

ISDA response to ESMA’s consultation paper on the trading obligation for derivatives

Introduction

1. The International Swaps and Derivatives Association (“ISDA”) welcomes the opportunity to respond to ESMA’s consultation on the trading obligation for derivatives under MiFIR.
2. Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 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.
3. In particular, we wish to highlight the following points, which we elaborate on in the body of our response:
 - a. We commend ESMA for the methodology used to determine which derivatives are subject to the trading obligation. We believe this is a sensible balance of evidence based analysis and judgment.
 - b. We do not believe that the proposed interaction of the trading obligation with package trades is workable. We propose alternative methodologies below, and given the urgency with which clarity in this area is needed, ask that ESMA clarify the approach in the Final Report.
 - c. We have serious concerns about the proposed start date of the trading obligation, in particular if there are not equivalence agreements in place with third-country jurisdictions. Even with equivalence agreements in place, there are material risks in implementing the trading obligation on 3 January 2018, as opposed to slightly later in Q1 2018.
 - d. We disagree with ESMA proposal to require trades above post-trade LIS to be traded on venue on the basis that pre-trade transparency will not apply and that therefore no additional protection is necessary. We note that under MiFIR Competent Authorities have full discretion on the approval of the waivers/deferrals and therefore ISDA believes that it is not appropriate for ESMA to rely on these protections for the purpose of the trading obligation. Should this rule remain, it is essential that ESMA clarify in the draft RTS that it is acceptable to pre-negotiate

the terms of such a transaction off-venue, given that liquidity is unlikely to be available on-venue at a price favorable to the client.

- e. We understand that ESMA has proposed that trades +/- 5 days from the benchmark tenor should be subject to the trading obligation to prevent firms from trading off-benchmark in order to avoid the trading obligation. Whilst we recognize this as a potential issue, we believe the fixing risk and impact on pricing would outweigh any perceived gain of trading off-venue.
4. We respond to ESMA's specific questions in the body of this paper. However we wish to raise a number of distinct issues not covered by the questions in the consultation.

Packages

5. We note that the consultation paper suggests that ESMA does not consider itself to have the legal power to address the correct treatment of packages for the purpose of the trading obligation, where one or more component is subject to the trading obligation. It suggests, however, that just one component being subject to the trading obligation could mean that the whole package has to be traded on venue, as no relief is granted to the trading obligated component. The consultation suggests that ESMA will address this in Q&A. ISDA considers that one component being subject to the trading obligation bringing the whole package in to scope is problematic and not in line with the policy intent of ensuring that only the most standardized and liquid derivative contracts are required to be traded on venue.

6. Indeed, requiring certain components of a package to be subject to the trading obligation will impose a trading obligation on instruments that are not subject to the clearing obligation. This seems to go completely against the MiFIR requirements.

Concerns with ESMA's proposed approach

7. We understand that ESMA's intent is for the application of the trading obligation to packages to be read alongside ESMA's proposed RTS on package orders for which there is a liquid market. Any trading obligated package would only be subject to pre-trade transparency on a trading venue, assuming that that trading venue has been granted pre-trade transparency waivers, if that package is considered to have a liquid market under the packages RTS. We still believe, however, that this would force a number of packages to be traded on venue and subject to pre-trade transparency despite liquidity not being available, even if all possible waivers are granted.

8. Further, as ESMA reassess market liquidity as part of the transparency calculations, the list of contracts that are considered as liquid is likely to expand. This would have a corresponding effect on the components of packages which would be subject to transparency, and the number of packages that would be subject to pre-trade transparency. It is therefore important to ensure that the RTS is developed with this in mind, and not based on the potentially narrower transparency calculations that will come in to force on 3 January 2018.

