ISDA Safe, Efficient Markets

ISDA view on the scope of OTC Derivatives Post Trade Transparency in revised MiFIR

(8 October 2024)

1. Executive Summary

On 9 July 2024, an ISDA delegation met ESMA staff working on MiFIR implementation.

During that meeting, ESMA encouraged ISDA to share with it the consensus developed among ISDA members as to how the MiFIR post trade transparency regime should be applied in practice.

This paper therefore addresses ISDA's interpretation of the scope of the post trade transparency regime regarding the following instruments, and explains its reasoning for these conclusions:

- **Interest Rate derivatives**: Only Spot Starting and IMM Fixed/Float and OIS swaps should be viewed as in-scope of trade transparency.
- **Index CDS**: Other than the Index CDS contracts subject to the EU clearing obligation, only the 'on-the-run' iTraxx Senior financials and iTraxx sub-ordinates financials contracts should be viewed as in-scope of trade transparency.
- **Securitised derivatives** are not in-scope of MiFIR trade transparency.

ISDA is continuing to work to establish consensus on other aspects of the MiFIR trade transparency regime and is likely to revert to ESMA in due course on these other aspects.

2. Interest Rate derivatives: Only spot-starting and IMM Fixed Float and OIS swaps should be covered by MiFIR trade transparency, as only these provide meaningful information to the market.

The MiFIR Level 1 text focuses trade transparency requirements on the most standardised and liquid contracts, information on which would provide meaningful price information to market participants.

a) Forward-starting Fixed/Float swaps are less liquid than Spot-Starting Fixed/Float swaps, add little value to MiFIR trade transparency, and are not intended to be in-scope.

The new MiFIR post-trade transparency scope is intended to apply to derivatives instruments that are sufficiently liquid [1] that reporting of their price to the market will be truly representative of the level at which those instruments are trading and therefore helpful to market participants.

[1] Single Name CDS referring to a GSIB – which are at best episodically liquid – are the only exception to this principle (they are scoped in under Article 8a.2(b)).

ISDA notes that recital 8 of the new MiFIR states that '*only interest rate derivatives with the most standardised and liquid currency and tenor combinations should fall within the scope of the transparency requirements*.'

We consider that a 2 year forward-starting interest rate swap with a 7-year tenor denominated in any of the G4 currencies is far less liquid than a spot starting 7-year interest rate swap in any of the G4 currencies. Forward starting swaps are typically traded to hedge a specific interest rate risk in the future. They often have customised dates relating to that specific interest rate risk in the future. As such, publishing the price of these swaps is not as helpful for market participants.

We understand that strong consideration is being given to forward-starting swaps being allocated a collective ISIN per type of contract in the forthcoming Delegated Act on the OTC Derivative Identifier (e.g. all forward-starting Euro-denominated fixed/float contracts within the tenors listed in MiFIR Article 8a would get the same collective ISIN), or (slightly more granular) a collective ISIN for each tenor for each type of contract (e.g. each 5 year forward-starting Euro-denominated fixed/float contract) would get the same collective ISIN)). Under either outcome, a relatively wide spread of prices could be published for the same ISIN, with the chief benefit of that ISIN being to show that the trade is not a spot-starting benchmark trade.

As such we therefore believe that the post-trade transparency regime is best served by focusing on spot-starting IRS and excluding forward-starting IRS

We acknowledge the European Commission view, as expressed to us by email on 11 June 2024, that the co-legislators formulated the legal provisions defining the scope of post-trade transparency as 'non-exhaustive'. We also recognise that the European Commission has the power to refine the scope of post-trade transparency through Delegated Acts under MiFIR Article 8 (a)(2), so the scope of trade transparency will change over time.

Nevertheless, in consideration of the principles underpinning the definition of the scope of post-trade transparency, we believe that, as of the time of writing, it is reasonable to take the view that forward-starting swaps should not be viewed as subject to MiFIR post-trade transparency.

b) As reporting of FRAs and Basis Swaps would not provide meaningful information to market participants, these instruments should not be covered by MiFIR trade transparency requirements.

ISDA believes that in the Interest Rate derivatives asset class, only Spot-starting and IMM Fixed-Float Swaps that are subject to the clearing obligation, cleared and that fall within the whole year tenors listed in Article 8a should be covered by trade transparency in the new MiFIR,

While the clearing obligation for Interest Rate derivatives is broader than this product set, we note that recital 10 of MiFIR also links application of trade transparency requirements to 'the most standardized and liquid currency and tenor combinations.'

Regarding other Interest Rate derivatives products that are subject to the clearing obligation:

Forward Rate Agreements (FRAs):

- Among FRAs, only contracts using EURIBOR comply with all the criteria provided in MiFIR Article 8a for application of public trade transparency. There is no trading in FRAs using other rates.
- While there is some volume in EUR--denominated FRAs, this volume is almost entirely comprised of administrative, non-price forming transactions resulting from post trade risk reduction (PTRR) activities. These transactions are exempt from trade transparency under Article 31 paragraph 1 of new MiFIR in any case. Only the 1-year EUR-denominated FRA trades at all and only a tiny (single digit) percentage of the volume in these transactions is comprised of price-forming (non-PTRR) trading activity.

