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| 20 September 2016 | ESMA/2016/1389 |

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| Reply form for the Discussion Paper on the trading obligation for derivatives under MiFIR |
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| Date: 20 September 2016 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Discussion Paper on the trading obligation for derivatives under 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\_TO\_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\_TO\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

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

ESMA\_MiFID\_TO\_ESMA\_REPLYFORM or

ESMA\_MiFID\_TO\_ESMA\_ANNEX1

***Deadline***

Responses must reach us by **21 November 2016.**

All contributions should be submitted online at [www.esma.europa.eu](http://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](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# Introduction

Please make your introductory comments below, if any:

< ESMA\_COMMENT\_MIFID\_TO\_0>

1. Clarus Financial Technology welcomes the opportunity to comment on this discussion paper. Clarus provides research, data and analytics for the Swap markets. Our Data products provide transparency on OTC Derivatives trading by collecting and normalizing data from Trade Repositories, Clearing Houses and Swap Execution Facilities. See <https://www.clarusft.com/products/about-our-data-products/>
2. Our comments are on Section 7 Liquidity assessment and Section 9 Package Transactions, as we are concerned that the quality and granularity of the TR data used for the Liquidity assessment is not good enough for this purpose.
3. OTC Derivatives are a global market, one with global participants and global liquidity and we believe that trading obligations should be consistent across jurisdictions for the same currency and product. Comparing the ESMA preliminary analysis results with CFTC MAT determinations in the US and with US Swap Repository Data shows significant differences. We believe these would not be present if ESMA had access to a more granular dataset and we would encourage ESMA to conduct another assessment with a better dataset.
4. An article with many of our comments was published in Sep 2016 at <https://goo.gl/igiZqI> and this has been widely read by industry participants along with the Oct 2015 article at <https://goo.gl/yJPeqH>

< ESMA\_COMMENT\_MIFID\_TO\_0>

1. Do you agree that the level of granularity for the purpose of the trading obligation should apply at the same level as the one used for calibrating the transparency regime of non-equity instruments? If not, which level of granularity for the TO would you recommend and why? Would that differ by asset class and type of instrument?

<ESMA\_QUESTION\_MIFID\_TO\_1>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_1>

1. Do you agree that all derivatives currently subject to or considered for the CO are admitted to trading or traded on at least one trading venue? If not, please explain which classes of derivatives are not available for trading on at least one trading venue.

<ESMA\_QUESTION\_MIFID\_TO\_2>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_2>

1. How should ESMA determine the total number of market participants trading in a class of derivatives? Do you consider it appropriate to carry out this assessment with TR data or would you recommend other data sources?

<ESMA\_QUESTION\_MIFID\_TO\_3>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_3>

1. In your view, what should be the minimum total number of market participants to consider the following classes of derivatives as sufficiently liquid for the purpose of the trading obligation? i) OTC interest rate derivatives denominated in EUR, USD, GBP and JPY; ii) OTC interest rate derivatives denominated in NOK, PLN and SEK; iii) Credit default swaps (CDS) indices? Should you consider that this assessment should be done on a more granular level, please provide your views on the relevant subsets of derivatives specified in 1.-3.

<ESMA\_QUESTION\_MIFID\_TO\_4>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_4>

1. Do you agree with this approach? Do you consider alternative ways to identify the number of trading venues admitting to trading or trading a class of derivatives as more appropriate?

<ESMA\_QUESTION\_MIFID\_TO\_5>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_5>

1. On how many trading venues should a derivative or a class of derivatives be traded in order to be considered subject to the TO?

<ESMA\_QUESTION\_MIFID\_TO\_6>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_6>

1. What would be in your view the most efficient approach to assess the total number of market makers for a class of derivatives? Where necessary, please distinguish between: i) The phase prior to the application of MiFID II (i.e. before January 2018); ii) The phase after the application of MiFID II (i.e. after January 2018).

<ESMA\_QUESTION\_MIFID\_TO\_7>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_7>

1. How many market makers and other market participants under a binding written agreement or an obligation to provide liquidity should be in place for a derivative or a class of derivatives to be considered subject to the TO?

