EFAMA
European Fund and Asset Management Association

CONSULTATION RESPONSE

Brussels, 14 August 2025

EFAMA RESPONSES TO THE IOSCO CONSULTATION ON PRE-HEDGING

Summary EFAMA position:

We agree that pre-hedging should only take place for genuine risk management purposes as defined in IOSCO's consultation report:

(i) the dealer having a legitimate expectation of a client transaction;

(ii) the available liquidity;

(iii) current market conditions; and

(iv) the extent of pre-hedging that is required (i.e., proportionality)

Legitimate expectation of a client transaction: this should be limited to a bilateral OTC transaction. Dealers in a competitive RFQ situation should automatically be ruled out from having a 'legitimate expectation of a client transaction'. In a competitive bid where there are, for example, 4 dealers quoting, by definition there will be 3 dealers who will not win the trade, they cannot therefore be deemed to have a legitimate expectation of a transaction. On the other hand, the risk of negatively impacting the price for the client by pre-hedging based on the RFQ information is very real and should not be allowed.

Proportionality: If a dealer has a genuine risk management rationale for pre-hedging, then regulation should not prescribe how the dealer should go about managing that risk. However, you should not be permitted to over-hedge i.e., pre-hedge over 100% of the size request as that would not be based on having a legitimate risk management rationale.

Disclosures: Whilst general upfront disclosures may be sufficient for routine trades, dealers should provide trade-by-trade disclosures for ad-hoc trades so that firms have the opportunity to make an assessment based on liquidity conditions and prevailing market conditions as to whether they want the trade to be hedged or not and have the ability to refuse. It should be explicitly defined as the dealer's responsibility to inform the client if they believe their pre-hedging activities could negatively impact the client's trade.

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Consent: Following the appropriate trade-by-trade disclosure, where necessary, clients should have the right to request further detail on the foreseen pre-hedging and should be able to explicitly inform the dealer whether they want pre-hedging in relation to a specific transaction.

Client benefit: the dealer must always be able to document and demonstrate that best endeavours were undertaken to benefit the end client. However, we do not support a highly prescriptive approach to post-trade client disclosures on pre-hedge trades. This would be operationally challenging / costly to implement as it would involve tagging pre-hedge trades vs. inventory management trades (often a challenge as pre-hedges may not be on a one-to-one basis with client orders during the course of flow trading). In addition, data provided would be flawed and misleading as the dealer has no ability to definitively say what impact a pre-hedge trade had on the market – dealers do not have visibility on how trades would have impacted vs. other activities / market-moving events at the same time.

The basic principles should be that the client is always informed, pre-hedging should never negatively impact the execution the client receives, and it should not be used as a means for the risk taker or bank to make a profit at the client's expense.

Q3	**Available Liquidity 1** Do you agree that pre-hedging of wholesale transactions should be acceptable where there is sufficient liquidity in the underlying instrument/s to hedge after the trade is agreed to? Please elaborate.
A3	**Discussion points** • Should pre-hedging be allowed in products with "sufficient liquidity"? • How do we define "sufficient liquidity"? • Is explicit consent necessary with pre-hedging products with "sufficient liquidity"? The decision rationale on whether to prehedge or not should firstly flow from a legitimate expectation of being awarded a trade, followed by disclosure and consent from the end-client. Once these tests have been met we have difficulty envisioning a definition of liquidity for purposes of prehedging. The definition of liquidity can vary from instrument to instrument, and between markets, i.e liquidity in OTC derivative markets varies from liquidity profiles in fixed income markets. Further to this the level of liquidity can vary between instruments and markets over different timespans e.g. month-to-month, month end, quarter end, day to day, intra-day. Finally, the concept of liquidity is also impacted by other external factors such as market events. Trade size is also a relative concept as it cannot be considered in isolation to other factors such as market events, volatility and time of trade which all influence the size of the trade relative to the market.

