European Securities and Markets Authority

Reply form for the Discussion Paper on the trading obligation for derivatives under MiFIR

20 September 2016 | ESMA/2016/1389

European Securities and Markets Authority

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 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'.

Introduction

Please make your introductory comments below, if any:

< ESMA_COMMENT_MIFID_TO_0>

TYPE YOUR TEXT HERE

< ESMA_COMMENT_MIFID_TO_0>

Q1. 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>

Q2. 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>
We agree with the approach placing the CO range of products as reference products for the TO. Nevertheless we want to raise our concerns regarding the fact that at the moment there are no trading venues available for OTC IRS and CDS.
<ESMA_QUESTION_MIFID_TO_2>

Q3. 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>

Q4. 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>

Q5. 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>

Q6. 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>

Q7. 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>

Q8. 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>

Q9. 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>

Q10. 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>

Q11. 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>

Q12. 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>

Q13. 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>

Q14. 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>
We agree with the approach chosen to waive transactions above the post-trade large in scale thresholds. Moreover, bearing in mind the aim of protecting market participants from negative markets impact deriving from the disclosure of orders to the public, we strongly suggest to exempt from the TO every derivative instruments (IAS classification) whose only purpose is to hedge assets and liabilities in the banking book for the following reasons:

- When issuing a bond (both in benchmark size and in private placement format) or entering a loan agreement, a debtor may want to hedge any interest rate risk through the use of derivative instruments where he receives the coupon rate of the bond (or the coupon of the loan) and pays a floating rate (3m or 1m usually) plus a margin (if any). Such derivative transaction is classified as "HEDGING" under IAS compliant accounting rules. The market value of the derivative serves the accounting valuation of the hedged instrument (bond or loan).The derivative itself will not be subject to any termination of restructuring unbound to the hedged instrument. As the pricing of the bond and the terms of the hedging derivative are executed simultaneously, the negotiation of the swap on a trading venue could undermine the accuracy of the pricing. Taking into consideration the above, as the indicative yield of the notes is agreed in advance with the final investors during the book-building process, the disclosure to the public of this kind of transactions before the pricing of the hedged instrument could trigger significant market movement of the price and of the yield of the hedged instrument with negative impact on the final investors;

- Analogously, when a bank is hedging (through derivatives) particular instruments such as TLTRO or large mortgages' pools, counterparties can get information (because of TO) of what the bank is doing and how the bank is managing its assets in size and timing. This information are particularly sensitive because hedging instruments (under IAS classification) are not stand-alone transactions. We think that this information should not be disclosed to the public.

To sum up, we strongly advise against the disclosure to market participants of any information about how a bank is managing its assets and liabilities as part of a hedging strategy. This is to avoid: sharing of restricted information, adverse movements of the market and the communication of other price sensitive information to market participants.
<ESMA_QUESTION_MIFID_TO_14>

Q15. 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>

Q16. 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>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_TO_16>

Q17. Do you agree with the approach taken with regard to calculating tenors?

<ESMA_QUESTION_MIFID_TO_17>
No. In our experience the amount of trading taking place on interest rate instruments preceding or following by some days the standard tenors is negligible, there is no perceivable buying or selling interest, and trades are infrequent. Most of trading takes place on the exacts standard tenors. E.G in the market people trades the 5 years IRS, not the 5 years + 1 day. If the calculation of time to maturity is performed as difference between execution and maturity date, in disregard of market conventions (i.e. end-of-month, holiday calendar, etc.) we believe there is a constant distortion. The calculation should be done using effective dates and this would result in less false outside-tenor, and ESMA should avoid adjustments (+/- x days) in order to include more trades.
Given this we would advise to exempt the interest rate instruments outside the standard tenors from the trading obligation.
<ESMA_QUESTION_MIFID_TO_17>

Q18. 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>
In addition to the reasons mentioned, we believe that the calculation method is introducing a regular bias by disregarding market conventions, which should be punctually taken into account in calculating standard tenors' dates.
<ESMA_QUESTION_MIFID_TO_18>

Q19. 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>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_TO_19>

Q20. 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>

Q21. 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>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_TO_21>

Q22. 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>

The analysis of the OIS market seems fairly poor in light of the huge liquidity that distinguishes this product.