9. Bringing an entire package in scope when only one of its components is subject to the trading obligation is also problematic because trading venues do not currently have the functionality to allow less standardized packages to be traded on their venues. A significant proportion of packages would be captured by this interpretation, the majority of which cannot currently be executed on venue. There is little time for market convention to develop to allow the trading of packages on trading venues and firms are therefore highly dependent on trading venues developing this functionality to ensure that they can meet their own obligations. In the interim this would undermine firms' ability to provide liquidity to the market. Subjecting package types that cannot actually be traded on a trading venue as a package will force market participants to execute the components separately, incurring additional execution costs and exposing them to greater risks, and causing them to lose the benefits arising from executing the components collectively as a package that are available to market participants today. For example, a package which includes both a 5yr fixed-to-float interest rate swap and a BOBL listed futures contract¹ cannot currently be traded on a single trading venue. The US rules acknowledge this and as a result, such packages benefit from on-going no action relief. As another example which would not be able to be traded on a single venue, a package containing a 5yr **untranch**ed iTraxx Main (subject to the trading obligation) and a **tranche** of 5yr iTraxx Main (not subject to the trading obligation). Currently tranches are not available for execution on MTFs so it would not be possible to execute both components on the same MTF.

10. We also note that requiring certain components of a package to be subject to the trading obligation will impose a trading obligation on instruments that are not subject to the clearing obligation. This seems to go against the MiFIR requirements.

Alternative approach

11. ISDA suggests that only packages *where all components are subject to the mandatory clearing obligation* under EMIR and where *at least one of those components forming the package is subject to the trading obligation should be brought in scope*. This is likely to help ensure that only the most standardized and liquid packages are required to be traded on venue as required under MiFIR.

12. It is also important to only require packages to be traded on venue *where the package can be executed on a single trading venue*. In the absence of this principle it is unclear whether the execution of all the legs of the package could be simultaneous and contingent on each other, and it is also unclear how pre-trade transparency would work. If this principle is not adopted by ESMA, whilst we believe this would cause significant difficulties from a technological and compliance perspective, it would at the very least be essential for ESMA to clarify that when trading packages investment firms are able to pre-negotiate terms off venue before executing the trade on venue. In

¹ A standardized futures contract with an underlying basket of medium-term German government bonds.

the absence of this, it is unclear how investment firms could trade packages, and we believe it is likely that the individual components would need to be executed separately.

13. Finally, we suggest that ESMA makes clear that packages should not be subject to the trading obligation where there is no trading venue in the EU which allows that package to be traded. Clearly in the absence of this condition it is impossible for market participants to trade such packages.

14. ISDA suggests that, ESMA may consider packages such as, for example, IRS curves and IRS butterflies to be appropriate to be required to be traded on venue. These are standardized and generally liquid packages which trading venues offer for trading.

15. **Given the urgency with which the market needs to understand how ESMA considers the trading obligation to apply to packages, it is essential that ESMA clarifies this in the Final Report.**

Intra-group exemption

16. Article 28 of MiFIR contains an exemption from the derivative trading obligation for intragroup transactions as defined in article 3 of EMIR. Where one of the counterparties to a transaction between two entities in the same group is established in a third country, article 3 of EMIR permits such transactions to qualify as “intragroup” only where the European Commission has adopted an equivalence decision for the relevant jurisdiction under article 13(2) of EMIR. To date, no such equivalence decisions have been adopted. Under EMIR, both the clearing obligation and margin rules leverage the same intragroup definition. In the EMIR RTS, for both the clearing obligation (recital 12, article 3(2)) and margin rules (recital 40, article 36(2)), specific transitional provisions allowing for up to a 3 year deferral were included such that these contracts are not subject to these obligations during the deferral period. As the same conditions apply for the MiFIR trading obligation we ask ESMA to include the same three-year transitional period in this RTS.

17. The resolution of this issue is imperative. Should this issue not be resolved, global financial groups would not be able to transfer risk between EU entities and entities established in third country jurisdictions that are awaiting the European Commission equivalence decision (in particular the US given the importance of the trading volume with EU investment firms). This would cause major issues for group risk management and the ability of firms to comply with prudential requirements.

Temporary suspension of the trading obligation

18. Under the European Commission legislative proposal on the EMIR review, there is a proposal to grant ESMA and the European Commission powers to temporarily suspend the clearing obligation under EMIR. ISDA welcomes this, and would also welcome a similar power

for ESMA to suspend the mandatory trading obligation under MiFIR. We question what would happen to the trading obligation were the clearing obligation be suspended. Whilst the trading obligation is not part of EMIR it is directly linked, as the derivatives subject to the trading obligation are a sub-set of those derivatives subject to the clearing obligation. Should the clearing obligation be suspended for a class of derivatives that are wholly or partially subject to the trading obligation, it is vital that the trading obligation is simultaneously suspended. If this is not the case, the derivatives would still be required to be traded on venue, and hence would likely be required to be cleared under the rules of the trading venue, meaning that the suspension would have little practical effect.