	The resulting rules shouldn't be overly prescriptive, we want to avoid getting entangled in detailed scenarios like whether trade terms are agreed upon, whether pricing is fixed or floating and subject to market movements, or whether there are options to withdraw from the deal, what's ample liquidity etc. From a buy-side asset manager's perspective, a one-size-fits-all liquidity test could be impractical and potentially harmful. Inflexible universal definitions of "sufficient liquidity" may not capture the nuances of different asset classes or trading conditions. What is "sufficient" in a highly liquid government bond might be completely different for an emerging-market bond or a less-traded derivative. Overly strict liquidity criteria could inadvertently discourage dealers from providing quotes in borderline cases for fear of violating rules. For instance, if dealers worry that a regulator might later judge a market not liquid enough by some formula, they might decline otherwise workable trades or avoid pre-hedging even when it could benefit execution. This could hinder efficient execution, especially for large orders where some pre-hedging might help manage risk without significant market impact. In short, attempting to codify liquidity thresholds across all markets could reduce the flexibility needed for optimal execution, to the detriment of end investors.
Q10	**Market Impact and market integrity** Should dealers be able to demonstrate the actions they took to minimise the market impact of their pre-hedging trading? In the event of not entering the anticipated client transaction, are there any considerations for dealers to minimise market impact and maintain market integrity prior to unwinding any pre-hedging position?
A10	**Discussion points** • Should dealers be able to demonstrate the actions they took to minimise the market impact of their pre-hedging trading? We reiterate that it is not acceptable to pre-hedge in electronic RFQ markets where multiple dealers are in competition with each other to win a trade or in the 'call around' scenario where counterparties obtain prices by contacting multiple dealers. In such a situation, it is by definition impossible to fulfil the earlier test of 'a legitimate expectation of winning a trade' meaning that pre-hedging will almost certainly result in price degradation. Dealers should verify that they are in a competitive bid, and only upon receiving confirmation that they are in a bilateral OTC should they proceed with pre-hedging if it is deemed appropriate for the transaction. In other situations, we believe that the dealer should be able to demonstrate the principal intent was to improve the outcome for the client and did not directly act against the clients' benefits either for a specific transaction or on an ongoing basis. To minimise market impact, we recommend proportional trading to the anticipated client order, supported by robust compliance policies, documentation, and oversight to ensure transparency and prevent market manipulation. Dealers should limit trade sizes, avoid aggressive market moves, and maintain records for regulatory review, aligning with IOSCO's recommendations to minimize market impact and maintain market integrity. Proportional trading should only be undertaken after client consent and clear intent to benefit the client. We emphasize, however,

	that the requirements to minimize market impact should not be overly burdensome, as this can also risk making dealers more hesitant to hedge even where it would have been to the client's benefit. Natural market forces also act to deter behaviour that is not to the benefit of the client: Dealers who abuse pre-hedging and move prices against clients risk losing trust and future business. In practice, reputable dealers tread carefully because their commercial incentives favor good client outcomes.
Q11	**Policies and procedures** Do you agree with this recommendation on appropriate policies and procedures for pre-hedging? If not, please elaborate.
A11	**Discussion points** • Should dealers have appropriate policies and procedures to manage and controls the risks associated with pre-hedging? • Are the existing regulations and global guidelines sufficient for policies and procedures? IOSCO's proposed policies and procedures appear reasonable for bilateral OTC trades, though care should be taken to avoid overly prescriptive guidance. Policies and procedures are important, but they should remain flexible and principles-based to accommodate different markets and to avoid stifling legitimate market-making activity. Also please refer to our response to Q10 above.
Q12	**Disclosure** What type of disclosure would be most effective for clients? Why?
A12	**Discussion points** Are generic disclosures sufficient or should dealers provide specific upfront disclosure for each trade? Our experience to date, which is supported by IOSCO's findings is that the upfront disclosures are commonly used by dealers to outline their pre-hedging practices. Yet what is included in the disclosures can vary from one dealer to another. Further to this the disclosures are often covered in firms Terms of Business (ToB) in which pre-hedging is only one of a range of matters covered and as a result the disclosure can often be buried deep in the contractual terms meaning it is easily overlooked and/or lacks sufficient detail. In order to ensure clients are fully aware of and understand the brokers potential to pre-hedge trades these disclosures should, at the very least, hold a more prominent position in dealers Terms of Business (ToB). Further to this the disclosures shared by brokers with clients should provide the client with the dealers' definition of pre-hedging, its general rationale for when it would apply pre-hedging, the types of transactions and the circumstances in which the dealer may pre-hedge. However, overly frequent or extremely detailed disclosures should be avoided as they would slow down the execution process, resulting

