

13 November 2017

**Verena Ross**  
**European Securities and Markets Authority**  
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**France**

### **Outstanding uncertainties in the MiFIR post-trade transparency framework**

Dear Verena,

One of the key changes introduced by MiFIR, in particular in the secondary markets area, is the introduction of a pre-and post-trade transparency framework for non-equities trading, both on-venue and OTC. Whilst MiFIR establishes the groundwork for this framework, it leaves a significant amount of detail to Level 2, and even more interpretive and technical issues to regulatory clarification, for example through Level 3. ISDA, AFME, and GFXD members are aware of the huge task that this has left to regulators, and are grateful for the ongoing clarity that has been and continues to be provided by ESMA and National Competent Authorities (NCAs). The various ESMA Q&A, Opinions and consultations, as well as consultations and industry outreach by NCAs have been extremely useful.

Within OTC derivatives MiFIR introduces particular challenges. Many of these relate to the data that is required, the new industry concepts that are introduced, and the complex flow of data which underpins the transparency framework. MiFIR also introduces complex inter-dependencies that do not currently exist, both for firms to satisfy their regulatory obligations but also to be able to continue trading from a technical perspective. An additional layer of complexity in the implementation stage is introduced by the split of responsibilities between ESMA and NCAs, and also ANNA-DSB being introduced as new central and single commercial utility that derivative market participants are dependent on to satisfy their regulatory obligations.

Whilst NCAs, ESMA and ANNA-DSB are each working to ensure that they meet their own obligations under MiFIR and publish clarifications where needed, the transparency framework is – from an investment firm’s perspective – a unified and highly inter-connected project. Accordingly, to ensure coherent implementation of the transparency framework under MiFIR, it is imperative that all decisions and clarifications are coordinated.

We wish to highlight some key areas where firms are facing uncertainty in their implementation of the transparency framework, which in isolation could be considered trivial, but when viewing the transparency framework as a whole are integral. It is vital that ESMA, NCAs and ANNA-DSB coordinate in the final months before MiFIR is implemented, or investment firms will not have the necessary information to hand to be able to implement the transparency framework under MiFIR. Whilst we seek to highlight the most significant areas of uncertainty in the body of this letter, we attach an annex which

elaborates on these issues in more detail, and highlight key areas of uncertainty that the industry faces. This is by no means exhaustive, but seeks to identify some key areas of uncertainty that remain.

#### Financial Instrument Reference Data System publishing systematic internaliser identity

The Financial Instrument Reference Data System (FIRDS) is a central part of the transparency framework, and is not something that has previously existed for non-equities. Whilst trading venues have quite rightly been engaged in testing, this opportunity has been less available for investment firms and systematic internalisers, who are also required to report through the system (either directly or indirectly depending on their NCA).<sup>1</sup> Understanding how this system works and the smooth implementation of it is critical to investment firms' compliance with the reporting elements of RTS 2, RTS 22, and RTS 23. Whilst we are therefore grateful for the extensive technical guidance and documentation that has been provided regarding FIRDS functionality, we would note that firms first sight of the FIRDS output file has taken place in mid-October, leaving just weeks for firms to analyse and implement their solutions which rely upon it.

Specifically, we also have a major concern, that the FIRDS output file will include systematic internaliser reference data without masking the identity of the systematic internaliser (via a MIC or LEI code). Unlike trading venues, systematic internalisers put their balance sheet at risk when trading, and are directly exposed to the trading they provide a platform for. Publishing the identity of the systematic internaliser in turn potentially exposes the systematic internaliser's trading interest for all trades for which a systematic internaliser submits reference data. Systematic internalisers will generally only submit reference data for illiquid and infrequently traded instruments. For example, a systematic internaliser may report reference data where the underlying is traded on a trading venue (ToTV), say for a defaulted credit exposure. Making this interest publicly available through FIRDS, even with no price or volume data, substantially inhibits the systematic internaliser's ability to trade at market terms, and is completely contrary to the built-in safeguards of the transparency framework in MiFIR.

