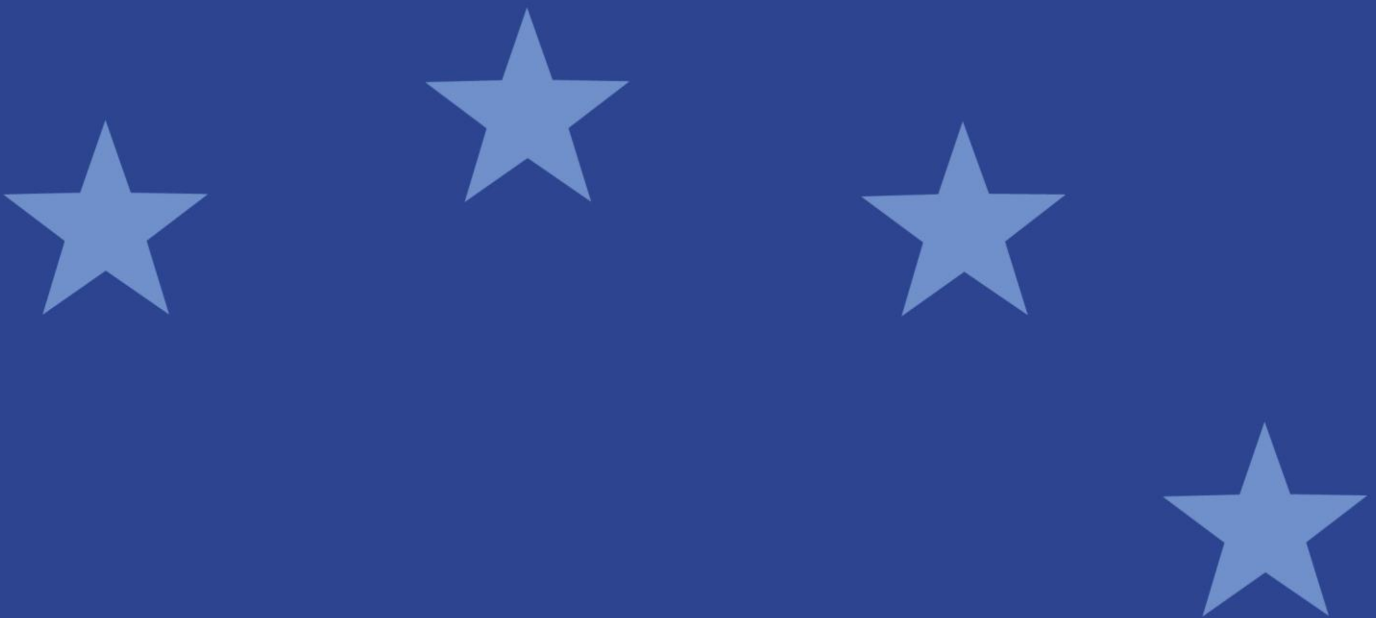
Reply form for the Addendum Consultation Paper on MiFID II/MiFIR



18 February 2015

European Securities and Markets Authority

Date: 18 February 2015

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Addendum Consultation Paper on MiFID II/MiFIR, 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 properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA_ QUESTION_MIFID_ADD_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- 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:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider

Naming protocol

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

ESMA_MiFID_ADD_NAMEOFCOMPANY_NAMEOFDOCUMENT.

E.g. if the respondent were ESMA, the name of the reply form would be:

ESMA_MiFID_ADD_ESMA_REPLYFORM or

ESMA_MiFID_ADD_ESMA_ANNEX1

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

Deadline

Responses must reach us by **20 March 2015.**

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/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_MIFID_ADD_1>

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

(i) FIA Europe members support the legislative goals that ESMA's transparency proposals aim to achieve. However, FIA Europe members are concerned ESMA is trying to capture a certain percentage of the market rather than actually trying to determine which instruments are liquid or not. FIA Europe considers that such an approach is erroneous and may result in wrong classifications of illiquid instruments as liquid and vice versa.

(ii) The quality and type of data used for all asset classes under consultation is of insufficiently poor quality and consequently ESMA should consider a complete re-examination of the data used. FIA Europe's members are concerned that, in some cases, incomplete data sets (e.g. not covering global markets), tainted data sets (e.g. TR data which includes non-price forming compression trades), or short data sets 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 overhaul their data.

(iii) The time period of three months of data examined is too short to properly account for any anomalous trading activity during that time and may not accurately depict the liquidity of the markets of those asset classes over a normalised timeframe, particularly for FX and CDS Derivatives which are extremely cyclical in nature.

(iv) 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 credit derivatives, not having sufficient granularity.

(v) Further granularity is required in setting sub-classes for the liquidity assessments and in setting quantitative liquidity thresholds on some instruments.

(vi) 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.

< ESMA_COMMENT_MIFID_ADD_1>

[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.

Q1. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer detailed per asset class identified (deliverable forwards, non-deliverable forwards, options, swaps, spread betting contracts and futures) addressing the following points:

(1) Would you use different qualitative criteria to define the sub-classes? Please also specify if you agree in distinguishing or not distinguishing between deliverable and non-deliverable contracts. If you would distinguish between deliverable and non-deliverable contracts for other classes besides forwards, please provide your feedback as specific as possible with regard to the sub-classes that should be deemed liquid for deliverable contracts and those for non-deliverable contracts, pointing out the differences between the two subgroups.

(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 some specific classes declared as liquid in ESMA's proposal as illiquid (and vice versa)? Please provide reasons for your answer.

<ESMA_QUESTION_MIFID_ADD_1>

Introduction - Liquid Market Definition Comments

FIA Europe members disagree with ESMA's determinations of liquidity for Foreign Exchange Derivatives (FX) and broadly support the position adopted for foreign exchange derivatives by the Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA)[2].

Key Concerns / Recommendations

FIA Europe members support the legislative goals that ESMA's transparency proposals aim to achieve. However, ESMA should bear in mind that products have developed to suit the needs of investors and consequently have evolved to have different liquidity characteristics. FIA Europe highlights the following concerns:

(i) That ESMA is trying to capture a certain percentage of the market rather than actually trying to determine which instruments are liquid or not. FIA Europe considers that such an approach is erroneous and may result in wrong classifications of illiquid instruments as liquid and vice versa.