	in missed market opportunities and degraded pricing. Ultimately, It falls on clients to ensure they are aware and understand the risks associated with the transactions they request and regularly evaluate the execution they receive. Clients should also consider if there are any unintended consequences for their liquidity providers by virtue of the way in which they present their orders. Overall, general upfront disclosures may be sufficient for routine trades but dealers should provide trade-by-trade disclosures for ad-hoc trades so that firms have the opportunity to make an assessment based on liquidity conditions and prevailing market conditions as to whether they want the trade to be hedged or not and have the ability to refuse.
Q13	**Upfront disclosure 1** Should upfront disclosure be applicable irrespective of factors such as the size and complexity of the transaction and/or other factors such as level of client sophistication? Are there any key challenges for dealers to providing pre-trade upfront disclosures?
A13	**Discussion points** • Should dealers provide pre-trade upfront disclosures? Sufficient information should be provided by the dealer to enable the counterparty to materially assess the implications of pre-hedging activity on a trade-by-trade basis in order to provide informed consent or object to the dealer pre-hedging. Once, there is ex-ante disclosure to and consent from the client on a trade-by-trade basis of the dealer's intention to pre-hedge, then it should be left to the discretion of the dealer to decide what level of pre-hedging is appropriate. It should not be assumed that counterparties have given implicit consent to pre-hedging based on a generalized relationship level disclosure, such as one included in a Terms of Business or other contractual documentation governing the relationship between dealer and counterparty.
Q14	**Upfront disclosure 2** What should be the minimum content of any upfront disclosure? Please differentiate between bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions.
A14	**Discussion points** • What should be the minimum content of any upfront disclosure? Disclosures must be clear, specific, and provided before pre-hedging activity. This includes explaining the dealer's intent to pre-hedge, the potential market impact, and how the dealer will minimize adverse effects on the client's execution price. Disclosures should detail the dealer's

	risk management strategy and confirm that pre-hedging is not speculative but aimed at facilitating the client's trade. For example, in a competitive bid scenario, a dealer might disclose to a client that it plans to buy small lots of a bond to prepare for a potential $100 million order, ensuring minimal market disruption. *Determining a "minimum content" checklist for disclosures is, however, tricky, and from the buy-side we should caution against overly rigid templates.* We certainly want all the key points (intent, potential impact, mitigation plans) covered in any disclosure. However, **if regulators mandate an extensive laundry list of items for every disclosure, there's a risk that disclosures become boilerplate**. Dealers might adopt a compliance-driven approach—checking all the required boxes with generic language—without truly enlightening the client. Over-prescribing content could also stifle innovation in how firms communicate risk to clients. For instance, electronic trading systems might eventually use standardized flags or pop-ups for disclosure; if the rules are too prescriptive, they might not accommodate such efficient methods. In short, while a baseline of transparency is crucial, any rules on content should allow **professional judgment and adaptation to the medium** (voice, electronic, RFQ) so that the disclosure remains meaningful. The priority is that clients *truly understand* the practice and its implications, rather than that every disclosure document looks the same but says little of substance.
Q15	**Trade-by-trade disclosure 1** Should trade-by-trade disclosure be proportional to factors such as the size and complexity of the transaction and/or other factors such as level of client sophistication? What should be the minimum content of trade-by-trade disclosure? Please differentiate between bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions, in particular in electronic trading platforms.
A15	**Discussion points** • When are dealers advised to make trade-by-trade disclosures? Dealers should provide trade-by-trade disclosure to enable the counterparty to understand the impact of pre-hedging on their transaction and give them the opportunity to object. It should not be assumed that counterparties have given implicit consent to pre-hedging based on a generalized relationship level disclosure, such as one included in a Terms of Business or other contractual documentation governing the relationship between dealer and counterparty. As outlined earlier, given the impact of pre-hedging in competitive RFQs/request for price on fairness and market efficiency, we strongly recommend that pre-hedging in competitive RFQ and "call around" markets should not be considered appropriate. Trade-by-trade disclosures that are proportional to trade size and complexity, we believe, would be difficult to implement. Yes, the buy side would appreciate that routine small trades aren't bogged down by over-disclosure, while big complex trades get more attention – but crafting rules to that effect is difficult. If too vague, dealers won't know where to draw the line and might default to over-disclosing every time to be safe, defeating the purpose. Alternatively, if regulators set hard thresholds (e.g. above $X million must disclose in triplicate), those could become quickly outdated or inapt for certain markets. There's also a fairness issue: smaller or less sophisticated