19. Whilst this may not currently be within the legal competencies of ESMA, we believe this is an important issue that policymakers and regulators should consider addressing. This could be addressed as part of the EMIR review or/and may require a change to the MiFIR level 1 text, as it is fundamental to the practical effectiveness of a suspension.

20. Further, we note that an ability to suspend the trading obligation would allow ESMA flexibility in the event that liquidity dries up in contracts subject to the trading obligation. This could, for example, result from market specific issues, or changes in rules by third-country regulators. The ability to suspend the trading obligation would allow EU regulators to mitigate the risk of liquidity deteriorating further.

21. Therefore, we also suggest that MiFIR should also allow for the temporary suspension of the trading obligation as a matter of urgency where the liquidity of a class of financial instruments or a subset thereof falls below a certain liquidity thresholds and without requiring ESMA to submit a new RTS to the European Commission (as required under Article 32(5) of MiFIR). Several areas in MiFIR, such as the pre and post-trade transparency requirements, include provisions for the temporary suspension of the transparency requirements when the liquidity falls below a certain threshold. We therefore believe that a similar provision should be included as part of the mandatory trading obligation under MiFIR.

Pension funds exemption

22. On a separate point relating to the EMIR review, we welcome the proposal to extend the current exemption from clearing for pension scheme arrangements. ISDA is similarly supportive of the exemption from the trading obligation for pension funds as set out in 28(1) of MiFIR. We would like to highlight, however, that it needs to remain intact and not be endangered by timing issues arising from the implementation of an extension to the pension scheme arrangements exemption under the EMIR Review proposal and the current exemption expiring in August 2018. Again, we emphasize the need for the necessary changes to MiFIR are made alongside any changes to EMIR to ensure practical delivery of the policy objective.

Q 1: Do you agree with ESMA’s assessment and proposed way forward for the criteria assessing the number and types of active market participants? If not, please explain your position and how you would integrate these elements into the liquidity test.

23. ISDA welcomes the decision to move to a more judgement based assessment of liquidity for the purpose of determining the trading obligation. Whilst the data sources available are an essential base of evidence for understanding liquidity in different instruments, as ESMA recognizes, they are not without limitations. We believe that this change in approach has resulted in a sensible proposal for the instruments considered to be subject to the trading obligation.

24. In particular, ESMA’s decision to consider MTF data in the analysis underpinning the consultation is sensible. Whilst this is a limited data set, we believe that it significantly enhances the quality of the data available, and compliments the trade repository data. Again, we believe that this has enhanced the output of the analysis.

25. Further, we strongly welcome ESMA’s decision not to deem a tenor point in a currency subject to the trading obligation unless there are at least three different benchmark tenor points in that currency considered sufficiently liquid to be subject to the trading obligation. We believe that this is a sensible principle, which strikes a balance between ensuring that truly liquid contracts are traded obligated, whilst ensuring that there are not undue barriers and costs in place to access liquidity in those contracts and currencies.

26. Following from this, ISDA also strongly agrees with the removal of SEK and JPY from the trading obligation proposal. This is a sensible decision by ESMA, particularly for SEK, for which we believe liquidity could have been significantly damaged had a trading obligation been imposed, inhibiting end users access to the currency. We note that this may change in the future, and therefore, as noted above, the principle that at least three different benchmark tenor points in that currency should be considered sufficiently liquid in order for the currency to be subject to the trading obligation is welcomed.

27. We note ESMA’s comment on page 18 of the consultation paper, that “only IRD classes with at least three liquid benchmark tenor points should be considered subject to the TO”. We assume this to mean three liquid benchmark tenor points *in a currency*, as is suggested in other parts of the consultation. We would be grateful for clarification, however, should this not be the case.

Q2: Do you agree with the revised proposal not to exempt post-trade LIS transactions? If not, please explain and present your proposal

28. We disagree with ESMA’s proposal not to exempt post-trade LIS transactions from the trading obligation, and are unclear about the policy rationale.