(ii) The data used is of insufficiently poor quality and consequently ESMA should consider a complete re-examination of the data used.

(iii) The quality and type of data used in the FX liquidity analysis, i.e. Trade Repository (TR) data collected over a three month period between 1 March 2014 and 31 May 2014. It is clear that a three month data set is too short to properly account for any anomalous trading activity during that time and may not accurately depict the liquidity of the markets of those asset classes over a normalised timeframe, particularly for FX Derivatives which are extremely cyclical in nature. The data shows that the Non-Deliverable-Forwards (NDFs) market is significant in size, where according to several industry surveys (including those statistics cited in ESMA's Clearing Obligation Consultation Paper for FX NDFs) it actual-

[2] The GFXD was formed in cooperation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24 global Foreign Exchange (FX) market participants,[1] collectively representing more than 90% of the FX inter-dealer market.

ly represents approximately 4% of non-spot markets. In this instance, FIA Europe suggest that ESMA refer to the Bank of International Settlements (BIS) or Bank of England (BoE) Survey data from October 2014 to verify their data and offer a better representation of how the market is actually split, in terms of which instruments and currency pairs are actually liquid. The current division has led to the inclusion of a number of false-positives (such as the inclusion of the Angolan Kwanza). It is evident from the data collected that this is trade data collected resulted from trade reports submitted to TRs under the European Market Infrastructure Regulation (EMIR). The NDF vs DF distinction would appear to be drawn by sorting data through use of the 'trade flag' (i.e. cash versus physical settlement). This is attributable to the use of Field 18 (Delivery Type) of the UPI report, whereas ESMA should in fact be looking at Fields 2 and 3 to correctly identify the instruments as NDFs or DFs. This is pertinent because at the time when those trades were submitted, most dealers would have been using ISDA taxonomy to identify trades. Indeed it would appear that from some results that the view of the FX derivatives market is quite distorted. Table 48 of draft RTS 9 (FX NDF Liquid Classes), COP-USD pair with a tenor from 4 days to 7 days is considered liquid and the Large-In-Scale (LIS) thresholds are set at a clearly unrealistic €700 million, which is greater than the average daily volume for that market. The inclusion of precious metals in the analyses, particularly for FX derivatives. For example, under Table 48 of draft RTS 9 (FX NDF Liquid Classes) USD-XAU is included as a liquid class of NDFs. We recommend that reference to contracts relating to precious metals should be included in the assessment of Commodity Metal Derivatives under the main Consultation Paper so as to avoid duplicative rules.

Instead, FIA Europe recommends:

(i) That ESMA repeat its analysis having corrected for a number of issues in the classification of trades, most particularly between Non-Deliverable and Deliverable Forwards. We consider that the instrument identifiers to enable this to be done are available in the EMIR TR, although do recommend that ESMA use more recent EMIR TR data (since the early data may have suffered from some data quality issues since resolved), relating to a longer time period (in order to address concerns that 3 months' data is unrepresentative).

(ii) That failing such a repeat of the analysis, ESMA may not wish to place full reliance on this dataset, or could compensate through the use of higher liquidity thresholds for the average frequency and average size of transactions liquidity parameters than might otherwise have been appropriate.

(iii) That ESMA remove the "spread betting" class altogether and instead allocate the trades into this class more granularly according to the specific nature of the transactions. The term "spread betting" should not be used, and instead definitions of actual product types should be provided, according to market standard taxonomies. ESMA must make an appropriate determination of liquidity on each of the resultant subclasses. Failing that, the "spread betting" asset class should be relabelled "Others" and determined to be illiquid due to the non-homogeneity of the underlying instruments. We also note that the LIS for EUR-HUF for tenor from 1 day to 4 days is drastically higher than any other pair, which is not reflective of the nature of the market.

(iv) That ESMA compensate for that fact that two of the key elements of the definition of a liquid market have not been taken into account, specifically the number and type of market participants, and the average size of spreads. We understand why ESMA may have encountered difficulty incorporating these liquidity parameters, but MiFIR does require their consideration, and therefore recommend that ESMA compensate for the potential misclassification of illiquid sub-classes as liquid through higher liquidity thresholds for those liquidity parameters actually used (i.e. average frequency and average size of transactions), than would otherwise have been possible had the full set of liquidity parameters been considered.

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

(vi) Make clearer and more specific compensation for the inadequacies in, and the errors of the liquidity assessment, through setting lower LIS and particularly SSTI thresholds than might otherwise have been possible had a more accurate determination of liquidity been possible. This is of greatest importance where the liquidity assessment of the subclasses is most erroneous.

FIA Europe position for specifically exchange traded FX derivatives – FX Futures and exchange traded FX Options:

FIA Europe does not agree with ESMA's proposal for the definition of a liquid market for exchange traded FX Futures and Options.

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 concerns, as certain approaches described in the consultation paper will negatively impact Exchange traded derivatives (ETDs) which clearly is not the intention of the Level I text.

ETDs are already characterized by a high degree of 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’, i.e. the same day. Batch produced reports already contain information subject to non-disclosure limits. It needs to be acknowledged that liquidity formation in ETDs is different and exchanges have implemented appropriate frameworks, rules and processes, in order to create and support a public order-book. 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 clearing and trading environment.

For FX futures and FX options specifically, the initial approach to define liquid market with criteria like (i) average notional amount per day and (ii) number of days traded and (iii) average number of trades per day is applicable but the thresholds have to be increased for at least the average notional amount per day for NDFs, deliverable forwards and options. In order to determine appropriate thresholds for liquid markets the average traded volumes (ADV) published by BIS on a regular basis should be considered as a reference. Referring to ADV published in the recent Triennial Central Bank survey 2013 an average notional amount per day greater than or equal to EUR500 million is far too low for instruments such as deliverable forwards (680 USD billion), NDFs (127 USD billion), swaps (2228 USD billion) and options (approximately 337 billion USD). FIA Europe therefore recommends ESMA to take a threshold of around 0.5-1% of the overall average daily FX volume as an appropriate level to decide whether an instrument is deemed to be liquid or illiquid.