It is important that when reference data is made public, the identities of the executing counterparties are made anonymous, as with trades executed on a trading venue, in order to avoid the reference data requirements becoming an additional transparency regime, which is clearly not the intention of MiFIR. We believe that publishing the identity of this counterparty data in the case of systematic internaliser submissions to FIRDS, particularly for less frequently traded and illiquid instruments, is a major policy decision that has not previously been envisaged in the legislation. If the publication of systematic internaliser MIC and LEI codes in FIRDS is indeed intentional, we would strongly urge ESMA to reconsider this decision.<sup>2</sup>

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<sup>1</sup> We do note that some "opted-out" NCAs have engaged in testing for investment firms in their jurisdiction.

<sup>2</sup> In RTS 23 compliant FIRDS submissions, a valid LEI code is mandatory for field 5 *Issuer or operator of the trading venue identifier* while a valid MIC mandatory for field 6 *Trading venue*.

### Traded on a Trading Venue (ToTV)

We are most grateful for the clarity provided by ESMA's Opinion on ToTV. Shortly after the Opinion was published, ISDA sent ESMA a note explaining that whilst we support ESMA's approach of making ToTV as simple as possible by linking ToTV to RTS 23, we had some concerns regarding the practical implementation of the Opinion if read literally. In particular, we questioned the misalignment of the ToTV Opinion with our understanding of how ISINs will be constructed, and the impact that this might have on FIRDS. The recent update to ESMA's MiFIR data reporting Q&A, which states that transaction level (volatile) attributes should not be submitted in reference data and hence cannot be used in the ToTV assessment, is therefore welcomed.

There are a number of other binary questions relating to ToTV, such as,

- a) clarification that the assessment is on a T+1 basis in line with the publication of FIRDS data, and,
- b) clarity that where an OTC derivative matches the attributes of an on-venue derivative but has additional economic terms not captured by reference data in FIRDS, it is still considered to be TOTV and shares the ISIN of the on-venue derivative.

For transparency to be interpretable by market participants it is important that systematic internalisers have a common understanding of how ToTV works, and there is sufficient time to incorporate that understanding in to systems. We would welcome any further clarifications to TOTV being communicated as soon as possible, and would be happy to compile a list of these binary questions, should ESMA have an interest in considering them.

### Identification of systematic internaliser status

Under MiFIR OTC post-trade transparency reporting, in a given transaction the seller reports unless the buyer is a systematic internaliser and the seller is not, in which case the systematic internaliser reports. However there is no single source listing which investment firms are a systematic internaliser at the level of granularity necessary to determine post-trade transparency reporting. We understand that this is not something that will be provided by regulators.

It is therefore important to understand how regulators expect this to work. Given that the post-trade transparency reporting requirements will often be very close to real time, identifying whether the counterparty is a systematic internaliser in the instrument on a trade by trade basis causes significant practical challenges, and will generally not be workable. There is material risk that the exchange of this information might be missed. Beyond the challenges this places on firms, it is likely that in some cases this will lead to over-reporting, and in others under-reporting, which in turn compromises post-trade transparency data. This compromises the data that regulators will use to determine the liquidity and trading thresholds which regulators are required to calculate under MiFIR. It is unclear what the regulatory expectation is on how the process of identifying SIs should work, in the context of millions of transactions taking place every day. A communication to industry would be extremely helpful, and we would be eager to discuss the difficulties in this area further.

## Deferrals

A number of NCAs have set out their approach to implementing the deferrals permitted under MiFIR. However, the majority have not. Whilst there is an application process for trading venues to use deferrals, it is unclear what the process is for investment firms, and so this needs to be publicly articulated by NCAs. It is vital to understand what the deferral (if any) will be in each Member State, particularly when two counterparties based in different Member States trade a MiFID non-equity financial instrument OTC. In this situation the deferral (if any) will depend on the location of the reporting counterparty.