29. We believe that by following this approach ESMA has not taken account of its mandate under Article 32(3) of MiFIR which requires ESMA to determine whether the class of derivatives

is only sufficiently liquid in transactions below a certain size. We believe that this assessment should be undertaken by ESMA regardless of the potential waivers and deferrals which might be applicable to LIS transactions. In particular, we would note that national competent authorities have full discretion on the approval of waivers/deferrals and therefore it is not appropriate for ESMA to rely on these protections for the purpose of the trading obligation. We would therefore strongly encourage ESMA to reconsider its position on this issue.

30. Another argument provided by ESMA in its consultation paper relates to the fact that trading venues can offer trading protocols that allow for the private negotiation of large trades, thereby removing any concerns about information leakage. We would however question whether all trading venues (including trading venues that will be deemed equivalent) have the same trading protocols.

31. Further, voice intermediation is typically critical to ensure that the terms of such large risk transfers are agreed efficiently and effectively, but this may not always be available over a trading venue.

32. Our understanding from the ESMA consultation paper is that the terms of such a trade can be negotiated off-venue, and then reported on to a venue once the terms are agreed. If ESMA does not allow the exemption of large transactions from the trading obligation, as a minimum, this should be made clear in the RTS, as per paragraph 97 of the consultation paper. That section referred to the “flexibility of trade execution” provided in MiFIR, meaning it was not necessary for ESMA to exempt large trades from the trading obligation because trading venues can develop protocols which allow for transactions to be negotiated away from the trading venue but subject to the rules of the trading venue. We understand that such protocols may include certain conditions, such as size requirements linked to the size of pre-trade waivers for the relevant instrument. Not allowing firms to negotiate the trade off-venue will be extremely problematic as it is highly unlikely that liquidity would be available on-venue for large trades.

Q 3: Do you agree with this proposal? If not, please explain why and provide an alternative proposal for ESMA to populate and maintain the register.

33. ISDA welcomes the proposal to maintain a register of both instruments and trading venues, including third-country trading venues. Whilst recognizing that unlike CCP recognition third-country trading venues are not required to be assessed by ESMA, and hence ESMA may not have this information readily available, it would be extremely useful for market participants, and having the information in one place would deliver material efficiencies.

34. Regarding the proposed register of classes or sub-set of classes of derivatives subject to the trading obligation, we note that the consultation suggests to include *notional type*. ISDA suggests that only instruments with a fixed notional should be subject to the trading obligation as it is the market standard, and it is unclear what other types of instruments are envisaged by this category.

We note that this is consistent with the approach taken by international regulators such as the CFTC.

35. In addition, we would be grateful for clarity on what is meant by *optionality*, which is proposed to be included in the public register. We understand that this is a reference to optionality within the relevant derivative contract (e.g., cancelable swaps or extendable options would not be subject to the trading obligation) as opposed to, say, an optional mutual break clause, but would welcome further guidance on this.

36. Whilst appreciating that it might be too early in the process for ESMA to offer a commitment, we would welcome any thinking on the timing of when the register might be updated. To be of the most use to industry, and to ensure that it can be relied on in order to meet regulatory obligations, investment firms will need to be confident that it is updated in a timely manner. Similarly, we would welcome any clarity on when the register would first be available.

Q 4: Do you agree with this proposal? Would you add other parameters e.g. day count convention of the floating leg, notional type (constant vs. variable), fixed rate type (MAC vs. MAC)? If yes, please explain why and provide the parameters.

37. As mentioned in our response to question 3, we suggest that fixed notional is set, as opposed to notional type. This is consistent with the treatment by the CFTC, and we note that including variable notional would bring a broad suite of bespoke swaps in to scope which are not liquid.

38. We recognize that the details provided in the consultation offers a material level of granularity, which is welcomed. We note however that this granularity is not mirrored in the RTS legal text. In order to ensure that there is common understanding of which products are subject to the trading obligation, the details set out on pp. 30-31 of the consultation should be replicated in the RTS in order to provide greater certainty to the industry. We would also welcome inclusion of additional details, including business days (Holiday calendar) and Business Day convention.