The defined parameters/ criteria for ETD appear to be appropriate, however, the thresholds are not applicable for listed exchange traded FX futures and the determined sub-classes. As FX futures are highly standardized products designed to concentrate volume in selected contract months with time to maturity up to 3 months, thresholds of one trade per day and USD 30,000 notional amount on average are too low. Exchange traded FX futures with 1 trade per day and 0.3 contracts traded on average (30,000 EUR= 0.3*100,000 EUR contract value) can only be perceived as illiquid in the light of transparency.

The market perception is that liquid exchange traded futures, in the sense of transparency, must have at least 2,000 trades per day and reach a daily notional amount of EUR 1billion corresponding to 10,000 contracts per day.

A fundamental difference exists between exchange traded futures and options. In futures contracts, a front-month driven nature is visible but in options a clear difference is visible that reflects the relative illiquidity of the broad range of options. Liquidity is not easily bundled in all strikes during the entire trading day in the options even if it is typically concentrated around at the money strikes, and that the instrument as such has long periods of no or low activity in all of the strike prices available.

Due to the nature of FX options ticket sizes are much higher in options than in futures. Currently market makers at some exchanges are required to quote at least 50 contracts on the bid and offer in the options order-book. It is perceived by the market that liquid exchange traded FX options must have at least 100 trades per day and reach a daily notional amount of EUR 500 million corresponding to 5,000 contracts per day.

Notwithstanding the above, ESMA is encouraged to consider how to appropriately calibrate liquidity and LIS/SSTI and pay due regard to the calibration of liquidity and LIS/SSTI for those products which have economically similar outcomes, for example FX Futures and Forwards, but are wrapped into different product wrappers. An example would be the classification of FX Futures, for which most currency pairs outside of EUR-USD were considered as illiquid, whereas the corresponding FX Forwards were considered to be liquid (this specific instance could be attributed to the use of Trading Venue data as opposed to TR data used in the rest of the sample, which could explain the exclusions in this instance). Notwithstanding that these are different wrapper types, some corresponding

similar products in these different classes have been classified as liquid or illiquid differently which could potentially result in a 'rotation' of products between wrappers as a result of conflicting regulatory requirements. Consequently, FIA Europe suggests that ESMA should consider a holistic approach the classification of contracts with economically similar outcomes and in terms of how the product is wrapped.

(1) Would you use different qualitative criteria to define the sub-classes? Please also specify if you agree in distinguishing or not distinguishing between deliverable and non-deliverable contracts. If you would distinguish between deliverable and non-deliverable contracts for other classes besides forwards, please provide your feedback as specific as possible with regard to the sub-classes that should be deemed liquid for deliverable contracts and those for non-deliverable contracts, pointing out the differences between the two sub-groups.

In response to this question, FIA Europe members agree with the GFXD position to use different criteria to define the sub classes and reference is made to its response.

EMIR trade reporting and instrument mapping: We do not believe that EMIR trade reporting data has been categorized by ESMA to a sufficient degree of granularity to determine the liquidity of FX instruments. FIA Europe members support the view that the FX instruments should be categorized as per Annex 3.6.1, included for ease in Figure 1 below. The proposal allows the market to be considered in-line with the ISDA FX taxonomy which accurately represents how the market trades FX. For non-spot trades, participants report this data under the 'Product ID Value' field to the TRs, and we suggest that this data should be made available to ESMA for consideration.

(i) The ISDA FX taxonomy is as follows:

- FX spot
- FX NDF (non-deliverable forwards) (Product ID Value: Foreign Exchange: NDF)
- FX NDO (non-deliverable options) (Product ID Value: Foreign Exchange: NDO)
- FX forward (Product ID Value: Foreign Exchange: Forward)
- FX vanilla options (Product ID Value: Foreign Exchange: Vanilla Options)
- FX simple exotics (including barriers and digitals) (Product ID Value: Foreign Exchange: SimpleExotic)
- FX complex exotics (Product ID Value: Foreign Exchange: ComplexExotic)

(ii) EMIR trade reporting currently does not recognize this taxonomy. Instead trade repositories permit reporting firms map data submissions using the following EMIR reportable fields:

- Product ID 1: CU (currency)
- Product ID 2: FW (forwards), OP (options), SW (swap), OT (other)

(iii) For example, DTCC maps their FX trade submissions as follows:

- FX Spot – mapped to 'OT'
- FX NDF – mapped to 'FW'
- FX NDO – mapped to 'OP'

- FX Fwd – mapped to 'FW'
- FX Vanilla Option – mapped to 'OP'
- FX Simple Exotic – mapped to 'OP'
- FX Complex Exotic – mapped to 'OT'

ESMA also note that they have performed additional mapping of the data to the 'Other' bucket and have re-classified this as 'Spread-betting'. As discussed above, this is not appropriate to FX derivatives defined under MiFID Annex C4, so should be disaggregated and split by ESMA into the appropriate sub-product classes for in order to achieve an appropriate determination of liquidity at a suitably granular level. Annex 2.1.1 paragraph vi on page 210 of the CP defines how ESMA have re-pointed data and created the 'Spread-betting' bucket. We believe that this approach is not accurate and grossly miss-represents what should be included in the 'Other' bucket, namely FX complex exotic options, which represent approximately 2% of the FX market and are widely considered to be bespoke and illiquid in nature.