The wide use as a short term trading and hedging instrument is not well represented in the tenor points upon which the analysis is built: the flexibility inherent to the product determines a natural fragmented distribution of durations.

The study should therefore cover a wider range of buckets, at least all the monthly tenors up to 1 year (i.e. tenors like 1, 2M are not represented and may be quite significant). We find hard to assess an analysis where a significant part of the database is probably gone missing. Moreover, longer durations up to 10 years, whose use for hedging purposes is increasing, should not be forgotten.

Furthermore the OIS market is widely active in forward dates that are here excluded, both IMM dates (used in combination with FRAs in quoting basis spreads) or forward on ECB maintenance period dates.
<ESMA_QUESTION_MIFID_TO_22>

Q23. 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>
We consider the thresholds used in this analysis just enough to represent a liquid market, going below 10 deals per day wouldn't be representative. Thinking forward, when the OTF will be in use, we expect to see a higher number of market makers than the minimum of two as stated in the RTS 4, in order to replicate the variety of counterparties we currently see in the market.
<ESMA_QUESTION_MIFID_TO_23>

Q24. 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>
The OIS is a standard product with just few conventions, the payment frequency in case of deals longer than 1 year (where deals can be exchanged with one final payment or annual ones) could be considered.
<ESMA_QUESTION_MIFID_TO_24>

Q25. 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>
We find quite difficult to comprehend the argumentation about the FRA market. We don't have the statistics that may have brought ESMA to differentiate deals based on their purpose, according to which the so-called post-trade risk reduction (that manages for example basis risks or refixing) is not based upon "actual transactions".

What we think is that there shouldn't be such a distinction because if a FRA is exchanged, regardless of the platform on which they are dealt or their purpose (hedging, spread against OIS, directional trading…), still remains a FRA and it'll count as a deal, otherwise they would be just mere "technical risk adjustments" in portfolios.

Moreover we recall the ECB Euro Money market survey volumes where it is evident that the Forward Rate Agreement market maintained a substantial stability in the recent years, and as far as we know the report is not based on specific segments of the market.
<ESMA_QUESTION_MIFID_TO_25>

Q26. In case you consider FRAs should be considered for the TO, which FRA subclasses 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>
The most liquid tenors in the FRA market are those against standard "Libor" fixing in 1-3-6-12 month, with volumes more concentrated around the 3rd and 6th month tenor.

The basic elements to be considered, apart from the notional amount and the contract rate, should be value, fixing and maturity dates and the floating rate defined in the contract (i.e. Euribor 3m fixing).

These data, if correctly gathered should eliminate the inconsistencies ESMA encountered in the dataset preventing a correct market analysis.

<ESMA_QUESTION_MIFID_TO_26>

Q27. Would you consider the two index CDS as sufficiently liquid for being covered by the TO?

<ESMA_QUESTION_MIFID_TO_27>
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<ESMA_QUESTION_MIFID_TO_27>

Q28. 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>

Q29. 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>

Q30. Do you agree with the proposed application dates? If not, please provide an alternative and explain your reasoning.

<ESMA_QUESTION_MIFID_TO_30>
NO we consider the proposed date too tight, in order to make sure that all counterparties can set up the necessary links to trading venues. From a legal and operational point of view, such process requires long and time-consuming efforts for all the institutions involved.
<ESMA_QUESTION_MIFID_TO_30>

Q31. 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>
YES, at least an additional year
<ESMA_QUESTION_MIFID_TO_31>

Q32. 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>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_MIFID_TO_32>

Q33. 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>

Q34. 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_34>
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<ESMA_QUESTION_MIFID_TO_34>

Q35. 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>