<ESMA\_QUESTION\_MIFID\_TO\_8>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_8>

1. Do you agree with the proposed approach or do you consider an alternative approach as more appropriate?

<ESMA\_QUESTION\_MIFID\_TO\_9>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_9>

1. Do you agree that the criterion of average size of spreads, in particular in case of absence of information on spreads, should receive a lower weighting than the other liquidity criteria? If not, please specify your reasons

<ESMA\_QUESTION\_MIFID\_TO\_10>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_10>

1. Which sources do you recommend for obtaining information on the average size of spreads by asset class?

<ESMA\_QUESTION\_MIFID\_TO\_11>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_11>

1. What do you consider as an appropriate proxy in case of lack of information on actual spreads?

<ESMA\_QUESTION\_MIFID\_TO\_12>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_12>

1. Do you agree with the suggested approach? If not, what approach would you recommend?

<ESMA\_QUESTION\_MIFID\_TO\_13>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_13>

1. Do you agree that trades above the post-trade large in scale threshold should not be subject to the TO? If not, what approach would you suggest? Should transactions above the post-trade LIS threshold meet further conditions in order to be exempted from the TO?

<ESMA\_QUESTION\_MIFID\_TO\_14>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_14>

1. How highly should ESMA prioritise the alignment of the TO with transparency? What would be the main consequences for the market if some instruments are covered by transparency and not by the TO or vice versa? If the two are not fully aligned, would a broader scope for the TO or for transparency be preferable, and why? In case of a broader or narrower scope for the TO (compared with transparency), how should the two liquidity tresholds relate to each other?

<ESMA\_QUESTION\_MIFID\_TO\_15>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_15>

1. Do you agree with the proposed methodology to eliminate duplicated trades or would you recommend another approach? Do you agree with selecting Option 2?

<ESMA\_QUESTION\_MIFID\_TO\_16>

ESMA should not select Option 2 based on the stated rational that “Option 2 was chosen because it removes a number of records that is in between Option 1 and 3 and allows a more precise data selection (contrary to Option 1 it captures also the situation of non-direct clearing, and contrary to Option 3 it is not based on solely one field but takes into account a combination of fields).”

Instead ESMA should look for a control dataset that can be compared covering the product types and time period and determine whether the trade counts and trade notionals for the Options are reasonable.

As a comparison we looked just at US Trade Repository data that we collect in our SDRView product on the basis that we have confidence in this dataset given that public dissemination in the US is single side reported and sufficiently granular (trade level) to allow us to isolate price forming trades and sub types of trades

Using [SDRView](http://sdrview.clarusft.com/%22%20%5Ct%20%22_blank) for the same six-month period that ESMA used and the largest 7 IRS Fixed Float currencies, cleared and price forming trades only, we see the following:



An average of 35,000 trades a month, while other currencies only add 1,500 to this number. If we also include Uncleared Swaps, the monthly average rises to 40,000 trades. Meaning that in the US, there were 240,000 Fixed Float Swaps reported in the same six- month period as ESMA’s Option 2 dataset with 475,515 trades.

The BIS Triennial Survey (2016) found that turnover of OTC Interest Rate Derivatives is broadly similar in New York and London, both accounting for ~40% of global volumes.

We would therefore expect a similar number of trades in the ESMA data set as were reported to US SDRs (240,000 trades) and the fact that the ESMA Option 2 number is almost double the US one is concerning.

<ESMA\_QUESTION\_MIFID\_TO\_16>

1. Do you agree with the approach taken with regard to calculating tenors?

<ESMA\_QUESTION\_MIFID\_TO\_17>

It is wrong to calculate tenor as the difference between maturity and execution date, instead tenor should be determined by using trade date, effective (start) date and maturity date and using the business holiday calendar and date roll conventions specific to each currency.

In addition spot starting swaps (e.g. 5Y Swap) should be distinguished from forward starting swaps (e.g. 1Y into 4Y). The flaw in not doing so is that many swaps are forward start, which are not distinguished from spot starting, so a 5Y into 5Y forward would end up in a 10Y tenor. This approach is carried down into the liquidity assessment by tenor further muddying the figures for liquidity in a vanilla swap for a benchmark tenor. We know from US TR Data that Forward Start Swaps represent roughly 20% of the overall volume in USD IRS.

<ESMA\_QUESTION\_MIFID\_TO\_17>

1. Do you agree with the reasons mentioned above or is there another explanation for the significant number of trades outside of benchmark dates?

<ESMA\_QUESTION\_MIFID\_TO\_18>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_18>

1. Does this result reflect your assessment of liquidity in fixed-float IRS? If not, please explain on which subclasses you disagree and why.

