provision of information to CCPs	Clarification.
Article 4(4)	Clarifications in respect of "excess margin"	We have suggested a number of amendments to this provision to achieve the following: - Clarification that the parties in an indirect clearing arrangement may wish to specify the particular CCP (where multiple CCPs are used) to which excess margin (so-called "mandatory excess" - i.e. amounts that the clearing member calls for over and above the CCP requirement) should be posted. The first reference to "in accordance with any relevant terms of the indirect clearing arrangements" seeks to accommodate any such agreement, without detracting from the general principle that such mandatory excess should be onward posted to a CCP. - Clarification that the clearing member requirement to onward post to the CCP the value of margin received in respect of indirect clients does not apply to "pre-funding" or "voluntary excess" (i.e. amounts received by the clearing member over and above the margin called for by the clearing member). To achieve operational efficiencies, clients sometimes provide such prefunding that

		they wish to remain with the clearing member until further notice (typically in anticipation of future margin requirements). We have therefore suggested that such amounts should be "treated in accordance with any relevant terms of the indirect clearing arrangements" (i.e. as agreed between the parties). We believe this is consistent with the intention of the EMIR Q&A CCP Q8(a) regarding the treatment of excess margin. We have sought to make our amendments general in nature and avoid undue granularity in this context. We very much encourage ESMA to consider fleshing out the proposed wording by Q&A, as it did in EMIR Q&A CCP Q8(a). However, we note that certain aspects of EMIR Q&A CCP Q8(a) have created uncertainty in the market (particularly in relation to the identification of "voluntary excess") and therefore we would strongly encourage further consultation among market participants before publishing a similar Q&A for the MiFIR RTS.
Article 4(5)	Clarification in respect of segregated account at the CCP	The proposed removal of the word "individually" clarifies that the CCP, on request of the clearing member, is only required to open a (omnibus) segregated account for the exclusive purpose of holding the assets and positions of the client's indirect clients. We understand this to mean that for each of the clearing member's clients providing indirect clearing services, the clearing member will require the CCP to maintain a single segregated account solely for that client's indirect clients. The inclusion of the word "individually" could lead to uncertainty in light of the particular meaning of that term under Article 39 of EMIR and, moreover, the absence of that term in Article 5(2) of the EMIR RTS. We therefore think it would be preferable to remove it.
Article 4(7)	Clarification that (i) clearing members will use reasonable endeavours to pay liquidation proceeds to indirect clients; and (ii) in certain circumstances clearing members may pay liquidation proceeds to the client on account of the indirect client. .	Article 4(7) does not impose a hard obligation on clearing members to initiate the return of liquidation proceeds directly to indirect clients (a so-called "leapfrog payment") – rather, it requires clearing members to establish "robust procedures" that include details of the "steps required to initiate" such leapfrog payment. However, we believe it is nonetheless critical that this provision clearly acknowledges that there are circumstances in which the clearing member may need to pay liquidation proceeds to the client on the account of the indirect client, in order to: - provide an important flag to indirect clients that they might not receive a direct payment of liquidation proceeds. This is particularly important given that we expect the significant majority of indirect clients to remain in net omnibus accounts in reference to which there is very little prospect of a leapfrog payment being made because the clearing member (i) will not know the identity of the indirect client and (ii) will not be able to calculate

		the portion of indirect client's exposure to the client that is collateralised by assets and positions at the clearing member level; and - allow the clearing member to design a realistic "robust procedure" that contemplates and properly provides for scenarios where it is necessary to pay liquidation proceeds to the client for the account of the indirect client. Clearing members may conclude that they are unable to do this without our suggested amendment. We have therefore introduced the concept of using "reasonable endeavours" to make the leapfrog payment and we have also referred to two specific circumstances (insufficient information and legal / regulatory conflict) in which the clearing member's "robust procedure" is permitted to contemplate payment of liquidation proceeds to the client for the account of the indirect client. The inclusion of "reasonable endeavours" provides a more accurate description of what a clearing member will do (and therefore what its "robust procedure" should contemplate) following a client default. For example, a clearing member's procedure for managing client default would likely include steps to (i) ascertain the identity and other necessary details for each indirect client in a gross omnibus account; (ii) establish amounts due to each such indirect client; and (iii) perform KYC and other checks before making the payment. It is possible that the clearing member (a) may not be able to ascertain the identity of (or other essential information pertaining to) some or all GOSA indirect clients; (b) may not have sufficient information to calculate amounts due; or (c) may discover that the indirect client is a terrorist or sanctioned entity. In any of those circumstances the clearing member would not be in a position to make the leapfrog payment, but would nonetheless have used reasonable endeavours to initiate such payment. The inclusion of two specific circumstances (insufficient information and legal / regulatory conflict) in which the clearing member's "robust procedure" is permitted to contemplate payment of liquidation proceeds to the client for the account of the indirect client is designed to address clearing members' concerns that they could be required to adopt procedures to initiate leapfrog payments in circumstances where such payments would be either impossible due to insufficient information or open to legal challenge because (i) indirect clients may be subject to sanctions or other similar requirements that prevent payment; or (ii) the insolvency law applicable to the client could prevent the direct payment to the indirect client. We would expect such insolvency law incompatibilities to arise

