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| Response Form to the Consultation Paper |
| MiFIR report on Systematic Internalisers in non-equity instruments |

**Responding to this paper**

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **18 March 2020.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

**Instructions**

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_SINE\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_SINE\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_SINE\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open Consultations” 🡪 “Consultation on MiFIR report on Systematic Internalisers in non-equity instruments”).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. 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 not to disclose the response 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 heading [Legal Notice](http://www.esma.europa.eu/legal-notice).

**Who should read this paper**

This paper is of interest mainly to systematic internalisers active in non-equity instruments as well as clients of such systematic internalisers, and any associations representing their interest.

**General information about respondent**

|  |  |
| --- | --- |
| Name of the company / organisation | ISDA |
| Activity | Other Financial service providers |
| Are you representing an association? |  |
| Country/Region | Other |

**Introduction**

***Please make your introductory comments below, if any***

<ESMA\_COMMENT\_CP\_SINE\_1>

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 71 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: [www.isda.org](http://www.isda.org/). Follow us on Twitter @ISDA.

<ESMA\_COMMENT\_CP\_SINE\_1>

**Questions**

1. : Do you consider that there is a need to clarify what a “firm quote” is? If so, in your view, what are the characteristics to be met by such quote?

<ESMA\_QUESTION\_CP\_SINE\_1>

At this stage, ISDA notes that market participants have a common and clear understanding of what constitutes a firm quote and that this is no need to open a debate about the meaning of a ‘firm quote’.

<ESMA\_QUESTION\_CP\_SINE\_1>

1. : (For SI clients) As a SI client, do you have easy access to the quotes published, i.e. can you potentially trade against those quotes when you are not the requestor? Do you happen to trade against SIs quotes when you are not the initial requestor? How often? If it varies across asset classes, please explain.

<ESMA\_QUESTION\_CP\_SINE\_2>

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<ESMA\_QUESTION\_CP\_SINE\_2>

1. : What is your overall assessment of the pre-trade transparency provided by SIs in liquid non-equity instruments? Do you have any suggestion to amend the existing pre-trade transparency obligations? If so, please explain which ones and why.

<ESMA\_QUESTION\_CP\_SINE\_3>

As a general remark, ISDA broadly agrees with ESMA’s legal analysis and its related conclusion that the pre-trade transparency regime for SIs in non-equity instruments is rather complex and burdensome for SIs. While SIs are complying with their pre-trade transparency obligations by publishing their quotes for non-equity instruments to the public, buy-side clients do not show particular interest in quotes.

ISDA would like to raise concerns in relation the treatment of derivatives under MiFIR’s pre-trade transparency regime.

* **The treatment of non-Traded on a Trading Venue (non-ToTV) instruments is bringing complexity and inaccuracies**

ISDA note that the objective of the SI regime is to ensure a level playing field between systematic internalisers and multilateral trading venues by requiring greater transparency in relation to OTC trading of venue-traded instruments, i.e. ToTV.

Consequently, RTS 1 and RTS2 define transparency requirements. However, Systematic internalisers also have to provide reference data – in accordance with RTS 23 – to the FIRDS system for uToTV instruments[[1]](#footnote-2).

This approach is problematic for the following reasons:

* Transparency in relation to non-standardised OTC derivative instruments will be meaningless and arguably misleading as these instruments share reference data with standardised instruments that are traded on trading venues, amid additional price forming terms that alter the product.
* The requirements to report reference data to the FIRDS system requires the creation of ISINs. If bespoke, non- standardised and not widely traded products are subject to the creation of ISINs, the amount of ISINs will be significant, causing inaccuracies in transaction reporting, while also not constituting transparency advantages for clients since these products are not widely distributed and available on trading venues.
* Therefore, the requirement of RTS 23, which requires SIs to submit uToTV data to FIRDS, contributes to less accurate and more misleading data in FIRDS. It should be noted that FIRDS only contains the uToTV data of instruments traded via SIs.
* In light of the above, legislators should consider whether the reference data in relation to uToTV instruments that NCAs are receiving ultimately supports the original policy objectives of the reference data reporting regime.
* Beyond transparency objectives, the absence of clarification that the scope of the SI regime and the ToTV concept are aligned leads to confusion for investment firms to determine their SI status with respect to certain asset classes. The mandatory SI determination –among other criteria – requires determining the ‘total trading in the European Union in a specific instrument’, which is impossible for non-ToTV instruments. ESMA acknowledged this shortcoming in its Q&A on Transparency, Question 11.
* **Liquidity assessment of derivatives needs re-calibration**

As ESMA points out in Paragraph 26 of the consultation paper, derivatives are subject to a static determination with respect to liquid or illiquid markets. With respect to most equity derivatives, which are deemed liquid, ISDA believes that this approach is problematic for the following reasons:

* The static determination in RTS2 is not aligned with the MiFIR Level 1 text, which defines a liquid market as being “where there are ready and willing buyer and sellers on a continuous basis”.
* It undermines the objective of requiring less pre-trade transparency for less liquid markets. It is therefore likely that requiring pre- trade transparency for de-facto illiquid markets may have negative impacts on liquidity and higher hedging costs for end-users.

