

EFAMA response to the ESMA Discussion Paper on the trading obligation for derivatives under MiFIR

The European Fund and Asset Management Association¹, EFAMA, welcomes the opportunity to comment on the ESMA Discussion Paper (“DP”) on the trading obligation for derivatives under MiFIR.

As a principle, EFAMA supports every effort made to enhance financial market regulation which reinforces the stability of the financial system, of which MiFIR is an important part.

Prior to replying to the consultation, we wish to make the following general remarks.

1. General Comments on the type of venue and the role of the CCPs.

In the preamble of the DP, ESMA reminds that it must determine whether these cleared derivatives (or a subset of them) should be traded on-venue, meaning on a regulated market (RM), multilateral trading facility (MTF), organised trading facility (OTF) or an equivalent third-country trading venue.

Referring to the backdrops as described on point 65, the status of CCPs and their possible treatment as trading venues (possibly OTF) should be clarified.

We strongly encourage ESMA to ensure that all venues types are available from the first day of the entry into force of the obligation.

We consider that this would be the sole way to protect market liquidity and avoid market disruption.

Should it not be the case, we are of the strong view that this would create legal uncertainty for the allocation of existing transactions to trading venues and would deprive markets from existing liquidity.

¹ **EFAMA** is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 61 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end 2015. Just over 30,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining 25,900 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

2. Detailed reply.

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?

We do agree with ESMA's analysis as it would facilitate IT set-up and improve legal certainty, especially if the requirements are swiftly endorsed and published rapidly.

However, we also believe that the definition of the scope of application of the trading obligation is extremely important as:

- the trading obligation on non-equities instruments as currently described only applies to centrally cleared derivatives. As a consequence, the calibration criteria and values must be adapted to the cleared OTC derivatives only; and
- the calibration must be applied to instruments considered as liquid instruments. As a consequence, the calibration can only be assessed by asset class with a sufficient level of granularity to be meaningful.

Therefore, we are of the opinion that dedicated thresholds should be defined at least by currency and tenors for IRS and remaining time to maturity of the transaction for credit derivatives.

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.

We disagree with ESMA's proposal.

To avoid any risk of disruption, we strongly believe that:

- there should be at least 2 trading venues accepting each asset class to be able to benefit from and to ensure portability; and
- we would recommend to consider approving all trading venues, including OTFs, from the first day of the entry into force of the legislation; and
- to the extent only one trading venue were to remain accessible (for instance if one trading venue ceases its services or following merger of trading venues), we believe trading obligation should be suspended until a second trading venue accept asset classes.

We consider that this would facilitate the application of the trading obligation for derivatives by offering the largest possible choice of venues.

We also believe that, by extending the access to OTF from the first day of application of the trading obligation, ESMA would avoid questions of back-loading of transactions between venues.

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?

The only fully representative way to determine the total number of participants is that ESMA collects, analyses and publishes the data collected, starting with the data available at TRs.

This approach would provide with full information on the depth of the market for each class of derivatives. Therefore the data available at the level of the TRs are an important starting point but should also be duly calibrated to ensure the adequate representation of the market.

We also believe that the nature of the counterparty to the trade should be taken into account.

As recognised by ESMA (e.g. through its definition of categories of counterparties to derivatives transactions), regulated funds, asset managers managing clients' assets, NFC and NFC+ usually have lower trading frequencies. Therefore, the calibration of the TO should take those criteria into account, imposing thresholds that are sufficiently high to only impact the most frequent users of cleared derivatives.

In that perspective, we believe that the data collected and the level of granularity should be set at the level of the counterparty to the transaction. Referring to umbrella funds managed by an asset manager, the assessment should be at the level of the sub-fund subject to the transaction.

Lastly, we are of the view that ESMA should consider potential entry cost, either direct (fees) or indirect (IT access & required set-ups) for implementing OTFs to ensure that market participant number remains stable post TO in order to ensure liquidity on a given asset class do not vanish following entry into force of trading obligation.

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.

We are of the view that the assessment should be performed with the same level of granularity as for the assessment of TO, i.e. by asset class, currency and tenor.

Assessment should be taking out of scope instruments that cannot be effectively traded through at least on two OTFs (e.g. "broken dates" or customised forward dates) to ensure liquidity assessment for a given instrument is assessed on effectively tradable instrument on OTFs.

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?

Regarding the number of trading venues, we do not agree with ESMA's approach. We consider that there should be:

- at least two trading venues accepting an asset class before being subject to the trading obligation to allow porting in case of default; and
- a minimum amount of transaction by trading venue to qualify the instrument as liquid. Having 10 venues trading each 1 derivative does not provide liquidity on the market but might eventually only provide portability.

When considering the number of available trading venues, ESMA should also take into consideration the relevance of the trading venue within its market and in particular assess volumes that would go through such trading venue.

Financial strength of the trading venue and capital requirement should be considered as well to ensure reliance of market participants on such venue.

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?