39. We also query the proposal to require instruments +/-5 days of the benchmark to be subject to the trading obligation. We agree that checking +/-5 days of the benchmark is important when assessing liquidity, but there is typically significantly less liquidity for trades with a tenor of +/- 5 days off a benchmark tenor than for trades in benchmark tenors (as off-benchmark swaps require bespoke pricing from liquidity providers to manage fixing risk). It is not appropriate to subject such instruments to the trading obligation, especially since establishing the parameters of such trades typically requires voice negotiation which (as mentioned in our response to question two above) is not always available on venues.

40. We would strongly recommend removal of the requirement for instruments +/- 5 days of the benchmark to be subject to the trading obligation, as it expands the scope of the EU trading

obligation significantly beyond the obligation in other jurisdictions (in particular the US). We note that while off-benchmark trades do take place in the US, there are most often legitimate commercial reasons for entering into these transactions and they are not simply an attempt to avoid the MAT rules.

41. We understand that ESMA may be concerned about the risk of investment firms avoiding the trading obligation by trading off benchmark. Whilst this is possible, we do not believe that this would be a credible option for an investment firm, due to the impact on pricing, client requirements, and fixing risk, to name a few. Any perceived benefit of attempting to trade off venue by trading off benchmark would be outweighed by the pricing and hedging risk associated with such a move.

42. Further, off-benchmark swaps are not subject to the CFTC MAT rules, which only mandate benchmark contracts to be traded on SEFs. We have carried out initial analysis on this question, which confirms trading off benchmark activity in the USA to be very limited.

43. At the very least, if ESMA does intend to retain this requirement we would ask ESMA to clarify that the reference to 5 days is to 5 calendar days.

Q 5: For each Case, specify if you agree with the proposal of qualifying the sub-classes as liquid for the purpose of the trading obligation and if not, please explain why and provide an alternative proposal.

44. We support the proposals in case A1 and case A2.

45. However, we would welcome inclusion of additional detail in the description of these sub-classes such as holiday calendar and business day convention as relevant features of each sub-class.

46. ISDA believes that the trading obligation should apply where contracts are sufficiently liquid in the EU. So whilst in principle we support alignment with the trading obligations in force in other key jurisdictions, this should only be the case where there is sufficient liquidity in those contracts in the EU.

Q 6: Would you also consider any of these possible sub-classes as liquid? Which other combinations of fixed leg payment frequency and floating leg reset frequency specifically would you consider to be sufficiently liquid?

47. With regards to the additional features highlighted in red in case A3 and case A4, we agree that these contracts are not sufficiently liquid in the EU and should therefore not be subject to the trading obligation.

48. We therefore agree with ESMA's proposal to start with a more narrowly defined set of IRS denominated in EUR compared with the US until ESMA expands its liquidity analysis based on more trading data. As ESMA notes, ESMA can reconsult on a broader trading obligation in the future, where ESMA understands that there is sufficient liquidity to warrant doing so. This can be done once there is greater visibility on the level of genuine liquidity/trading activity in Europe for each type of contract or on an approach that could ensure more globally consistent implementation of the trading obligation.

49. We note that case A3 (3 month Euribor) refers to a semi-annual reset for the floating leg. This does not seem to make sense in the context of a contract based on a 3 month reference rate and we wondered if this might have been included in error. A similar point arises in relation to case A4, which refers to a quarterly reset on a 6 month reference rate. We wondered if case A3 should refer only to a quarterly floating leg reset frequency, and case A4 only to a semi-annual floating leg reset frequency.

50. More generally, we also note that international inconsistencies mainly exist because of differences across jurisdictions in the methods and criteria for determining what instruments should be subject to the trading mandate. In order to avoid these inconsistencies and prevent the fracturing of liquidity, international standards on these methods and criteria should be set and agreed at a global level. We appreciate that international harmonization of standards is not within ESMA's power, but we would ask ESMA to raise this with the European Commission.

Q 7: For each Case, specify if you agree with the proposal of qualifying the sub-classes as liquid for the purpose of the trading obligation and if not, please explain why and provide an alternative proposal.