	clients might end up less protected if rules assume they don't need as much disclosure (when in fact they might benefit from more education). It might be more effective to set broad principles (e.g. "clients should be informed and consent when their trade could be materially impacted by pre-hedging") and let industry practice calibrate the proportionality, rather than micromanaging via regulation. Also refer to our reply to question 12.
Q16	**Trade-by-trade disclosure 2** Are there any challenges or barriers to trade-by-trade disclosure in the context of competitive RFQs and in the context of electronic trading? If yes, please elaborate.
A16	**Discussion points** • Should dealers make trade-by-trade disclosures in competitive RFQs and electronic trading? Clients should have the ability to explicitly inform the dealer that they do not want pre-hedging to take place in relation to a specific transaction, regardless of the trading protocol, with the caveat that if there is a competitive RFQ scenario, pre-hedging is simply not acceptable.
Q21	**Consent 2** Should dealers be required to obtain explicit prior consent to pre-hedge for certain types of transactions? Please elaborate your response to the question for bilateral OTC transactions, for competitive RFQ systems and for those in electronic trading platforms.
A21	**Discussion points** • Should dealers be required to obtain explicit prior consent to pre-hedge for certain types of transactions? We strongly advocate that dealers should be required to obtain express affirmative client consent prior to pre-hedging for less routine trades, and where conversation and consent is feasible. A pragmatic approach might be to differentiate: for **large or sensitive trades**, explicit prior consent makes sense; for small or vanilla trades, a well-disclosed general agreement might suffice, as long as the client can opt out at any time. We caution that if dealers feel obtaining consent is too cumbersome or risky, they may simply **choose not to pre-hedge at all** or even not quote aggressively on large trades, which could **reduce liquidity.**
Q25	**Industry codes** Do you believe that the industry codes already meet some or all the recommendations? If so, please explain in detail how.

A25	**Discussion points** • Do the industry codes already meet some or all the recommendations? While we encourage IOSCO to leverage the FX Global Code and FMSB standards as they are widely adopted and understood by the industry, we do not believe that any single industry code presently provides clear and comprehensive guidance on what should be considered a genuine risk management rationale ,how this concept should operate in the context of competitive RFQ scenarios, and appropriate recommendations on disclosure and consent. Therefore we would welcome IOSCO guidelines that disallow pre-hedging in a competitive or a 'call-around' scenario, while urging some caution in the degree of prescriptiveness for acceptable pre-hedging in a bilateral OTC scenario. Commercial incentives already align with existing industry codes: dealers who flout them face reputational damage and loss of business, which is a powerful motivator to behave responsibly. Building on these existing norms is preferable to layering on heavy regulation. Overregulation could inadvertently conflict with or duplicate the guidance in industry codes, creating confusion. It might also reduce flexibility; industry codes are often principle-based and can be updated more easily as markets evolve, whereas hard rules might lag behind market innovation. For example, if a new trading protocol emerges, industry groups can quickly articulate how pre-hedging should be handled, while formal regulations would take time to adapt. The buy-side benefits when dealers adhere to high standards voluntarily and competitively – it means we can trust the playing field without needing a rule for every situation. Therefore, we urge IOSCO to seek a balanced approach: address clear abuses, but recognize that existing market mechanisms (reputation, competition, and industry standards) already work against the most harmful behaviors. An overreach in rule-making could impose costs and complexities that outweigh the benefits, potentially harming market liquidity and innovation that ultimately serve investors.

ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages about 34 trillion of assets on behalf of its clients in Europe and around the world. Its membership consists of 29 national associations, 52 global asset managers, and 24 associate members. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Savings & Investments Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

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