We believe that there should be at least:

- two trading venues by type of venue and by class of derivative;
- with a minimum number of transaction for each category of venue.

See also our reply to Q5

Q9: Do you agree with the proposed approach or do you consider an alternative approach as more appropriate?

We disagree with the approach proposed.

We are of the opinion that it is only when the two conditions are met (high liquidity and high number of participants) that the trading obligation could be imposed.

In all other circumstances described by ESMA, the trading of derivatives on a venue should be optional.

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

We agree with ESMA that this criteria should receive a lower weighting.

It might even be relevant to discard that criteria if no or limited data is available.

Q11: Which sources do you recommend for obtaining information on the average size of spreads by asset class?

In order to obtain the most relevant data as soon as practically feasible, we would recommend ESMA collect data from:

- Stock exchanges;
- TRs;

- Clearing houses;
- Data vendors; and
- Eventually CCPs if imposed by ESMA

Q12: What do you consider as an appropriate proxy in case of lack of information on actual spreads?

We do not think that a proxy is needed.

If however, a proxy is required, we would suggest the joint use of the three following criteria:

- The number of trades; and
- The number of active participants by
 1. venue type;
 2. instrument class;
 3. currency; and
 4. tenor.

Q13: Do you agree with the suggested approach? If not, what approach would you recommend?

As a principle, we disagree with the fact that, because an obligation comes later into force for certain categories of market participants, this obligation causes less negative effect.

The issues described by ESMA remain identical or are even more acute for the categories 3 and 4 due to their business nature.

Otherwise, we do agree with the criteria, provided that the calibration of the values are appropriately set.

When defining TO, it is critical that ESMA sets criteria that offer a sufficient level of liquidity for stakeholders that are not subject to TO.

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?

We do agree with ESMA that the large-in-scale transactions should not be subject to the trading obligation.

We believe that, due to the difficulty to anticipate the speed for the execution of the transaction and multi-jurisdictional reality of such large trades, the large derivatives trades should not be subject to the trading obligation nor being subject to the same transparency rules.

Similarly to our proposal for bonds, we are proposing that:

1. If a derivative has been deemed to be illiquid and benefits from the LIS and SSTI waivers, publication of the details of the transaction would be automatically delayed for their public disclosure beyond 48 hours, and up to four weeks, without needing an ex-ante agreement from NCAs.

2. the broker that takes part to the transaction informs the NCA ex-ante of the trade and the large size nature of the transaction without the need of an ex-ante approval and discloses the trade to the public once the transaction is settled.

Lastly, we would encourage ESMA to align as much as realistically possible with international standards in order to facilitate cross-border application of the G20 rules on derivatives.

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 thresholds relate to each other?

We consider that the priority should be on market transparency:

- The goal of market transparency applies on all instruments;
- The criteria to define transparency regimes are immediately available.

Additionally, we believe that the TO should not be aligned with transparency obligation to the extent the trading venues effectively need to support instruments subject to TO. Indeed, to the extent that trading venues cannot handle broken dates for instance, imposing TO to such instruments in order to align treatment of the TO with transparency regime would simply prevent market participants subject to TO from trading those instruments.

Q18: Do you agree with the reasons mentioned above or is there another explanation for the significant number of trades outside of benchmark dates?

We are of the view that other explanations are available.

Considering the retained methodology, instruments outside of benchmark dates could be related to forward starting transaction whereby tenor is to be observed between effective date and maturity date.

This could also be related to customized transaction with broken dates with long or short dated initial period (namely asset swaps).

Q19: Does this result reflect your assessment of liquidity in fixed-float IRS? If not, please explain on which subclasses you disagree and why.

We do not fully agree with the assessment proposed.

We are of the view that tenors should only include instruments that are in the +/- 5d variation range.

Beyond +/-5d, instruments with broken dates might become hardly tradable on venues and would be caught in scope for the purpose of assessing liquidity which is not consistent with their requirement of liquidity.

Q20: What thresholds would you propose as the liquidity criteria? What minimum number of counterparties would you consider appropriate for introducing the TO?

As stated earlier, there should be a sufficient number of counterparties to assess liquidity.

Therefore, the model should rely on categories of counterparties to ensure that a sufficient number of counterparties is available across all categories submitted to TO.

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?

We believe that filters on standardised terms (payment frequencies on fixed and floating legs, floating rate type...) should be considered to ensure that only effective clearable transactions are taken into consideration.

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

Generally speaking, we agree with the methodology chosen by ESMA.

However, considering that:

- the proposed regime is not final;
 - the proposed regime is still subject to a consultation, a review by the EU Commission and the scrutiny period in Parliament; and
 - the implementation phase by investment firms can only start once the text is finally approved,
- we believe that every decided applications dates should all be moved by 1year (2 years for categories 3 and 4).

Q31: Do you consider necessary to provide for an additional phase-in for the TO for operational purposes 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.

As per our reply to Q30, we consider that all the deadlines suggested should be moved by one year at the minimum to allow appropriate operational changes and avoid major implementation issue.

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