		more frequently in arrangements involving non-EU clients (such as the United States – please see further discussion in respect of Article 5(6)), but they could also arise in respect of EU clients (please note our concerns in relation to the purported override of conflicting Member State law in connection with Recital 5). We have suggested an additional disclosure requirement to ensure that indirect clients are properly informed of risks relating to conflicting insolvency laws in Article 5(6). In further support of our amendments, we note that Article 48(7) of EMIR contemplates (albeit in limited circumstances) a CCP making a payment to the clearing member for the account of the client. Our suggested amendments would therefore avoid the concern that the RTS would "gold plate" the EMIR Article 48(7) requirements by imposing a higher standard on clearing members than that imposed on CCPs under Article 48(7) of EMIR.
Article 4(8)	Conforming clearing member's risk monitoring obligation with equivalent obligation on CCP	Both CCPs and clearing members are subject to obligations to "identify, monitor and manage" risks related to indirect clearing arrangements. However, the CCP's obligations are limited to "material" risks that "could affect the resilience of the CCP". We propose to include the same wording for the clearing member's obligation to ensure (i) consistency and fairness in the requirements on CCPs and clearing members, respectively; and (ii) that clearing members do not face an entirely open-ended obligation that may be impossible to comply with. We also propose that the clearing member's obligations under this provision are by reference to the information received from the client under Article 5(7). This is to address the concern that this obligation could be read as requiring the clearing member to perform due diligence and credit assessments on each indirect client, which would not be practicable or scalable and would likely result in the cessation of indirect clearing services.
Article 5(1)	Provision of net omnibus account to unresponsive indirect clients	In the absence of indirect client's response as to the choice of segregation under Article 4(2), our amendment clarifies that the client can decide to provide indirect clearing services to such indirect clients by putting them in a net omnibus account. This provision ensures that there is no disruption to orderly functioning of ETD markets and that the uncertainty which arose out of EMIR Article 39(5) and practical issues that CMs have faced with implementing Article 39, which often included passive and unresponsive clients, are mitigated. It is expected that clients can only make this assumption after reasonable attempts have been made to get an indirect client's choice of account and the indirect client still hasn't responded.

Article 5(2)	Clarification regarding record keeping	See amendment to Article 4(2)(b).
Article 5(3)	Clarification in respect of segregated account at the CCP	See amendment to Article 4(5).
Article 5(4)	Equivalent amendment to Article 4(4) regarding treatment of excess margin	See amendment to Article 4(4). We have also removed the duplication in a disclosure requirement on clients which is already envisaged in Article 5(1).
Article 5(6)	1. Clarification that contractual provisions to facilitate direct payments to indirect clients apply only where indirect client has selected a gross omnibus account. 2. Clarification that contractual provisions to facilitate direct payments to indirect clients are not required if such provisions would contradict applicable law.	<u>1. Contractual provisions to facilitate direct payments to indirect clients apply only where indirect client has selected a gross omnibus account.</u> We suggest limiting the provision in this manner because the direct return of liquidation proceeds to the indirect client is only possible if the client has selected a gross omnibus account. There is very little prospect of a leapfrog payment being made to indirect clients in a net omnibus account because the clearing member (i) will not know the identity of the indirect client and (ii) will not be able to calculate the portion of indirect client's exposure to the client that is collateralised by assets and positions at the CM level – in other words, the clearing member cannot ascertain the indirect client's share in excess margin that sits with the defaulting client. It is therefore not necessary for contractual arrangements to be put in place for net omnibus indirect clients. <u>2. Contractual provisions to facilitate direct payments to indirect clients are not required if such provisions would contradict applicable law.</u> In certain cases the introduction of contractual provisions to facilitate the direct payment of liquidation proceeds to the indirect client would be contrary to, or incompatible with, the insolvency law applicable to the client. We have sought to recognise this in the RTS by not requiring the client to introduce such provisions where contrary to or inconsistent with applicable insolvency law. Instead, where contractual terms that facilitate 'leapfrog' payment are contrary to or inconsistent with third country laws or regulations, the client should provide indirect clients with relevant risk disclosure. While we would expect such conflicts to be more likely to arise with respect to third country clients, it is possible that they could also arise under Member State law. A key example of a jurisdiction whose laws would be