<ESMA\_QUESTION\_MIFID\_TO\_19>

No it does not, as the types of fixed-float IRS are crucial to understand liquidity and the information on the conventions are necessary to distinguish types of Swaps. Standard Swaps trade with respect to a specific Index (e.g. Euribor, Libor) and Tenor as well as specific conventions on payment frequency, day count and calendars. Such Swaps are well traded and likely to be liquid, while Swaps with non-standard terms are less likely to be liquid.

In the US the CFTC [MAT](https://www.clarusft.com/glossary/mat/%22%20%5Co%20%22Glossary%3A%20MAT%22%20%5Ct%20%22_blank) table distinguishes between Spot starting par swaps, IMM swaps, MAC swaps, none of which has been possible for ESMA to do with TR data.

ESMA analysis shows that EUR 1Y, 8Y, 9Y, 12Y have a much lower number of trades than the other tenors and comparing with the CFTC tables we find that these tenors are not MAT.

Again we need a control dataset to know whether the above is reasonable. So lets turn again to [SDRView](http://sdrview.clarusft.com/%22%20%5Ct%20%22_blank) on the assumption that EUR IRS traded by US persons are likely to be a fraction of the European, most likely less than half.

The table below shows this data.



Comparing the two datasets:

* It is surprising that the ESMA counts and notionals are not much higher
	+ e.g. for 5Y [SDRView](https://www.clarusft.com/glossary/sdrview/%22%20%5Co%20%22Glossary%3A%20SDRView%22%20%5Ct%20%22_blank) has 6,320 trades while ESMA has 8,918.
* USD SDR data lends credence to the ESMA finding that 1Y and 9Y may be liquid
* But it does not support the ESMA finding on 8Y and 12Y

However the fact remains that in this case the ESMA numbers look lower compared to the US than we would expect. And the Sum of the ESMA EUR trade counts also looks a much smaller fraction of the overall IRS total in Option 2 of 475,515; a number I would expect to be dominated by EUR IRS in benchmark tenors.

For the other currencies:

* GBP only has 5Y, 10Y, 30Y as sufficiently liquid
* Contrast this with CFTC MAT which has 2Y, 3Y, 4Y, 5Y, 6Y, 7Y, 10Y, 15Y, 20Y, 30Y
* SDRView data shows that 1Y, 2Y, 3Y, 15Y should be considered
* JPY has 5Y, 7Y, 10Y, 20Y as sufficiently liquid
* CFTC does not have a MAT in place for JPY IRS
* Japan has 5Y, 7Y, 10Y as MAT
* USD has 1Y as sufficiently liquid while it is not MAT for CFTC
* CFTC has 2Y, 3Y, 4Y, 5Y, 6Y, 7Y, 10Y, 12Y, 15Y, 20Y, 30Y
* SDRView data is higher than ESMA for USD IRS, as we would expect
* SDRView for 10Y has 34,876 trades while ESMA has 12,014
* SDRView for 7Y has 8,857 trades wile ESMA has 1,921

<ESMA\_QUESTION\_MIFID\_TO\_19>

1. What thresholds would you propose as the liquidity criteria? What minimum number of counterparties would you consider appropriate for introducing the TO?

<ESMA\_QUESTION\_MIFID\_TO\_20>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_20>

1. What further specifications (e.g. payment frequency, reset frequency, day count convention, trade start type) would you consider necessary for specifying the trading obligation for fixed-float IRS? How would you determine these additional specifications?

<ESMA\_QUESTION\_MIFID\_TO\_21>

Firstly subtypes of fixed-float IRS need to be characterised, so Vanilla Spot Starting Par Swaps, Forward Swaps, IMM, MAC etc.

And the conventions for the standard trade established and the volume of these checked in a dataset to establish the trading obligation.

For EUR this means:

* Floating Leg, Index as EURIBOR 6M, reset frequency as 6M, payment frequency as 6M and daycount as ACT/360, calendar as EUTA
* Fixed Leg, fixed rate at par, payment frequency as 1Y, day count as 30U/360, calendar as EUTA

These conventions are known to market participants and documented by ISDA/FpML or may be gleaned from trade level data in TRs as these will be the most numerous trades in benchmark tenors.

<ESMA\_QUESTION\_MIFID\_TO\_21>

1. Does this result reflect your assessment of liquidity in OIS? If not, please explain on which subclasses you disagree and why.