Figure 1: GFXD proposal for Annex 3.6.1 defining FX instrument categorization under MiFIR

Financial Instrument	Product Types	Sub-Product Types	Recommended Liquidity sub-categories
Foreign Exchange Derivatives	Futures	N/A	Currency Pair
	Options	Non-Deliverable Option - NDO (only European type options are NDO - not any other FX options settled in non-deliverable currency)	
		Vanilla Option (European and American)	Maturity
	Forwards	Deliverable Forward	
		NDF	
	FX Swaps	Deliverable FX Swap	
		Non-Deliverable FX Swap	
	Others	Simple exotic (Barrier & Digital)	
		Complex Exotic	

<u>For Exchange Traded FX derivatives specifically</u>

The decision whether an instrument is categorized as deliverable or non-deliverable should clearly refer to the criteria of 'settlement type' of a transaction and thus depending on the key characteristic, if the notional principal

amount of a transaction has been completely exchanged or if it was settled against a reference point e.g. an exchange rate fixing and where no physical transfer of the notional amount occurs. It is strongly recommended to distinguish FX options between non-deliverable options (NDO) and deliverable options (DO) in the same manner as for the described FX forward contracts. This differentiation is common market practice (see industry standards documentation such as Master Confirmation Agreement for non-deliverable currency option transactions provided by the Trade Association for the Emerging Markets (EMTA) in conjunction with the ISDA. Therefore the class of NDOs should be included in the ESMA proposal as well. The same criteria (settlement style) and methodology should apply for FX options as for FX forwards. This amendment will anticipate the future development of more currencies becoming fully convertible and in consequence also more liquid.

ETDs should also be differentiated between deliverable and non-deliverable FX futures as well as deliverable and-non deliverable FX options.

Although ETD FX futures are in a very early stage with regard to their product life-cycle, market participants exchanges clearly expect that exchange traded futures liquidity will be predominantly split among the front month contracts and the following two serial contracts months (first 2 back month contracts) with time to maturity up to 3 months. This consideration is based on the experience in futures trading in other asset classes such as fixed income and money market as well as the market structure of the foreign exchange market, in specific the liquidity provided in FX forwards and the indicated market interest in FX futures.

Table 8 (page 165 f. in the Addendum consultation paper) differentiates between several maturity buckets and therefore partially reflects the aforementioned condition. It is therefore required to differentiate between FX futures with “time to maturity” up to 3 months and FX futures with “time to maturity” greater than 3 months to better reflect the anticipated liquidity profile of this specific instrument. To implement sub-classes within this instrument showing a much higher granularity is therefore not useful.

In order to be consistent among comparable instruments/classes as products having a very similar risk profile such as exchange traded futures, deliverable and non-deliverable forwards, ESMA is required to apply the same methodology including parameters and thresholds for those instruments

(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 members do not believe that the approach followed by ESMA to use the parameters - average number of trades per day and average notional amount traded per day - are the appropriate parameters to use. FIA Europe supports the position adopted by GFXD.

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

Agreeing with the GFXD position, FIA Europe members would define some classes declared liquid by ESMA as illiquid and vice-versa and the explanation is provided below:

ESMA have included on page 16 of the Addendum Consultation Paper (CP) 2 charts which show the notional and trade distribution of FX derivatives, essentially summarizing the data used by ESMA in this CP.

It is immediately obvious that these charts do not mirror the data published in the Bank of International Settlements (BIS) Triennial Central Bank Survey of Foreign Exchange turnover (http://www.bis.org/publ/rpfx13fx.pdf), nor that published by the Bank of England (BoE) in its semi-annual FX surveys (http://www.bankofengland.co.uk/markets/Pages/forex/fxjsc/default.aspx). Both of these sources are widely accepted by the FX industry (including Central Banks) as being representative of turnover within the FX markets, both sources reporting similar market splits by instrument traded and currency pairs.

For the comprehensive comparison between the data set used by ESMA and the BIS and BoE analysis outlining relevant inconsistencies and the scale of inconsistencies we refer to the GFXD response.

The impact of these data inconsistencies is that:

(i) Some FX instruments we had expected to be considered liquid have been classified as illiquid

- e.g. deliverable forward USDAUD crosses

(ii) Some FX instruments which we had expected to be to be considered illiquid have been classified as liquid

-e.g. deliverable forward non-USD crosses

FIA Europe members agree with GFXD's conclusion that the data should be collated once EMIR trade reporting is considered accurate and representative of actual trading patterns, including the correct mapping of FX instruments as traded by the market.

We share the significant concerns on the approach ESMA took in terms of data used in and the associated data quality:

Trade Reporting miss-matches: EMIR trade reporting, unlike that in some other jurisdictions, is 2-sided in nature, meaning that both parties to a trade are required to report to a trade repository (TR). For FX, there are at least 6 trade repositories that have been registered in the EU. The dual sided nature of reporting creates the need for both parties to validate that their submission matches that of their counterparty and this is usually performed via exception (or 'miss-matching') reporting. During the first 3 months of data submissions (i.e. the extract used by ESMA in this CP), the ability for either party to check their submission for accuracy intra TR, or even inter TRs, did not exist due to the absence of any exception reporting. Even now, some 14 months since the go-live of EMIR trade reporting obligations, the availability of exception reporting is limited. ESMA therefore used miss-matched trade data in their assessment of trading activity in Europe, impacting their assessment of notionals, financial instruments and volumes traded.

Trading period: Table 1 on page 17 of the CP illustrates a high-level assessment showing which FX product types are liquid. Footnote 5 on page 17 clearly states that the number of trading days for the period of data chosen for analysis was 65. However, Table 1 states that the number of trading days for each of the product types was above 65, and for NDFs was actually 92. We believe that the number of days traded should not exceed 100% which this suggests that yet more of the data submitted to the TR was not representative. The number of days traded is a specific factor in the determination of liquidity, in that in order for a class of derivatives to be liquid, one of the categories assessed is the "number of days traded greater than or equal to 80% of the available trading days in the period". We believe this is a further example impacting ESMA's ability to make an accurate liquidity assessment.

FIA Europe supports GFXD recommendation in relation to the ESMA approach and its ability to Re-calibrate. FIA Europe shares the same concerns in that ESMA does not propose to recalibrate the liquidity assessment at all. In the May 2014 Discussion Paper, ESMA stated (on page 125, paragraph 44) that "the liquidity of the sub-categories needs to be re-assessed periodically". Instead, it is now clear that ESMA proposes no such re-assessment. This decision also implies that ESMA has chosen not to utilise the market data that MiFIR (or EMIR) will make available to facilitate recalibration, which misses the the opportunity to refine the liquidity classification over time (particularly given the concerns over the EMIR trade repository data noted above).

