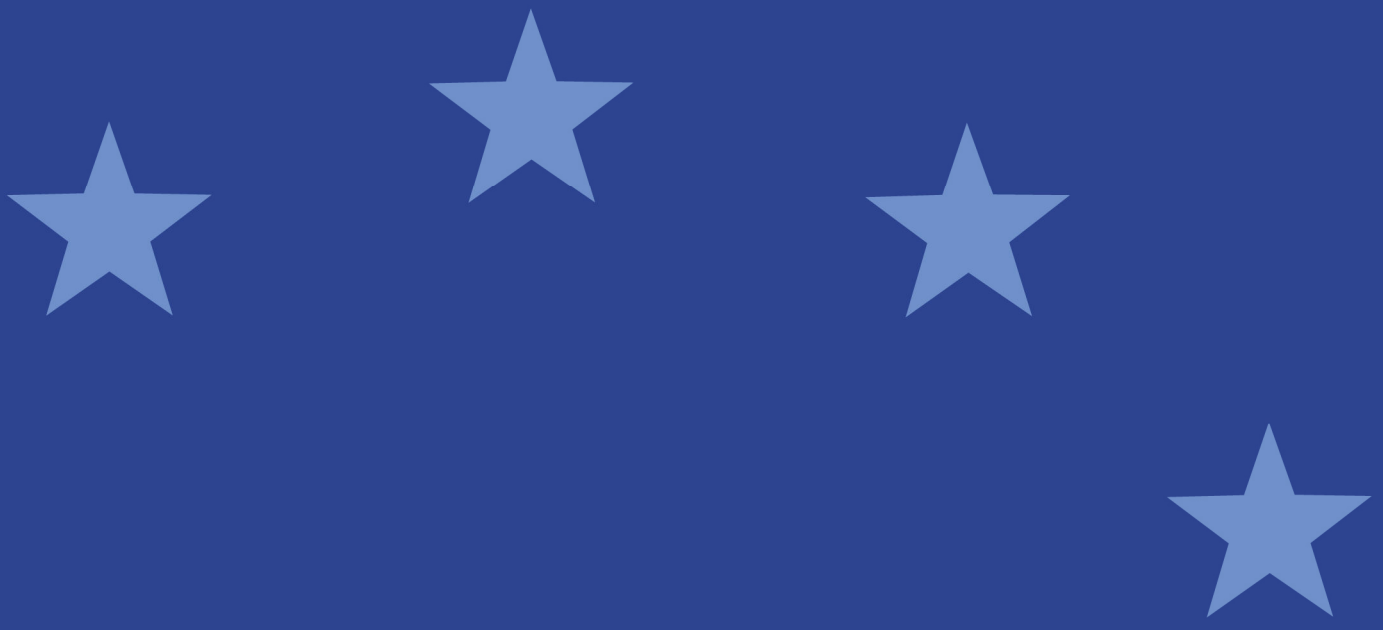




European Securities and
Markets Authority





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



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 >

Introduction

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on the Discussion Paper on the trading obligation for derivatives under MiFIR, launched by ESMA on 20 September 2016.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 25 global foreign exchange (FX) market participants,¹ collectively representing approximately 85% of the FX inter-dealer market.² Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market. Effective and efficient exchange of currencies underpins the world's entire financial system. Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasise the desire of our members for globally co-ordinated regulation, which we believe will be of benefit to both regulators and market participants alike.

FX forms the basis of the global payments system and as such both the number of market participants and the volume of transactions are very high with notional turnover, as per the last BIS report, being US\$5.1 trillion/day.³ The global FX market therefore presents some unique challenges for implementing G20 obligations when compared with other asset classes.

At this current time, we note that there is no mandatory clearing obligation under EMIR (EU regulation No 648/2012), or in any other jurisdiction, for any FX financial instrument. We also note that FX derivatives have been deemed illiquid for the commencement of MiFID II/R, primarily due to the unavailability of accurate market data and as such any transparency obligations for liquid financial instruments will not initially apply. It is therefore difficult, at this time, for us to hypothesise on the specific impacts that the proposals in the Discussion Paper could have on global FX business.