<ESMA\_QUESTION\_MIFID\_TO\_22>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_22>

1. What thresholds would you propose for the liquidity criteria? What minimum number of counterparties would you consider appropriate for introducing the TO?

<ESMA\_QUESTION\_MIFID\_TO\_23>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_23>

1. What further specifications (e.g. payment frequency, reset frequency, day count convention, trade start type) would you consider necessary for specifying the trading obligation for OIS? How would you determine these additional specifications?

<ESMA\_QUESTION\_MIFID\_TO\_24>

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<ESMA\_QUESTION\_MIFID\_TO\_24>

1. Do you agree that due to the specificities of the FRA-market, FRAs should not be considered for the TO? Do you agree that the majority of FRAs transactions serve post-trade risk reduction purposes rather than actual trades.

<ESMA\_QUESTION\_MIFID\_TO\_25>

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<ESMA\_QUESTION\_MIFID\_TO\_25>

1. In case you consider FRAs should be considered for the TO, which FRA sub-classes are in your view sufficiently liquid and based on which criteria? How should a TO for FRAs best be expressed? Should it be based on the first (effective date) or the second period (reference date)? Apart from the tenor, which elements do you consider necessary for specifying the TO for FRAs and why?

<ESMA\_QUESTION\_MIFID\_TO\_26>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_26>

1. Would you consider the two index CDS as sufficiently liquid for being covered by the TO?

<ESMA\_QUESTION\_MIFID\_TO\_27>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_27>

1. Do you agree that the TO for CDS should cover the on-the-run series as well as the first thirty working days of the most recent off-the run-series? If not, please explain why and propose an alternative approach.

<ESMA\_QUESTION\_MIFID\_TO\_28>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_28>

1. Apart from the tenor, which elements do you consider indispensable for specifying the TO for CDSs and why?

<ESMA\_QUESTION\_MIFID\_TO\_29>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_29>

1. Do you agree with the proposed application dates? If not, please provide an alternative and explain your reasoning.

<ESMA\_QUESTION\_MIFID\_TO\_30>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_30>

1. Do you consider necessary to provide for an additional phase-in for the TO for operational purposed and to avoid bottlenecks? If yes, please provide a proposal on the appropriate length of such a phase-in for the different categories of counterparties and explain your reasoning.

<ESMA\_QUESTION\_MIFID\_TO\_31>

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<ESMA\_QUESTION\_MIFID\_TO\_31>

1. Which types of package transactions are carried out comprising components of classes of derivatives that are assessed for the purpose of the TO, i.e. IRD and/or CDS? Please describe the package and its components as well as your view on the liquidity of those packages.

<ESMA\_QUESTION\_MIFID\_TO\_32>

In IRS a significant amount of volume is traded as packages, which we categorize into two distinct types, first those where each leg is an IRS (e.g. Curve/Switch and Butterflies) and second those where one leg is an IRS and the other a Future or a Bond (Invoice Spreads, Asset Swaps).

US SDR data for the same 6-month period in 2015 shows that Curves and Butterflies in USD IRS Fixed Float are 25% by trade count of the overall trade volume of price forming trades.

Curves and Butterflies should be subject to a liquidity assessment independently from outright swaps, with a TO determined accordingly e.g. A 5Y10Y Curve might be liquid and subject to TO while a 4Y5Y Curve may not.

Invoice Spreads and Asset Swaps require more detailed analysis as evidence suggests that trading of these is more prevalent in Europe than in the US.

<ESMA\_QUESTION\_MIFID\_TO\_32>

1. Are there packages that only comprise components of classes of derivatives that are assessed for the purpose of the TO? Do you consider those package transactions to be standardised and sufficiently liquid?

<ESMA\_QUESTION\_MIFID\_TO\_33>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIFID\_TO\_33>

1. Do you agree that package transactions that are comprised only of components subject to the TO should also be covered by the TO or should the TO only apply to categories of package transactions that are considered liquid? If not, please explain.

<ESMA\_QUESTION\_MIFID\_TO

<ESMA\_QUESTION\_MIFID\_TO\_34>

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<ESMA\_QUESTION\_MIFID\_TO\_34>

1. How should the TO apply for package transactions that include some components subject to the TO, whereas other components are not subject to the TO?

<ESMA\_QUESTION\_MIFID\_TO\_35>

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<ESMA\_QUESTION\_MIFID\_TO\_35>