Should NCAs take different approaches to implementing deferrals this will inevitably result in an unlevel playing field between investment firms and markets located in different Member States, and potentially less liquidity flowing to the jurisdictions with more stringent post-trade deferrals rules. Whilst we note that this is envisaged by the Level 1, coordination amongst NCAs would be strongly in the interest of a level playing field across Member States in OTC market trading. Beyond this, with less than 2 months to go until MiFIR comes in to force, it is now necessary to understand what approach NCAs will take. Without this clarity a key component of the transparency framework will not be in place, and investment firms will not know what rules that they are subject to from 3 January 2018.

## Finalisation of International Securities Identification Code (ISIN) and functionality for full set of Classification of Financial Instrument (CFI) codes

The MiFIR Level 2 requires derivatives which are ToTV or whose underlier is ToTV to be assigned an ISIN. ANNA-DSB has been assigned sole responsibility for issuing ISINs for derivatives, and so investment firms are legally bound to use ANNA-DSB for this service and agree to its commercial terms. It is important to highlight, however, some remaining ambiguity regarding the ISIN requirements.

Firstly, there is currently limited support for ISINs for exotic products, in terms of ANNA-DSB guidance and ISIN templates. As ISINs are an integral part of the technical processes underpinning the transparency framework, post-trade transparency in particular cannot technically work unless an ISIN is available. It is therefore vital that in order for investment firms to continue trading exotic products, it is confirmed that ANNA-DSB is able to finalise the ISIN construct, providing support for all CFI code combinations, with sufficient time to enable testing prior to MiFIR being implemented on 3 January 2018.

Secondly, there are some unexpected crossovers with the ISIN system for non-OTC derivatives and securities which is in place today (see questions in annex below), including issues of data quality of ISINs for this non-OTC derivative and securities domain,<sup>3</sup> as well as issues regarding derivatives listed on non-EEA Trading Venues. There are underliers that are already in scope for reference data under RTS 23, but associated derivatives do not have ISINs today. We note that such derivatives are not within the scope of ANNA-DSB. However, there is no clear path for non-EEA trading venues nor SIs to obtain ISINs for such

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<sup>3</sup> There are cases where such ISINs are being issued by numbering agencies that do not fully adhere to the ISO standard, and, ISINs being presented and distributed from primary sources such as Regulated Markets as 'ISINs' that are not valid ISINs. If used, these ISINs would face rejection by ESMA's FIRDS validation (or by an APA/ARM). The scale of this data quality problem is unknown. The implementation of ESMA's FIRDS validation of instrument reference data in January 2018, including such data, may be the first time the scale of this issue is known.

associated derivatives. A question related to this issue is found below in Annex 2: Technical assumptions in relation to Systematic Internalisers' obligations under Article 27 of MiFIR and RTS 23.

Finally, and most importantly, the correct functioning of the transparency framework for non-equities requires easy determination of what instruments are ToTV. This in turn requires ISINs to be issued for instruments, and the reference data for those instruments to be in FIRDS, in time for transactions in those instruments being executed at trading venues. It is unclear to market participants that trading venues will obtain ISINs in advance for the major sets of instruments they list or can be traded through their systems, and will then in turn send reference data in advance to FIRDS so that ToTV determinations can be made by all market participants. A statement from ESMA regarding expectations for how this may happen in advance of January 2018 and beyond would be welcome.

#### Interconnectedness of the transparency framework

All of the issues above require clarification in order for firms to implement the post-trade transparency framework. As discussed above, they are also highly interdependent on each other. We illustrate this interconnectivity in the visual in Annex 1, which attempts to lay out trade data flow for a single systematic internaliser trade.

Underpinning the transparency framework is a complex flow of data, and in order for firms to be able to fully comply all of the pieces need to be in place. These are not generally policy decisions, but rather technological connections and updates. It is important that investment firms have full sight of what will be made public by regulators and ANNA-DSB from 3 January 2018, in order to ensure that investment firms systems and compliance build correctly accounts for that.

Should the details underpinning the transparency framework not be communicated to investment firms with sufficient time to implement the transparency framework by 3 January, investment firms will not be able to implement the framework envisaged by the co-legislators. We would therefore be eager to discuss these issues further and assist ESMA in identifying the remaining issues, and workable solutions.