This static determination is a serious weakness of ESMA's approach which implies that an incorrect initial assessment of liquidity will have permanent implications. We encourage ESMA to reconsider whether the COFIA can be recalibrated more regularly, as improved market data becomes available and to better reflect changing liquidity conditions. In the absence of regular and accurate recalibration, we urge ESMA to compensate through both a more conservative initial assessment of liquidity, and by calibrating the LIS and SSTI thresholds at lower levels.

Finally, such a static approach will not leverage developments within the trade reporting requirements, most notably those being driven by ESMA as well as global standardisation through the use of the UPI.

FIA Europe supports GFXD's Liquidity Proposal:

It is believed that due to the policy objectives of ensuring transparency at the aggregate level of the FX derivatives asset class, ESMA should not attempt to find at least some liquid sub-classes in as many classes of FX derivatives as possible. Some classes are simply very illiquid or extremely heterogeneous. For instance, the GFXD regards simple and complex exotic options as being illiquid, yet due to the current product mapping in the EMIR trade reporting data these would be deemed liquid.

We therefore support and propose the following alternative approach.

Data Source: we believe that the Bank of International Settlements (BIS) Triennial Central Bank Survey of Foreign Exchange turnover (http://www.bis.org/publ/rpfx13fx.pdf), and the Bank of England (BoE) semi-annual FX surveys (http://www.bankofengland.co.uk/markets/Pages/forex/fxjsc/default.aspx) accurately reflects the FX trading landscape in Europe. Both provide a level of granularity which enables the markets to be assessed to enable a practicable application by regulators and market participants alike as well as meeting policy objectives.

Whilst the BoE survey captures the UK market only, it is important to understand that this represents 70% of the FX market in Europe (by notional traded) and is considered representative across Europe. Both data sources have been used over a number of years (BoE since 2008, for instance), with the data collection models being refined over time. These surveys are considered accurate by the FX industry, including central banks and ESMA (BIS was used by ESMA in the 2014 CP on FX NDF Clearing). This is obviously contrary to the EMIR trade repository data available to ESMA, which as we have discussed above is not considered in its current state to be representative of the European FX industry.
<ESMA_QUESTION_MIFID_ADD_1>

Q2. Do you agree with ESMA's proposal for foreign exchange derivatives? Please specify, for each sub-class (non-deliverable forwards (NDF), deliverable forwards (DF), FX options, FX swaps, spread betting and FX 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
(6) <u>for non-deliverable forwards (NDF) and spread betting contracts only:</u> express your preference for either "Alternative A" or "Alternative B". If you disagree with both ESMA's proposal provides your alternative proposal for the LIS threshold floor.

<ESMA_QUESTION_MIFID_ADD_2>

(1) deferral period set to 48 hours

FIA Europe member agree 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 National Competent Authorities (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) size specific to the instrument threshold set as 50% of the large in scale threshold

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 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) 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

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). And that whilst we agree with the use of criterion 1, we recommend 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.

As an observation of ESMA's proposals, in the proposed thresholds for NDFs – COP-USD pair with a tenor from 4 days to 7 days is considered liquid and the Large-In-Scale (LIS) thresholds are set at a clearly unrealistic €700 million, which is greater than the average daily volume for that market.

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

We disagree with ESMA's proposals. ESMA proposes that post-trade deferred publication levels shall be set equal to pre-trade large-in-scale sizes. In line with the GFXD response, FIA Europe members recommend that there should be a different SSTI for pre-trade transparency and post trade transparency because:

(i) The risk associated with the post trade threshold is the time permitted for the market maker to unwind and hedge risk. The pre-trade risks to the market maker are much greater than the post trade risks because the price formation process can be interfered with. Therefore, we believe that the pre-trade SSTI should differ from post trade SSTI and that the levels should be much lower. We do not believe that introducing different thresholds for pre-trade and post-trade would make the regime too operationally complex

(ii) For post-trade transparency, if the SSTI is set too high (further exacerbated for illiquid instruments that are incorrectly classified as liquid), the larger trades will be subject to real time transparency (without NCA discretion for deferral) and market makers will be unable hedge and unwind their positions. This will ultimately discourage market makers from committing capital to facilitate trades, resulting in less depth of liquidity and wider spreads, at the expense of investors

(iii) The disclosure of pre-trade risks are much greater than the post-trade risks because the price formation process can be intervened with:
  - Other dealers could price against the market maker with regards and result in a race to the bottom in pricing that does not reflect market risk. Further, the disclosure of prices pre-trade could result in predatory pricing practices; and
  - Other dealers could take contrarian positions against the market maker prior to execution, increasing the cost of hedging or unwinding of the market maker's risk.

<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. 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) 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 members agree with the GFXD proposals.

(6) for non-deliverable forwards (NDF) and spread betting contracts only: express your preference for either "Alternative A" or "Alternative B". If you disagree with both ESMA's proposal provides your alternative proposal for the LIS threshold

FIA Europe members agree with Alternative B.
<ESMA_QUESTION_MIFID_ADD_2>

Q3. Which is your preferred option for the definition of a liquid market of single name CDS? Please provide an answer detailed per underlying issuer type identified (sovereign and corporate), 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_MIFID_ADD_3>

FIA Europe disagrees with ESMA's determinations of liquidity for Single Name CDS and broadly supports the position adopted by ISDA[3].

We consider that this is a class of heterogeneous, generally illiquid derivatives, and that ESMA's determination that much of the class is liquid results from an assessment at an inadequate degree of granularity, using liquidity thresholds that are far too low (particularly given the broad classes used in the assessment) and using a short period of EMIR TR data originating from shortly after the EMIR Trade Reporting requirement came into effect, which has several issues. We therefore cannot support either Option A or Option B as currently proposed. Instead, we recommend that ESMA:

(i) Refines its assessment of single name by:
- Include a "Reference Entity" parameter to achieve suitably homogenous and granular classes in order to make an appropriate assessment of liquidity. Failing this, we cannot support the determination of broad Single Name CDS classes as liquid.
- Utilising higher liquidity thresholds which accord with the MiFIR definition of a liquid market – i.e. one where there are ready and willing buyers and sellers. This is necessary even where ESMA uses granular, homogenous classes, but is particularly critical where ESMA might continue to use broad, non-homogenous classes. We consider 15 trades per day and EUR10 million notional per day to be acceptable thresholds were ESMA to adopt granular, homogenous classes.