51. We support ESMA's proposal to include cases C2 and C4 in the scope of the trading obligation, subject to the following. We note that the 6Y USD IMM is proposed to be subject to the trading obligation, whereas the 7Y is not. We find this surprising as the 7Y is likely to be more liquid than the 6Y as most of the trading is done in the 7Y rather than the 6Y. We also note that in the US the 7Y is MAT, but not the 6Y. We therefore support cases C2 and C4 subject to this change.

52. We note that IMM trade type has been proposed for USD. The industry will require clarification as to whether that applies to just the next IMM start date or if ESMA propose to include subsequent IMM start dates. ISDA believes that the trading obligation should apply where contracts are sufficiently liquid in the EU. So whilst in principle we support alignment with the trading obligations in force in other key jurisdictions, this should only be the case where there is sufficient liquidity in those contracts in the EU.

Q 8: Would you also consider any of these possible sub-classes as liquid? Which other combinations of fixed leg payment frequency and floating leg reset frequency specifically would you consider to be sufficiently liquid?

53. We agree with ESMA's proposal to have a trading obligation in the EU that would initially start with a more narrowly defined set of IRS denominated in USD as these instruments are indeed more traded in the US than they are in the EU.

54. We therefore do not support inclusion of the details marked in red in cases C5 – C8 as we consider that there is not sufficient liquidity available for contracts with these features to be subject to mandatory trading.

55. We would also welcome clarification that compounding swaps (i.e., swaps in which the interest compounds forward until maturity instead of being paid periodically) are not intended to be within scope as it is not appropriate for these to be traded on trading venues.

56. We note that cases C5 and C7 (3 month Libor) refer to a semi-annual reset for the floating leg. This does not seem to make sense in the context of a contract based on a 3 month reference rate and we wondered if this might have been included in error. A similar point arises in relation to cases C6 and C8, which refer to a quarterly reset on a 6 month reference rate. We wondered if cases C5 and C7 should refer only to a quarterly floating leg reset frequency, and cases C6 and C8 only to a semi-annual floating leg reset frequency.

57. As mentioned above, we would welcome inclusion of additional detail in the description of these sub-classes. For example, holiday calendar and business day convention as relevant features of each sub-class.

58. In addition, we would be grateful for clarity on what is meant by *optionality*, which is proposed to be included in the public register. We understand that this is a reference to optionality within the relevant derivative contract (e.g. cancelable swaps or extendable options would not be subject to the trading obligation) as opposed to, say, an optional mutual break clause, but would welcome further guidance on this.

59. While we support global alignment of the trading obligations, we consider that only derivatives contracts that are sufficient liquidity in the relevant classes within the EU should be subject to the trading obligation.

60. More generally, we also note that international inconsistencies mainly exist because of differences across jurisdictions in the methods and criteria for determining what instruments should be subject to the trading mandate. In order to avoid these inconsistencies and prevent the fracturing of liquidity, international standards on these methods and criteria should be set and

agreed at a global level. We appreciate that international harmonization of standards is not within ESMA's power, but we would ask ESMA to raise this with the European Commission.

Q 9: For each case, specify if you agree with the proposal of qualifying the sub-classes as liquid for the purpose of the trading obligation and if not, please explain why and provide an alternative proposal.

61. We note that ESMA believes there is liquidity in the contracts listed in D1 and D2 and suggest that it is reasonable for these contracts to be subject to the trading obligation provided that there is liquidity available.

62. However, while we agree that there appears to be sufficient liquidity in the contracts listed in black in cases D1 and D2 (i.e., 2Y, 5Y, 10Y and 30Y for case D1, and all for case D2), we question the inclusion of the contracts marked in red (i.e., 3Y, 4Y, 6Y, 7Y, 15Y and 20Y in case D1) and we recommend that ESMA carries out further analysis to ensure that these contracts are sufficiently liquid.

63. As mentioned above, we would welcome inclusion of additional detail in the description of these sub-classes, such as holiday calendar and business day convention as relevant features of each sub-class.

64. ISDA believes that the trading obligation should apply where contracts are sufficiently liquid in the EU. So whilst in principle we support alignment with the trading obligations in force in other key jurisdictions, this should only be the case where there is sufficient liquidity in those contracts in the EU.

Q 10: Would you also consider the possible sub-classes here below as liquid? Which other combinations of fixed leg payment frequency and floating leg reset frequency specifically would you consider to be sufficiently liquid?