However, in addition to those comments we have made previously to ESMA on MiFIR⁴, there are certain points that we believe are worthy of consideration in the context of trading obligations, which we raise below.

We would welcome the opportunity to provide additional comments as and when FX is considered for a European trading obligation and note in this response we have only provided comments in this Introduction.

¹ Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, RBC, RBS, Scotiabank, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

² According to Euromoney league tables.

³ <http://www.bis.org/publ/rpfx16.htm>

⁴ AFME response to ESMA Consultation Paper on MiFID II / MiFIR 03 March 2015 <http://www.afme.eu/Documents/Consultation-responses-2147483034.aspx>

Executive Summary

- **We strongly support that trading obligations should be harmonised across jurisdictions; this applies to the process for determining trading obligation and the instruments to which the trading obligation applies**
- **Due to the lack of suitable data, it is difficult for us to assess the implications of different liquidity calibrations for European clearing and trading obligations**
- **We support that ESMA will consult the industry as and when considering a trading obligation for FX**

Harmonization of regulations across jurisdictions

The GFXD has historically supported the position that regulations for global markets, and in particular for the FX market, should be harmonised across jurisdictions in order to ensure a well-functioning, efficient and cost effective global market for all participants. As noted in the most recent BIS report⁵, sales desks in five countries intermediated 77% of all FX trading, with 8% of trading in the euro area. It is therefore imperative that regulations are well harmonized globally in order to avoid creating situations where parties are hindered or deterred from continuing to transact across borders, resulting in unwarranted market-liquidity bifurcations.

We believe that a trading obligation for FX should be harmonised globally, considering:

- the process in which a trading obligation is approved by regulators; and
- the financial instruments to be included in any trading obligation.

Evidence already exists to support the position that market bifurcation has occurred due to unaligned trading obligations, most notably with the 2013 US Swap Execution Facility rules⁶. Whilst no trading obligation currently exists for FX, the inclusion of footnote text inserted within these rules meant that US counterparties trading uncleared swaps through multi-multi venues were obliged to comply with trading obligations, i.e. treat those trades as if they were included within a trading obligation. The negative impact of these rules, e.g. on non-US persons executing outside of the US, has been reported through the following publications, all available at <http://www2.isda.org/functional-areas/research/research-notes/>:

- *'Footnote 88 and Market Fragmentation: An ISDA Survey' (December 2013);*
- *'Made-Available-to-Trade (MAT): Evidence of Further Market Fragmentation' (April 2014);*
- *'Cross-Border Fragmentation of Global Interest Rate Derivatives: H2 2015 Update' (May 2016).*

These publications demonstrate that the introduction of a trading obligation (or similar obligations) in one region can lead to a harmful bifurcation of the derivatives markets, in this instance the result being liquidity moving away from the US to other jurisdictions.

⁵ <http://www.bis.org/publ/rpfx16.htm>

⁶ <http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2013-12242>

An additional source of trading data, the FIA SEF tracker, demonstrates that FX NDF SEF traded volumes have remained consistent (January 2014- August 2016) since shortly after the introduction of the US SEF rules in October 2013, at USD 600-700B/month. Data prior to January 2014 is not available through this source, however, ISDA reported in their report December 2013 ‘Footnote 88 and Market Fragmentation: An ISDA Survey’ the following, stating that there had been a definitive shift in trading patterns:

5. Has there been a fragmentation in liquidity for derivatives transactions (i.e. to separate liquidity pools for trades involving and not involving US persons) since the coming into existence of SEFs and introduction of a new definition of US person?

60% of participants indicated that they observed some degree of market fragmentation resulting from the October 2 SEF rule and the new definition of a US person. The largest percent of responses by category revealed that foreign exchange (37%) was most significantly fragmented, followed by equity (19%) derivatives. Table 5 characterizes the degree of market fragmentation by derivative category.

Table 5: Cross-border Market Fragmentation as of Oct 2, 2013

	No Fragmentation	Some Fragmentation	Significant Fragmentation
Interest Rate	38%	63%	0%
Credit	26%	68%	5%
Foreign Exchange	21%	42%	37%
Equity	56%	25%	19%
Commodity	67%	27%	7%

Trading and clearing obligations

We believe that ESMA should also consider the US Treasury’s Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodities Exchange Act⁷, where it was stated that central clearing and exchange trading requirements would not apply in the US to FX swaps and FX forwards.