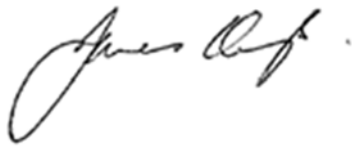
Sincerely,



Scott O'Malia  
Chief Executive Officer  
International Swaps and Derivatives Association, Inc.



Simon Lewis OBE  
Chief Executive Officer  
Association for Financial Markets in Europe (AFME)



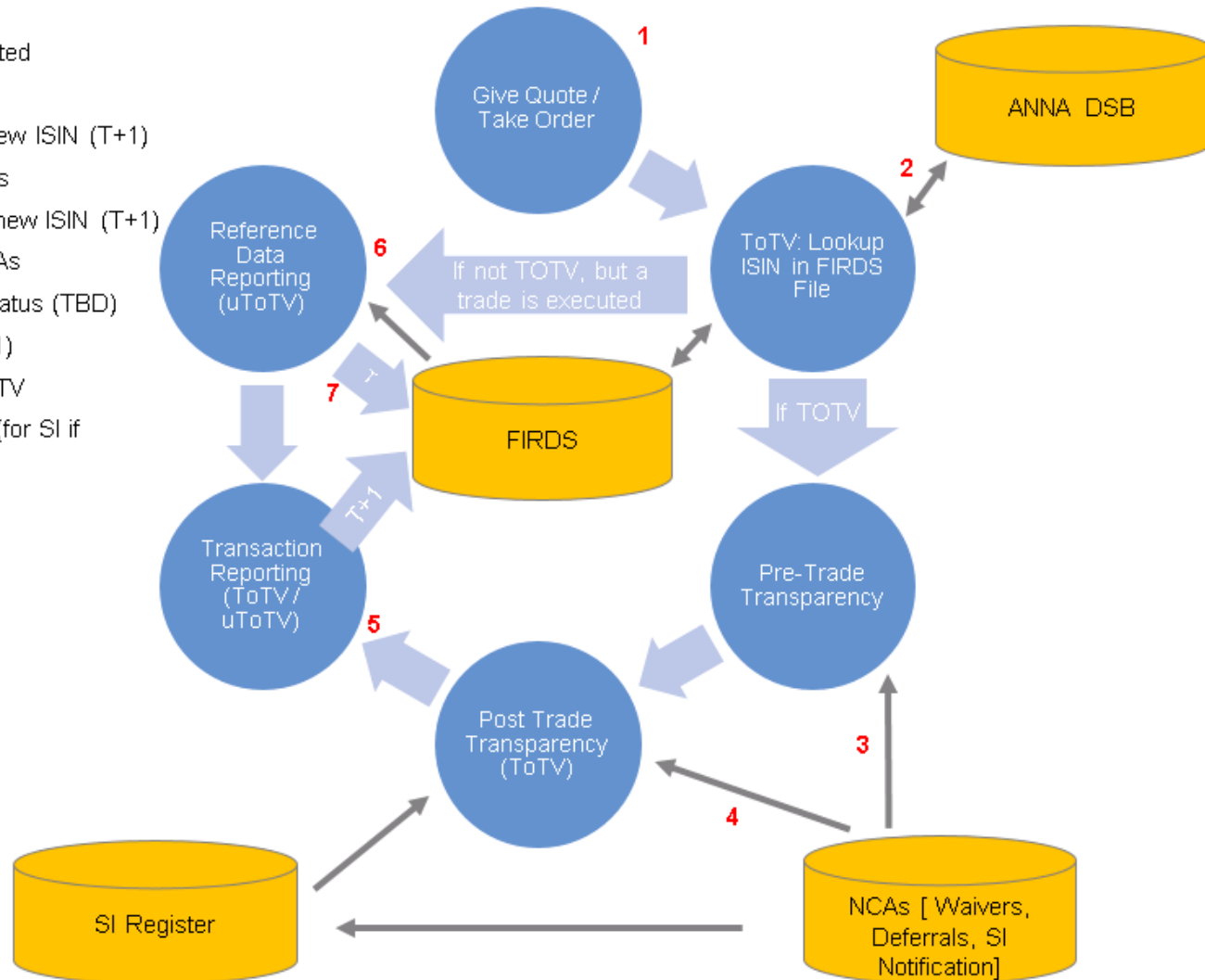
James Kemp  
Managing Director  
Global Foreign Exchange Division, GFMA