65. See response to question 9 above.

66. We note that case D4 (3 month Libor) refer to a semi-annual reset for the floating leg. This does not seem to make sense in the context of a contract based on a 3 month reference rate and we wondered if this might have been included in error. A similar point arises in relation to case D3, which refer to a quarterly reset on a 6 month reference rate. We wondered if case D4 should refer only to a quarterly floating leg reset frequency, and case D3 only to a semi-annual floating leg reset frequency.

Q 11: Do you agree with this proposal? If not, please explain why and provide an alternative proposal

67. We agree with ESMA that contracts in Libor in JPY are far less traded in the EU compared to other jurisdictions and therefore agree with the conclusion to consider these contracts illiquid for the purpose of the trading obligation.

Q 12: Do you agree with this proposal? If not, please explain why and provide an alternative proposal.

68. We note ESMA's proposal to include the first off-the-run series in the trading obligation. We note the very wide variation in the percentage traded in the first 30 days, which ESMA suggests to be between 16% and 94%. Given this variation, it is not clear whether liquidity will always be available during the first off-the-run series.

69. We note that the difference in trading volumes between the first off-the-run series and other off-the-run series is mainly due to unwinds that are traded around the time of the roll to switch positions to the current on-the-run series – following this activity, the first off-the-run series becomes like any other off-the-run series (albeit the one with the longest duration). Demand for any off-the-run series is generally due to a particular series containing a Reference Entity of interest that is not a constituent of the current on-the-run series. We note that between many rolls, series contain the same constituents and therefore this activity around the roll is a duration adjustment.

70. For the reasons above, we believe there to be increased unwind activity in the first 30 days of the off-the-run series. Nonetheless we are concerned that only considering the first 30 day of the first off-the-run series as liquid would add additional complexity and could confuse the functional trading of such a credit series. For this reason, should ESMA consider the first off-the-run series as liquid, we would support ESMA's proposal to consider the first off-the-run series as liquid for these purposes for the entire duration of the off-the-run series.

Q 13: Do you agree to the proposed timeline? If not, please explain why and present your proposal.

71. While ISDA appreciates that there is political will to ensure that the trading obligation comes into force as soon as possible, we have significant concerns that the proposed timeline could risk effective implementation, for reasons that broadly fall in to two categories – operational issues and equivalence.

Operational issues

72. Firstly, when MiFID II/MiFIR comes in to force on 3 January 2018, this brings huge technology changes for investment firms, market operators and regulators alike. The operational impact is significant, and requiring another technology implementation on the same day adds

operational risk, which resultantly risks trading functionality and successful MiFID II/MiFIR implementation.

73. In particular, we note that:

- a. We do not expect OTFs to be authorized until late 2017, and so it is implausible that investment firms will have time to connect to OTFs, test connections, and ensure that the appropriate legal documentation is in place. A smooth transition to MiFID II/MiFIR on 3 January 2018 would favour temporarily using the existing market infrastructure for the trading of derivatives that are in scope for the trading obligation. Even where firms have existing relationships with firms who will become OTFs, the legal relationship will fundamentally change with the introduction of the OTF rulebook, and technological connections need to be updated, for example to satisfy straight through processing rules, discussed below.
- b. We note that the straight through processing rules require trading venues to establish connectivity to CCPs in ways different to existing practices, and may require significant technological build and legal documentation before investment firms can become active members of the trading venue. For new trading venues where new multilateral connectivity is being introduced, it is important to carry out full end-to-end testing to ensure that connections to CCPs, middleware providers, venues and counterparties are secure and embedded. Should a trading obligation be implemented on 3 January 2018 and any teething issues occur, investment firms would effectively be denied the ability to trade through these venues, many of which we expect will be existing OTC liquidity pools, and hence investment firms will be denied access to liquidity pools that are currently available to them.
- c. Following from the above, we note that there is limited time available for clients to register at trading venues. We expect that trading venues will start to circulate their MiFID II compliant rulebooks in September, and whilst larger dealers are better resourced to assess these and put the necessary arrangements in place to trade through that venue, Category 2 firms may be less equipped to do so.
- d. Not all dealers, in particular smaller ones, will be members of the relevant trading venues. While we appreciate the certainty provided by aligning the phase-in of the trading obligation with the phase-in of the clearing obligation, and referring to the same categories of counterparty, not all Category 1 counterparties (i.e. clearing members) or Category 2 counterparties will be members of the relevant or the same trading venues. It will take some time for these counterparties to obtain membership of appropriate venues, or to put in place agreements with dealers that are already members.
- e. Should equivalence agreements be reached late in 2017, this will not provide sufficient time for in-scope firms to ensure systems are ready. Specifically, technology resources will need to be prioritized at in-scope firms in order to build the systematic controls and carry out testing to ensure compliance with the obligation to trade in-scope contracts on an authorized venue. Data inputs into these