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

[3] The International Swaps and Derivatives Association, Inc (ISDA). ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks.

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

FIA Europe members support the response of ISDA, which proposes differentiating the liquidity determination for single name CDS trading with a wide credit spread, both by delineating classes in the COFIA according to traded credit spread, and by utilising the credit spread (when trading wider than a specified threshold) as a factor that would result in a temporary suspension of transparency obligations.

FIA Europe members support the proposals and options brought forward by ISDA for a more appropriate approach for the definition of a liquid market for single-name CDS. For ease of reference, ISDA's recommendations are laid out below:

We recommend that ESMA consider the following options in the following order of appropriateness:

1. **Option 1:** Determining that all single name CDS are illiquid. This would be a similar conclusion to that made by ESMA for Non-financial Convertible Bonds and SFPs on page 102 of the December 2014 Consultation Paper, where (as ESMA describes on page 109 of the December 2014 Consultation Paper) the high proportions (>97%) of instruments underlying those classes found to be illiquid has resulted in ESMA determining those bond classes to be illiquid in their entirety.
2. **Option 2(A):** If ESMA rejects Option 1, adopting a granular COFIA approach (i.e. a name by name assessment) which is recalibrated periodically (perhaps annually) to identify those reference entities and tenors in which, based on the previous period's data, trading activity has exceeded thresholds which can be defined in the RTS.

   We propose using thresholds of 15 trades and EUR 10 million notional per day for this purpose. However, we would emphasise that the adoption of a granular COFIA approach is the key element of Option 2(A) rather than the level of the liquidity thresholds, although we believe that our recommended liquidity thresholds are appropriate to the single name CDS class.

   We expect ESMA to be well placed to undertake the periodic recalibration required by Option 2(A), utilising the trade reporting data that MiFIR will make available. ESMA would be able to make the list of reference entities and tenors found to be liquid public on its website and give firms a reasonable period to update systems and controls with the revised list.

3. **Option 2(B)**: If ESMA rejects Option 2(A), Option 2(A), as described above, without the periodic recalibration. Under this option, a more granular COFIA approach would be used to define sub-classes and each sub-class would be assessed against liquidity thresholds of 15 trades and EUR 10 million notional per day.

   Option 2(B) involves a one-time only (i.e. static) liquidity assessment, which would result in certain single name CDS being classified as liquid until such time as the RTS itself is modified. This is not sensible for a number of reasons, including:

   a) Over time, and due to changes in the circumstances of the company (news, debt outstanding, M&A activity etc), the amount of trading on a name may significantly reduce.
   b) If liquidity reduces the name will drop out of future indices which, in and of itself, will further reduce the liquidity on that name.
4. **Option 3:** If ESMA rejects Option 2(B)**,** adopt a modified version of Option B (as described on page 251 of the Addendum) which compensates for the high rates of sub-classes incorrectly classified as liquid through much lower LIS and SSTI thresholds to ensure that trading in these illiquid instruments above the LIS/SSTI thresholds benefits from the appropriate waivers. Please see our response to Question 5 for our proposals for setting appropriate LIS and SSTI thresholds. The disadvantage of this approach is that the compensation through lower SSTI would not be available to trading on any venues not granted waivers by their NCAs or where NCAs don't permit the full range of deferrals for trades exceeding the SSTI or LIS thresholds.

We recommend however that ESMA's proposed 'Option B' also be amended by referring to a subset of the indices deemed to be liquid. Although we understand the basis of 'Option B' and can see the merits in its simplicity, it is imperative that the calibration of liquidity under MiFIR recognises that material differences in liquidity exist across the spectrum of CDS single name trading. For example, Western European Sovereigns are not constituents of a liquid index. Moreover, there are significant differences between the indices in terms of their composition. The iTraxx Europe Crossover index for example can include names which have never previously traded in the CDS market: treating these new contracts as liquid and therefore in-scope for pre-trade transparency would lead to significant impairment to the liquidity of both those names and the index. We therefore recommend a different approach for Corporates compared to Sovereigns. For Corporates, we urge ESMA to distinguish between the established investment grade Corporate indices denominated in USD and EUR and other indices, comprised of more illiquid and high yield/distressed names. We therefore recommend that ESMA's 'Option B' should refer not to all indices deemed to be liquid but to the on-the-run version of two indices: the iTraxx Europe Main index and the CDX.NA.IG index. By modifying 'Option B' so that it captures the constituents of such investment grade Corporate indices, ESMA would capture the vast majority of single name CDS trading volume (excluding Sovereigns) and limit the number of instances where the transparency regime impairs rather than aids liquidity.

For Sovereigns, we would recommend that ESMA adopt a granular approach as laid out in Option 2(A) above. The number of Sovereign entities is a fraction of Corporates and yet the trading standards adopted exhibit significant regional variation, the end user base differs dramatically and there are significant differences with respect to regulation around their use. The only viable approach is therefore as assessment on a name by name basis.