For example, ISDA analysis of data drawn from EU trading venues and APAs shows that in the first 6 months of 2024, there were just 110 EUR-denominated FRA trades executed (almost all of which were PTRR trades).

As such, it is questionable whether post-trade transparency requirements for these contracts would pass cost-benefit assessment. EMIR reporting of these trades should ensure regulatory oversight, however.

Basis Swaps: Clearing-obligated basis swaps (those including EURIBOR as a reference rate) are illiquid at all of the tenor points listed in MiFIR Article 8a. ISDA analysis of data drawn from EU trading venues and APAs shows that in the first 6 months of 2024, there was just 1 such trade executed in the EU in each of the 1 year and 3 year tenors. Again, post-trade transparency for these contracts does not seem to pass cost-benefit assessment.

If, ultimately, ESMA insists that FRAs and Basis swaps that meet the criteria mentioned in Article 8a (even if too illiquid to align with Article 10) should be subject to MiFIR post-trade transparency it is vital that they benefit from appropriately calibrated deferrals from price reporting in light of this illiquidity.

3. **Other than the Index CDS contracts subject to the clearing obligation, only the 'on-the-run' iTraxx Senior Financials and iTraxx Sub-ordinates Financials CDS contracts should are in-scope of MiFIR trade transparency.**

ISDA believes that Article 8a.2(c) is intended to capture the iTraxx Senior financials and iTraxx sub-ordinates financials contracts only. We believe it would be disproportionate to require post-trade transparency under MiFIR for *any* CDS contract referring to an index of which a GSIB is a constituent reference entity.

Apart from the index CDS contracts that are subject to the EU clearing obligation, the iTraxx financials index contracts are by far the most actively traded and liquid among index CDS contracts including one or more GSIB reference entities.

A data exercise undertaken by ISDA, using DTCC Trade Information Warehouse (TIW) data from 2021 showed that 'on-the-run' iTraxx Senior financials index traded on average 41 times per day at that time (suggesting that it could sustain some level of price transparency (subject to current

RTS 2 deferral arrangements pending amendment of RTS 2 to apply new appropriately calibrated deferrals)).

We acknowledge that the regulatory interest in CDS referring to GSIB reference entities (following market events in Spring 2023) would be served by inclusion of the iTraxx Senior financials and iTraxx subordinates financials contracts in-scope (albeit that EMIR reporting and MiFIR transaction reporting should also provide regulators with this data, and that post-trade transparency reporting is intended for consumption by market participants). Inclusion of relatively illiquid index contracts containing one or a handful of GSIB reference entities only in the scope of MiFIR post-trade transparency would be disproportionate, however. It would also – given that contracts on GSIB reference entities would represent such a minor component of the value of such contracts - add little to market (or regulatory) understanding of market developments.

ISDA is also of the view that only the 'on-the-run' iTraxx Senior financials and iTraxx sub-ordinates financials contracts should be subject to post-trade transparency, as these contracts display much more liquidity than when 'off-the-run.'

It would furthermore seem a bizarre outcome if the 'off-the-run' iTraxx Seniors financials and iTraxx sub-ordinates contracts were viewed as in-scope of trade transparency when the 'off-the-run' versions of the clearing-obligated iTraxx Europe Main and iTraxx Europe Crossover are not. Again, regulators can obtain access to trade information pertaining to these contracts through EMIR reporting and MiFIR transaction reporting.

Again, we recognise that the European Commission has the power to refine the scope of post-trade transparency through Delegated Acts under MiFIR Article 8 (a)(2), so the scope of trade transparency will change over time. However, we believe that our interpretation of the scope is a reasonable one at time of writing.

4. Securitized derivatives

The MiFIR Review which resulted in the revised MiFIR regulation published in March 2024 took a quite different approach to definition of the scope of OTC derivatives transparency to that taken in MiFIR 1.

While MiFIR 1 focused on OTC derivatives that were 'traded on a trading venue', 2024 MiFIR instead prescribed a limit set of the most liquid, high-volume derivatives (with the only exception to this approach being the inclusion in-scope of Single Name CDS referring to GSIBs).

While the scope of OTC derivatives in MiFIR 1 was broad, securitized derivatives were addressed as an afterthought, first being explicitly addressed in RTS 2, when they were categorised as 'transferable securities'.

Given the prescriptive scoping of OTC derivatives transparency in 2024 MiFIR, we believe it is reasonable to take the view, at time of writing, that the co-legislators did not intend that securitized derivatives should be included in-scope of trade transparency in revised MiFIR.

We also observe that securitized derivatives are illiquid (as is underlined by securitized derivatives having been deemed illiquid under RTS 2), which would suggest that – unless they are explicitly named as in-scope of trade transparency (as is the case for SN CDS referring to GSIBs) – they should be completely out of scope of trade transparency.

Securitized derivatives are also not subject to the clearing obligation, which is one of the key criteria used to determine whether OTC derivatives in-scope of trade transparency in new MiFIR.

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