systematic controls will not be known until the list of products is finalised and the list of authorized MTFs and OTFs is known. We expect firms to embed code freezes from the beginning of December 2017, and so it is essential that the list of eligible trading venues is clear before then if the trading obligation is to come in to force on 3 January 2018.

- f. Under ESMA's proposed interpretation of how the trading obligation applies to package trades, a large number of packages will be required to be traded on venue even when there is no trading venue which offers the ability to trade those packages. Should this interpretation remain, therefore, trading venues need time to develop the ability to trade such packages.

Equivalence

74. More fundamentally, the successful implementation of the trading obligation is foremost dependent on equivalence decisions being made on time. Should a contract be subject to the MAT rules in the US and the trading obligation in the EU simultaneously, except for in the case of a dual-registered SEF-MTF/OTF, a US investment firm dealing with an EU firm cannot satisfy its regulatory obligations in the US, and an EU firm dealing with a US firm cannot satisfy its regulatory obligations in the EU, unless an equivalence agreement is in place. It is clear that cross-border trading would be hindered, and liquidity pools will fracture as a result. This does not benefit the EU or other jurisdictions. In addition, delayed equivalence decisions will require firms to commit resources to ensure minimal disruption to trading flows – a poor use of resource at what is already a busy period of market infrastructure change, especially given that such plans will only be required for a limited period of time until equivalence decisions have been made.

75. Implementing a trading obligation without equivalence agreements in place would impose a substantial competitive disadvantage on EU markets and invoke lasting damage on EU markets. ISDA analysis has shown that following the implementation of the MAT product set in the US without equivalence agreements, global swap market liquidity became fractured. But to implement a trading obligation in the EU, the world's second largest swap trading jurisdiction, which without equivalence agreements would be directly contrary to the US rules, would impose an irreconcilable regulatory barrier to cross border trade.

76. Whilst the US is the most important jurisdiction with whom an equivalence agreement must be in place when considering trading volume with EU investment firms, equivalence with other jurisdictions is also essential. If a trading obligation is imposed without equivalence with, say, APAC jurisdictions, the activities of EU firms in those jurisdictions would be significantly disrupted. Even though such jurisdictions (with the exception of Japan) do not have a trading mandate in place domestically, imposing a trading obligation on those EU firms would require a

repatriation of trading to Europe, disrupting those markets conventions, and ultimately competitively disadvantaging EU firms.²

We also note that equivalence determinations and assessment should be made more transparent and should be undertaken on an outcomes based approach rather than on a line by line analysis (which, given the inconsistencies described above, could be challenging to attain).

77. In the light of the above, it is essential that equivalence agreements are in place in advance of the trading obligation coming in to force, and firms need to have a very short period of time after 3 January 2018 in order to minimize operational risk around implementing the trading obligation and connect to OTFs.

78. We therefore suggest that ESMA proposes the implementation date of the RTS to come in to force on the later of:

- a. three months following the date of equivalence agreement(s) being in place with third-country jurisdictions (at the very least the USA); or
- b. three months following the publication of the RTS in to the Official Journal of the European Union.

79. We also note that under the existing proposal, ESMA proposes to align the implementation of the trading obligation with EMIR categories. As these categories may change as a result of the EMIR review, should ESMA adopt the alignment proposed in the consultation, any change under EMIR should bring a corresponding change to the trading obligation implementation dates.

² We note that this concern is subject to clarifications around the territorial scope of MiFID II/MiFIR, including if, and if so how, the trading obligation applies to third-country branches of EU investment firms.