If ESMA rejects Option 1, we further recommend that ESMA delineate between COFIA classes according to the traded credit spread, such that where the spread exceeds a threshold defined in the RTS (we recommend a spread of 450bps), the CDS is classified into a distinct illiquid class of CDS. For the avoidance of doubt, any reference entity whose quoting convention is in "points upfront", as is the case on distressed instruments, would also be classified into this illiquid class. Since the size of bid-ask spreads tends to be wider for reference entities trading with a wider credit spread, the purpose of distinguishing this illiquid class is to ensure that these reference entities are correctly identified as illiquid. This would permit ESMA to take account of the third criterion of the liquid market definition in Article 2(17)(iii) of MiFIR. We highlight again the idiosyncratic risk inherent to single name CDS that is very different from macro products. Single name CDS are impacted most directly by news and events specific to the credit or sector, which are impossible to predict. A reference entity which transitions to a lower credit quality has a higher implied probably of default and generally becomes less liquid, more volatile and trades with wider bid-ask spreads.
Regardless of which option ESMA decides upon, the idiosyncratic nature of single name CDS products requires there to be workable temporary suspension regime. Under MiFIR, NCAs have the power to temporarily suspend pre- and post-trade transparency requirements for trading venues and investment firms when the liquidity of a class of financial instruments falls below specified thresholds. ISDA recommends that ESMA permits to NCAs to suspend transparency obligations for a single-name CDS when its traded credit spread cap exceeds 450 bps. This is the case even if ESMA decides to incorporate the traded credit spread into its liquidity determination (as we have recommended in the paragraph above), as some NCAs may not exercise their discretion to grant waivers or deferrals for illiquid instruments but may still wish to utilise their temporary suspension powers when the credit spread cap exceeds 450bps.
<ESMA_QUESTION_MIFID_ADD_3>

Q4. For all the other classes (CDS Index, Bespoke basket CDS, CDS index options and Single name CDS options): do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer detailed per contract type (CDS and CDS options), underlying type (index, single name, bespoke basket) and underlying identified, addressing the following points:

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

1. **(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?**
2. **(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_MIFID_ADD_4>

FIA Europe disagrees with ESMA's determinations of liquidity for CDS Index and Index Options and supports the position by ISDA.

<u>CDS Index</u>

With regard to the quantitative criteria applied to this class, we note that the notional amount of one trade per day and €10mm notional per day are extremely low and cannot be considered consistent with the MiFIR definition of a liquid market, i.e. a market with ready and willing buyers and sellers on a continuous basis. We consider that 15 trades per day and €500mm notional per day would be thresholds more consistent with the MiFIR definition.

We also not that ESMA's definition of "on-the-run" status does not accord with market convention, and that ESMA has made methodological mistakes in its classification of index CDS with partial-year tenors. We support the recommendations of ISDA which are intended to correct for these methodological issues, and to better accord the RTS classification with market convention.

<u>CDS Index Options</u>

FIA Europe considers that further granularity is needed in the criteria used to divide sub-class. We propose that ESMA should include a 'time to maturity' criterion to reflect that liquidity would be concentrated in shorter dated options rather than longer dated options and thereby achieve more granular sub-classes. CDS Index Options are a relatively illiquid asset class, and we expect that use of appropriate degree of granularity will result in relatively few classes being found to be liquid.
<ESMA_QUESTION_MIFID_ADD_4>

Q5. Do you agree with ESMA's proposal for credit derivatives? Please specify, for each sub-class (single name CDS, CDS index, bespoke basket CDS, single name CDS options, CDS index options) 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.

<ESMA_QUESTION_MIFID_ADD_5>
FIA Europe members support the position adopted by ISDA.

FIA Europe is also concerned that large in scale (LIS), and therefore size specific to the instrument (SSTI) thresholds, have been calibrated with poor quality which is causing these proposed thresholds to be extremely large compared to normal market transaction sizes.
<ESMA_QUESTION_MIFID_ADD_5>

Q6. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer detailed per class of derivatives (freight derivatives, emissions derivatives, weather derivatives and other exotic derivatives) and contract type identified (options, futures, forwards, swaps, others). If you do not agree with ESMA's proposal for the definition of a liquid market, please specify per class of derivatives and contract type identified:

- **your alternative proposal;**

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

(7) which parameters and related threshold values would you use in order to define a sub-class as liquid. Please, provide reasons for your answer.

<ESMA_QUESTION_MIFID_ADD_6>

FIA Europe members have the following comments:

(i) Inclusion of precious metals in the FX analysis

The inclusion of precious metals in the analyses, particularly for Foreign Exchange (FX) derivatives was noted in the response to Q1. For example, under Table 48 of draft RTS 9 (FX NDF Liquid Classes) USD-XAU is included as a liquid class of NDFs. We recommend that reference to contracts relating to precious metals should be included in the assessment of Commodity Metal Derivatives under the main Consultation Paper so as to avoid duplicative rules.

(ii) Emissions

FIA Europe notes that the thresholds established in the Emissions Derivatives are denominated in Euro. We recommend that thresholds are denominated in tonnes of CO2 rather than Euro, so as to accurately represent the way in which the Emissions Derivatives market is traded.

FIA Europe also notes that further granularity is needed in this class. Therefore we suggest that ESMA replicate the 'Emissions Allowance Type' criterion applied in the main CP that is, dividing the Emissions Allowances by sub-classes falling into: European Union Allowances (EUA), Certified Emission Reductions (CER), European Union Aviation Allowance (EUAA), or Emission Reducing Units (ERU).

(iii) Emissions allowances and the EU Auctioning Regulation

FIA Europe draws to ESMA's attention a perceived conflict between MiFID II, MiFIR and ESMA's proposals regarding pre- and post-trade transparency for Emissions allowances under RTS 9 and the EU Auctioning Regulation (Commission Regulation (EU) No. 1031/2010), both of which relate to emissions allowances. FIA Europe is of the view that it is of the utmost importance that ESMA suitably amend RTS 9 in relation to Emissions allowances or ESMA risks creating a conflict between MiFIR/MiFID and existing European Union law.

By way of background, Phase III of the European Union Emissions Trading Scheme (ETS) commenced in 2013 and will operate until 2020. During this period approximately half of Phase III EU Allowances (EUAs) will be sold through regular auctions on exchanges, in accordance with Commission Regulation (EU) No. 1031/2010 (the "Auctioning Regulation"). EU Aviation Allowances (EUAAs) were introduced in January 2012 and following an initial postponement are now being auctioned in a similar way.