In addition, ISDA believes that the pre-trade transparency regime for certain categories of derivatives instruments (such as interest rate options and commodity derivatives) requires re-calibration.

This need for re-calibration is further amplified by the implications of Brexit.

<ESMA\_QUESTION\_CP\_SINE\_3>

1. : (For SI clients) do you have access to quotes in illiquid instruments? If so, how often do you request access to those quotes? What is your assessment of the pre-trade transparency provided by SIs in illiquid instruments?

<ESMA\_QUESTION\_CP\_SINE\_4>

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<ESMA\_QUESTION\_CP\_SINE\_4>

1. : (For SIs) Do you disclose quotes in illiquid instruments to clients upon request or do you operate under a pre-trade transparency waiver? In the former case, how often are you requested to disclose quotes (rarely, often, very often)? Does it vary across instruments / asset classes?

<ESMA\_QUESTION\_CP\_SINE\_5>

ISDA members, acting as SIs in non-equity instruments, are very rarely experiencing that clients are requesting the disclosure of quotes in illiquid instruments.

<ESMA\_QUESTION\_CP\_SINE\_5>

1. : Do you consider that there is an unlevel playing field between SIs and multilateral trading venues active in non-equity instruments, in particular with respect to pre-trade transparency? If so, please explain why and suggest potential remedies.

<ESMA\_QUESTION\_CP\_SINE\_6>

ISDA acknowledges the arguments ESMA raises in Paragraphs 42 with respect to a possible unlevel playing field between SIs and multilateral trading venues.

In particular, in the context of pre-trade transparency, co-legislators and regulators are facing the challenge to maintain a level playing field while taking into account the very different roles of SIs and multilateral trading venues in financial markets, i.e. pre-trade transparency rules should not be the same for trading venues and SIs as they function differently.

* As SIs are ‘trading on own account’ bilaterally with clients, a SI is acting as a counterparty and an investment service provider taking on proprietary risk. Therefore, as ESMA points out in Paragraph 42, SIs have to disclose their identity and put their own capital at risk, resulting in SIs being subject to capital requirements. ISDA would like to add that SIs are also subject to strict conflict of interest requirements as a result to the dual role SIs, i.e. counterparty and investment provider, play in financial markets.
* In this context, ISDA considers that the regulatory obligations for SIs in Article 18 exceed those for trading venues, and as such constitute an unlevel playing field. Those additional obligations require SIs to make the firm quotes ‘available to their other clients’ (Article 18(5)) and ‘enter into transactions under the published conditions with any other client to whom the quotes is made available (Article 18(6)). Therefore, ISDA believes that this obligation of ‘actionality’ by other clients should be removed. Please see ISDA’s suggested reforms, outlined in answer 8. SIs’ crucial role to provide liquidity also means that SIs require a degree of anonymity with respect to pre-trade transparency obligations as it is the case when dealers trade on multilateral venues. SI should therefore be allowed to anonymise their reports should they wish to.

Additionally, the pre-trade transparency obligations not only require a reporting obligation for SI but also requires SIs to ‘make the quotes available to other clients’ and ‘undertake to enter into transactions’. ISDA considers these additional obligations complex and not aligned with the obligations when quotes are sent to a multilateral trading venue.

Most importantly, as already mentioned in the answer to question 3, ESMA’s Level 3 guidance suggests that the SI regime may also apply to non-ToTV products. Therefore, SIs are faced with an additional administrative burden compared to trading venues, which by nature only deal with ToTV products. Another negative aspect of applying the SI regime not only to ToTV instruments is an incentive to trade those products on a ‘pure OTC’ basis and not via a SI.

<ESMA\_QUESTION\_CP\_SINE\_6>

1. : (for SIs who are also providing liquidity on trading venues): What are the key factors that determine whether quote requesters (your clients) want to receive the quote through the facilities of a trading venue or through your own bilateral trading facilities?

<ESMA\_QUESTION\_CP\_SINE\_7>

Clients would request quotes either through a trading venue or bilaterally depending on the type and size of the transactions or the market conditions.

<ESMA\_QUESTION\_CP\_SINE\_7>

1. : What is your view on the proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments under Article 16(6) and 18(7)?

<ESMA\_QUESTION\_CP\_SINE\_8>

ISDA strongly endorses ESMA’s proposal to simplify the pre-trade transparency regime for SIs by deleting MiFIR Article 18(6) and 18(7). ESMA’s argument in paragraph 45, i.e. dealers on trading venues do not have to execute multiple trades on a displayed quote, and the role of SIs being risk-takers, does not justify to introduce more stringent requirements and de-facto force multiple transactions on a given quote.