However, under MiFID II⁸, FX forwards (noting that an FX swap consists of two FX forwards, a near and a far leg), as defined by the European Commission supplementing regulation⁹, are deemed to be MiFID Instruments and so eligible for a potential MiFIR trading obligation and EMIR clearing obligation.

We believe that the introduction of FX trading obligations and/or clearing obligations solely in Europe would result in a bifurcation of liquidity between Europe and those jurisdictions that do not have such obligations, to the detriment of end-users and other market participants (including central banks) alike.

The link between of a trading obligations and clearing obligations is of particular significance for cross-border markets such as FX. Whilst both the US and Europe have a clear process requiring a clearing obligation to be ‘live’ before a trading obligation can be mandated, the initiation process in each jurisdiction is very different as is the timeframe between a clearing obligation and subsequent introduction of a trading obligation; the European process is considerably longer including an ESMA-led industry consultation phase.

⁷ <https://www.treasury.gov/press-center/press-releases/Documents/11-16-2012%20FX%20Swaps%20Determination%20pdf.pdf>

⁸ <https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2398-EN-F1-1.PDF>

⁹ http://ec.europa.eu/finance/securities/docs/isd/mifid/160518-delegated-regulation_en.pdf



ESMA acknowledges these differences within the Discussion Paper yet does not, in our view, seem to afford sufficient weight to the importance of harmonization between jurisdictions. We urge ESMA to consider the linkage element when considering a trading obligation for FX in Europe.

FX liquidity and MiFID

As reported by ESMA in their September 2015 Final Report Draft MiFIR RTS/ ITS¹⁰, due to the unavailability of ‘better data’, the entire class of FX derivatives has been deemed illiquid. Until requisite data is available and the market can accurately assess the impact of the transparency obligations upon FX, it is difficult to opine on whether the same liquidity calibrations should be used for the trading obligation as are used for transparency obligations under MiFID.

However, what is clear is that given recent events within the FX markets (such as the January 2015 CHF de-pegging and October 2016 GBP ‘flash-crash’) it is clear that any trading obligations need to carefully consider the variations within liquidity across the 24hr/5.5 day trading cycle that typifies the global FX market, as well as accommodate for any rapid gains/depreciations in a very volatile marketplace.

Whilst we support the proposal that trades above the large-in-scale threshold would not be subject to the trading obligation, we suggest that a suspension of a trading obligation needs to be flexible enough to accommodate situations where there is a rapid price movement in a currency, especially given the lack of a centrally agreed source of liquidity-pricing.

Conclusion

We appreciate the opportunity to share our views on this Discussion Paper issued by ESMA. Please do not hesitate to contact Andrew Harvey on +44 (0) 203 828 2694, email aharvey@gfma.org, or Fiona Willis on +44 (0) 203 828 2739, email fwillis@gfma.org, should you wish to discuss any of the above.

Yours faithfully

James Kemp
Managing Director
Global Foreign Exchange Division, GFMA

¹⁰ https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1464_-_final_report_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf

< 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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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 thresholds relate to each other?

<ESMA_QUESTION_MIFID_TO_15>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<ESMA_QUESTION_MIFID_TO_16>

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

<ESMA_QUESTION_MIFID_TO_17>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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 GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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 GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<ESMA_QUESTION_MIFID_TO_25>

Q26. In case you consider FRAs should be considered for the TO, which FRA sub-classes 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 GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>

[The GFXD does not have any comments to make in response to this question.]

<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>



[The GFXD does not have any comments to make in response to this question.]
<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>
[The GFXD does not have any comments to make in response to this question.]
<ESMA_QUESTION_MIFID_TO_30>

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.

<ESMA_QUESTION_MIFID_TO_31>
[The GFXD does not have any comments to make in response to this question.]
<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>
[The GFXD does not have any comments to make in response to this question.]
<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>
[The GFXD does not have any comments to make in response to this question.]
<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>
[The GFXD does not have any comments to make in response to this question.]
<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>

[The GFXD does not have any comments to make in response to this question.]

<ESMA_QUESTION_MIFID_TO_35>