Article 5 of the Auctioning Regulation, states that: "Auctions shall be carried out through an auction format whereby bidders shall submit their bids during one given bidding window without seeing bids submitted by other bid-

ders". In accordance with Article 5, which in effect sets out the necessary pre-trade transparency requirements, participants bidding in an auction via the auction platform are required to submit sealed bids during the auction window without seeing bids submitted by other participants. The Auctioning Regulation outlines in Article 61 the details to be notified to the market following an auction, including the volume of allowances auctioned, the auction clearing price, and the total volume of bids submitted. The auction platform is given 15 minutes after the close of the bidding window to announce the results (namely the aforementioned details). These requirements set out the necessary information that must be provided from a post-trade transparency perspective.

Further to the above background, in order to ensure exchanges can continue to operate auctions under the existing regulatory framework, ESMA should make suitable amendments to RTS 9 to ensure that the proposed pre-trade and post-trade transparency requirements under MiFID/MiFIR do not conflict with the Auctioning Regulation, and to ensure that additional requirements that are not meaningful in the context of such auctions are not imposed. FIA Europe recommends ESMA to introduce, in RTS 9, a pre-trade waiver to for Emissions auctions activity and similarly exclude Emissions auctions from the post-trade requirements. Otherwise, as explained above, ESMA risks creating a direct conflict with ESMA's proposals on pre-trade and post-trade transparency requirements and the Auctioning Regulation.

(iv) Freight

FIA Europe notes that the thresholds established in the Freight Derivatives are denominated in Euro. We recommend that thresholds are denominated in metric tonnes of cargo rather than Euro, so as to accurately represent the way in which the Freight Derivatives market is traded.

In relation to LIS/SSTI threshold, these are very high and do not accurately reflect the market and ESMA should revisit this.

<ESMA_QUESTION_MIFID_ADD_6>

Q7. Which is your preferred option? Please express your preference either for "Alternative A" or for "Alternative B". If you disagree with both ESMA's proposals provide your alternative proposal by answering the following question.

<ESMA_QUESTION_MIFID_ADD_7>

FIA Europe members support recalibration on an annual basis, however as discussed in other parts of the response, the threshold calculation mechanisms are not appropriate. Therefore, FIA Europe and its members support Alternative B with the modifications discussed to ensure that markets which are liquid captured and illiquid markets benefit from the pre-trade transparency waivers and post-trade transparency deferrals.

<ESMA_QUESTION_MIFID_ADD_7>

Q8. Please specify, for each class (defined as follows if you have stated your preference for Alternative A: freight derivatives, emissions derivatives, weather derivatives and other exotic derivatives. Defined as combination of underlying type and contract type if you have stated a preference for Alternative B: freight options, freight futures, freight forwards, etc.) 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.**

<ESMA_QUESTION_MIFID_ADD_8>

(1) deferral period set to 48 hours

FIA Europe member agree 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 National Competent Authorities (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) size specific to the instrument threshold set as 50% of the large in scale threshold

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 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) 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

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.

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

We disagree with ESMA's proposals. ESMA proposes that post-trade deferred publication levels shall be set equal to pre-trade large-in-scale sizes. FIA Europe recommends that there should be a different SSTI for pre-trade transparency and post trade transparency because:

(i) The risk associated with the post trade threshold is the time permitted for the market maker to unwind and hedge risk. The pre-trade risks to the market maker are much greater than the post trade risks because the price formation process can be interfered with. Therefore, we believe that the pre-trade SSTI should differ from post trade SSTI and that the levels should be much lower. We do not believe that introducing different thresholds for pre-trade and post-trade would make the regime too operationally complex

(ii) For post-trade transparency, if the SSTI is set too high (further exacerbated for illiquid instruments that are incorrectly classified as liquid), the larger trades will be subject to real time transparency (without NCA discretion for deferral) and market makers will be unable hedge and unwind their positions. This will ultimately discourage market makers from committing capital to facilitate trades, resulting in less depth of liquidity and wider spreads, at the expense of investors

(iii) The disclosure of pre-trade risks are much greater than the post-trade risks because the price formation process can be intervened with:

   i. Other dealers could price against the market maker with regards and result in a race to the bottom in pricing that does not reflect market risk. Further, the disclosure of prices pre-trade could result in predatory pricing practices; and

   ii. Other dealers could take contrarian positions against the market maker prior to execution, increasing the cost of hedging or unwinding of the market maker's risk.

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. 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_MIFID_ADD_8>

Q9. Do you agree with the approach taken for shares where any CFD based on a liquid share would be considered as having a liquid market? More specifically, please provide feedback on the following:

(1) Would you prefer to follow a similar approach as that proposed in option 2 on liquidity for equity derivatives (paragraph 90 page 132 of December CP), i.e. qualify all CFDs on equity as liquid irrespectively of the liquidity of the underlying?

(2) Would you have used different criteria to define the classes or sub-classes?

(3) Would you have used 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?

(4) Would you support extending the approach taken for shares to other equity (ETFs, depositary receipts and certificates) and equity-like instruments?

<ESMA_QUESTION_MIFID_ADD_9>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_ADD_9>

Q10. Do you agree with ESMA's proposal for the definition of a liquid market for CFDs on currencies? Please provide a feedback on the following in your answer:

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

<ESMA_QUESTION_MIFID_ADD_10>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_ADD_10>

Q11. Do you agree that CFDs on instruments other than equities and currencies are illiquid? If you do not agree with ESMA's proposal for the definition of a liquid market for those classes, please provide your alternative proposal specifying the following:

2. **How would you define the sub-classes, i.e. which qualitative criteria would you use?**
(4) **Which parameters and related thresholds would you use to classify a sub-class as liquid?**
(5) **Which sub-classes would you define as liquid?**

<ESMA_QUESTION_MIFID_ADD_11>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_ADD_11>

Q12. Do you agree with ESMA's proposal for CFDs? Please specify, for each sub-class (CFDs on equity, CFDs on currency, CFDs on commodity, CFDs on bonds, CFDs on futures on equity and CFDs on options on equity, others) if you agree on the following points providing reasons for your answer and, if you disagree providing ESMA with an alternative proposal regarding:

(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.**

<ESMA_QUESTION_MIFID_ADD_12>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_ADD_12>