However, in light of ESMA’s conclusion outlined in Paragraph 46, stating that SI would only be required to trade on the published quote with the requesting clients while enjoying discretion with respect to other clients, it may be argued that MiFIR Article 18(5) could also be further simplified or even deleted. Since it is only the requesting client who is expected to trade on the published quote, Article 18(5) requirements (and its caveats) do not add any meaningful benefit to pre-trade transparency.

<ESMA\_QUESTION\_CP\_SINE\_8>

1. : Do you consider that the requirements in relation to SI quotes in illiquid non-equity instruments (Article 18(2)) are appropriate? What is your preference between the options presented in paragraph 52 (please justify)?

<ESMA\_QUESTION\_CP\_SINE\_9>

ISDA supports ESMA’s proposal and shares the views as expressed from Paragraph 47 to 52.

* The pre-trade transparency regime for non-equity instruments in illiquid markets, including derivatives, is overly complex and proved to be difficult to apply in practice.
* Applying Article 18(1) to illiquid instruments while constructing another complicated waiver regime seems indeed to be suboptimal, as the complexities for SIs would possibly increase without serving clients with additional transparency.
* As a result, ISDA would tend to prefer Option 3, which suggest deleting Article 18(2). However, we are unsure of what ESMA’s has in mind when it mentions ‘developing an ad-hoc supervisory convergence tools for SIs’. Clarification on this point would be helpful. ISDA would welcome that a work stream in this regard includes the views of stakeholders via public consultations, to reflect applied market practices and increase the efficiency of supervisory convergence with respect to illiquid instruments. ISDA would endorse a deletion of Article 18(2) and recommends to use any supervisory convergence tool if its design is fit for purpose.

<ESMA\_QUESTION\_CP\_SINE\_9>

1. : What is your view on the recommendation to specify the arrangements for publishing quotes?

<ESMA\_QUESTION\_CP\_SINE\_10>

ISDA members estimate that there is no evidence to support that the current regime should be modified unless it is to clarify things that firms are already complying with in the derivatives space (under the Q&As for example).

<ESMA\_QUESTION\_CP\_SINE\_10>

1. : Do you have any comment on the analysis of Bond data and the relation with the SSTI thresholds as presented above?

<ESMA\_QUESTION\_CP\_SINE\_11>

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<ESMA\_QUESTION\_CP\_SINE\_11>

1. : Do you have any comment on the analysis of derivatives data and the relation with the SSTI threshold as presented above?

<ESMA\_QUESTION\_CP\_SINE\_12>

ISDA agrees with ESMA’s analysis, as expressed in paragraph 79 in the consultation paper, that ‘there is no evidence of significant quoting and trading activity just beyond SSTI thresholds. It follows that the data does not suggest any intention to circumvent pre-trade transparency obligation via the SSTI thresholds.

<ESMA\_QUESTION\_CP\_SINE\_12>

1. : What is your view on the influence of the SSTI thresholds on the pre-trade transparency framework for SI active in non-equity instruments? Are there any changes to the legal framework that you would consider necessary in this respect?

<ESMA\_QUESTION\_CP\_SINE\_13>

ISDA agrees with ESMA that no change to the legal framework appears necessary. However, there may be a need to recalibrate thresholds more broadly in the context of Brexit, possibly including SSTI thresholds.

As an example, in the context of OTC Interest Rate (IR) options, the transitional transparency calculations for the SSTI and LIS thresholds for these products are extremely high, in the billions of Euros. The calculations have probably only used data from listed options as opposed to OTC IR options, OTC IR options being very different products that trade at much smaller sizes. If the sub-asset class is interpreted to mean IR options and OTC IR options that are ToTV, the transparency calculations need to be re-run using a more representative sample, to avoid significantly impairing liquidity in those markets as a result of the thresholds as they stand.

<ESMA\_QUESTION\_CP\_SINE\_13>

1. : What is your view on the best way for ESMA to fulfil the mandate related to whether quoted and traded prices reflect prevailing market conditions and in particular: (1) the source of data for the SI quotes/trades (RTS 27, APA); (2) the source of market data prices; and (3) the methodology to compare the two and formulate an assessment?

<ESMA\_QUESTION\_CP\_SINE\_14>

ISDA members have constantly reported that there is no aggregated source of standardised data and that the existence of many APAs with no mandate to aggregate their data is aggravating the issue SIs consider obtaining the relevant data points in accordance with RTS 27 as burdensome without providing any added value for other market participants in terms of transparency. Therefore, ISDA would consider to standardize the submission of data for APAs.

<ESMA\_QUESTION\_CP\_SINE\_14>

1. UToTV means:

   - Financial instruments where the underlying is a financial instrument admitted to trading on a trading venue or

   - financial instrument where the underlying is an index or a basket composed of financial instruments admitted to trading or traded on a trading venue. [↑](#footnote-ref-2)