		inconsistent with the Article 5(6) requirement is the United States.[4] US FCMs act as intermediaries with respect to ETDs cleared through an EU CCP in several ways. - An FCM may be a direct clearing member of an EU CCP, which is the clearing organization for regulated markets both within and outside of the EU. For example, an FCM may be a direct clearing member of ICE Clear Europe, which clears ETDs executed on ICE Futures Europe, a recognized investment exchange supervised by the UK Financial Conduct Authority (FCA), and on ICE Futures US, a designated contract market subject to regulation by the CFTC. (ICE Clear Europe also clears OTC credit default swaps, which are outside the scope of RTS 38.) - An FCM may be a client of an FCM that is a direct clearing member of an EU CCP. - An FCM may be the client of an EU credit institution or investment firm that is a direct clearing member of an EU CCP. In each case, an insolvent FCM will be liquidated in accordance with: (i) the provisions of the US Bankruptcy Code (11 USC §§ 101 *et seq.*) (**Code**) and, in particular, Subchapter IV of Chapter 7 of the Code governing the liquidation of FCMs and other entities that fall within the definition of a commodity broker (11 USC §§ 761 *et seq.*); and (ii) the rules of the Commodity Futures Trading Commission (**CFTC**) with respect to the liquidation of an FCM (17 CFR Part 190). Under the Code, a clearing member of an EU CCP would be authorized to exercise its contractual rights to cause the liquidation, termination, or acceleration of a commodity contract[5]. 11 USC §§ 362(b)(6), 556. The proceeds of such liquidation must be returned to the trustee in bankruptcy for distribution to customers in accordance with the Code and CFTC Rules. 11 USC § 766(h); 17 CFR § 190.08. However, the Code makes clear that these proceeds will not be subject to the claims of the insolvent FCM's general creditors. Specifically, section 766(h) of the Code provides that the trustee "shall distribute customer property ratably to customers on the basis and to the extent of such customers' allowed net equity claims, *and in priority to all other claims,*" except the

[4] A high-level analysis has shown that very similar concerns and inconsistencies arise in relation to Swiss law as well.

[5] A commodity contract is defined to include: (i) a futures contract traded on a US futures exchange; (ii) a futures contract traded on a non-US exchange; and (iii) a swap cleared through a CFTC-registered derivatives clearing organization. 11 USC § 761(4).

		costs of administration. RTS 38 Article 5(6) requires a client that provides indirect clearing services to “include, in its contractual arrangement with indirect clients, terms to facilitate the prompt return to the indirect client of the proceeds from the liquidation of the positions and assets held by the clearing member for the benefit of the indirect client.” The US Bankruptcy Code would not prevent a clearing member from establishing “robust procedures” to allow for the prompt liquidation of the assets and positions of indirect clients following the default of an FCM client. However, to the extent that RTS 38 Article 4(7) would require a clearing member to return liquidation proceeds directly to the indirect clients of the US FCM, the RTS would be incompatible with the provisions of the US Bankruptcy Code and the rules of the Commodity Futures Trading Commission with respect to the liquidation of an FCM, as described above. Similarly, contractual arrangements between an FCM client and its indirect clients to facilitate the return of the liquidation proceeds directly to the indirect upon the default of the FCM would be incompatible with the US Bankruptcy Code and the CFTC’s regulations.
Article 5(7)	Clarification regarding client’s requirement to provide information to clearing member	The addition of the word “material” is introduced to conform with the proposed amendments to Article 4(8). We have also clarified that the client needs to submit to the clearing member sufficient information to identify the indirect clients only when the indirect clients have selected gross omnibus segregation, because only in that scenario will the indirect clients have any realistic chance of receiving a direct payment from the clearing member. We understand that this was the intention of the previous wording (the reference to paragraph 2 is a reference to indirect clients that select gross omnibus accounts).

<ESMA_QUESTION_CP_MIFID_244>

Q245. Do you believe that a gross omnibus account segregation, according to which the clearing member is required to record the collateral value of the assets, rather than the assets held for the benefit of indirect clients, achieves together with other requirements included in the draft RTS a protection of equivalent effect to the indirect clients as the one envisaged for clients under EMIR?

<ESMA_QUESTION_CP_MIFID_245>
Please see our response to Q. 244 above.
<ESMA_QUESTION_CP_MIFID_245>