## Appendices

### Annex 1: Trade flow for a systematic internaliser

Example Flow :

1. New OTC Instrument Quoted
2. ANNA-DSB provides ISIN
3. Pre-Trade Reporting for new ISIN (T+1)
  - Waivers from NCAs
4. Post-Trade Reporting for new ISIN (T+1)
  - Deferrals from NCAs
  - Counterparty SI Status (TBD)
5. Transaction reporting (T+1)
6. Check new trades for uToTV
7. Reference data reporting (for SI if instrument is uToTV)



## Annex 2: Technical assumptions in relation to Systematic Internalisers' obligations under Article 27 of MiFIR and RTS 23

The obligation to supply financial instrument reference data under Article 27 of MiFIR, further specified in RTS 23, applies to both trading venues and systematic internalisers. At this juncture, we would like to share assumptions regarding questions pertaining to the specific obligations on systematic internalisers for a smooth functioning of the FIRDS.

1. Given that Article 27(1) states that reference data should be provided for the purposes of transaction reporting under Article 26, should investment firms build their reporting systems to submit reference data to FIRDS under RTS 23 on the assumption that when they are acting as a systematic internaliser they only submit reference data for instruments for which they have executed a transaction, per the definition of execution of a transaction provided for transaction reporting in RTS 22? That is, that orders and quotes on an instrument do not trigger RTS 23 obligations for a systematic internaliser to submit reference data, while orders and quotes may trigger RTS 23 obligations for trading venues where instruments are listed.
2. We assume that a principle of minimal submissions to FIRDS is preferred by ESMA so as to alleviate any potential capacity constraints in the system. With this in mind we assume that reference data should not be submitted by systematic internalisers if an entry for the same reference data already exists in FIRDS indexed with the same ISIN instrument identifier. That is, should a systematic internaliser execute a transaction in an instrument which triggers an obligation under RTS 23, the systematic internaliser should not submit any reference data if they find the ISIN and reference data in FIRDS already (having been submitted by a trading venue previously or indeed by another systematic internaliser). However, due to the complexities addressed in this letter, and the as unclear flow and timing of information which is all dependent on the interconnectedness of the framework, many systematic internalisers will likely submit reference data for instruments which they know have been traded on their platform in a given day. This is the only way for a systematic internaliser to be certain that the necessary reference data is in FIRDS.
3. Are systematic internalisers required under RTS 23 to send reference data for listed derivatives they trade on a non-EU exchange, i.e. the exchange is not a MiFID trading venue, but the derivative underlier is a MiFID instrument which is ToTV in the EU? If yes, is the appropriate CFI code one for a listed derivative (e.g. O\*\*\*\*\* or F\*\*\*\*\*)?  
If so, what should be used as the instrument identification code when the exchange does not provide an ISIN code as there is currently not a process for a systematic internaliser to request an ISIN for these listed instruments from ANNA-DSB?



4. Certificates (securitised derivatives) are listed on a trading venues today (either Regulated Markets or MTFs). These certificates have ISINs already, prefixed with XS and issued by the securities numbering agencies as happens for bonds and shares (i.e. not in the scope of ANNA DSB, who issue ISINs for derivatives only).

When listing the Certificates, the ISIN issuers have classified such Certificates with a CFI of “RW\*\*\*\*” (Entitlement\_Rights-Warrants-X-X-X-X) and due to that classification as from January 2018 the underlying ISIN’s field (Field 26) is now also mandatory on the RTS 23 reference data submissions that the trading venue needs to perform.

Some of the certificates are on custom indices that do not have an ISIN code. The mandatory ISIN requirement reaching into the security to affect the underlying was never an expectation. This obligation will affect:

- i) all existing certificates that are currently listed and for which the underlyer is not identified through ISIN
- ii) all certificates that will be issued after January 2018.

It is unclear how this will work in practice given that it is not within the scope of ANNA-DSB.