



21 November 2016

European Securities and Markets Authority
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07
France

Dear Sir or Madam,

Re: Discussion Paper on the trading obligation for derivatives under MiFIR dated 20 September 2016

Managed Funds Association¹ (“**MFA**”) welcomes the opportunity to provide comments to the European Securities and Markets Authority (“**ESMA**”) in response to ESMA’s Discussion Paper on the trading obligation for derivatives under the Markets in Financial Instruments Regulation (“**MiFIR**”) dated 20 September 2016 (the “**Discussion Paper**”).² Terms defined in the Discussion Paper have the same meaning when used in this letter and the accompanying reply form.

As the European Commission noted in its original proposal³ for the revised Directive on Markets in Financial Instruments, the overarching objective of the MiFID framework is to further the integration, competitiveness and efficiency of the EU financial markets. MFA is a strong advocate of these values and understands that the trading obligation plays an important role in furthering such values.

¹ Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

² The Discussion Paper is available here: <https://www.esma.europa.eu/file/19738/download?token=0IMYim00>

³ The European Commission’s original proposal is available here: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011PC0656&from=EN>

MFA appreciates ESMA's efforts to implement a Level 2 regime for MiFID II and is grateful for the opportunity to respond to certain questions set out in the Discussion Paper. Outlined below, in brief, are MFA's main points of concern with regards to ESMA's proposed implementation of the derivatives trading obligation ("TO") under MiFIR:

- **Alignment of the TO with the U.S. CFTC's "made available to trade" ("MAT") regime.** Many MFA members conduct derivatives trading activity in both the U.S. and the EU, and thus will trade in-scope derivatives in both jurisdictions. The alignment of the U.S. and EU regimes would ease the administrative burden faced by such market participants subject to trading obligations in both jurisdictions, and ensure cross-border harmonisation such that the derivative contracts subject to the CFTC's trade requirement as MAT swaps will also be subject to the TO and vice versa.
- **Enhancement of the quality of data used by ESMA to assess which derivative contracts should be subject to the TO.** MFA is concerned by ESMA's reliance on data from trade repositories ("TRs") when assessing the liquidity of derivative contracts for the purposes of the TO. MFA recommends that ESMA should rely upon a broader set of data sources to assist its analysis, such as data from trading venues, CCPs and competent authorities ("CAs").
- **Product-level liquidity assessments of package transactions.** While certain types of package transactions are standardised and liquid, others are not, even where they include one or more instruments that when executed on a stand-alone or outright basis may individually be liquid enough to be subject to the TO. Based on MFA members' experience with the CFTC's treatment of package transactions under the MAT regime, MFA recommends that ESMA conduct product-level liquidity assessments of package transactions, and consult with the CFTC to develop a coordinated phase-in of the TO as applied to various types of package transactions that are traded in both jurisdictions.
- **General alignment of the TO with the transparency regime.** MFA believes that ESMA can achieve general alignment by initially lowering the thresholds for the liquidity assessment for the TO so that a broader and sufficiently comparable range of benchmark tenors as compared to the tenors of MAT swaps under the CFTC regime become subject to the TO. As a result, both pre-trade transparency requirements and the TO would apply initially to benchmark contracts, but not to non-benchmark tenors, which would benefit market participants trading the same benchmark contracts in both jurisdictions.
- **Requiring non-discriminatory access to trading venues.** MFA wishes to note the importance of ESMA requiring non-discriminatory access to trading venues for all eligible market participants subject to the TO. MFA encourages ESMA to take timely steps, such as issuing Level 3 Q&As, to further define the non-discriminatory access requirements for MTFs and OTFs to ensure that all market

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participants are able to meet their regulatory obligations under the TO, and to access the most beneficial pricing and the fullest range of available liquidity.

The list of points above is not exhaustive and MFA welcomes the opportunity to discuss our views, as set out in the attached Appendix, in greater detail with ESMA. Please do not hesitate to contact the undersigned at +1 (202) 730-2600 or Laura Harper Powell at LHarperPowell@managedfunds.org, with any questions that ESMA or its staff might have regarding this response.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing
Director & General Counsel



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 >

[TYPE YOUR TEXT HERE]

< 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>

MFA welcomes the approach taken by ESMA of initially only subjecting benchmark tenor dates within a class of interest rate derivatives to the trading obligation. MFA believes this approach will have the practical effect of broadly aligning the transparency regime with the TO, given that products that are subject to the CO, but not the TO, can receive a waiver from pre-trade transparency.

This approach would also conform more closely with the CFTC regime in the U.S. under which there is alignment between the pre-trade transparency requirement and the trade execution requirement for any swap that has been “made available to trade” (“MAT”) on a swap execution facility (“SEF”) or designated contract market (“DCM”).

MFA believes that closer conformity is important to achieve cross-border harmonisation between the CFTC and MiFIR regimes for determining in-scope derivatives subject to the trading obligations in both jurisdictions, as many MFA members conduct trading activity in both the U.S. and EU. If the regimes are aligned, then market participants who are already trading a derivative or class of derivative on a U.S. SEF or DCM, should also satisfy the TO once it comes into force. This alignment will ease the compliance burden faced by market participants subject to trading obligations in both jurisdictions.

MFA understands that ESMA may find it difficult initially to ensure complete alignment of the TO and transparency regime due to ESMA’s intention to consider only benchmark dates for the class of IRS for the TO, which differs from the approach used in RTS 2 for calibrating the transparency regime for non-equity instruments which includes all contracts with both benchmark and non-benchmark tenors. However, MFA urges ESMA to ensure that it calibrates both the TO and transparency regime as closely as possible. MFA further discusses how ESMA might achieve this calibration in response to Q15 below.

MFA is reassured to see that ESMA is opting for the “bottom-up” approach rather than the “top-down” approach when assessing which derivative contracts will be subject to the TO. This approach prevents an indiscriminate application of the TO by ESMA and ensures that only derivatives made subject to the CO can be subject to the TO. MFA considers that there should not be a circumstance in which derivatives whose characteristics are such that ESMA has determined them not to be subject to the CO are made subject to the TO. Accordingly, MFA considers that ESMA should not rely upon the “top-down” approach when considering derivatives to be subject to the TO.



<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>

MFA agrees with ESMA's decision to initially only consider a subset of derivatives that are subject to the CO for the imposition of the TO. In particular, MFA agrees with the approach specified in paragraph 67 on page 29 of the DP, as it is similar to the U.S. CFTC's approach, where a subset of derivatives currently subject to the clearing obligation has been determined to be MAT and thus subject to the trade execution requirement. Such similarity is vital for achieving cross-border harmonisation between the CFTC and MiFIR regimes.

Please see the CFTC's list of such MAT swaps in the following link:

<http://www.cftc.gov/idc/groups/public/@otherif/documents/file/swapsmadeavailablechart.pdf>

MFA considers that whether or not a derivative contract is traded on a trading venue is a question of fact. Accordingly, whether or not a trading venue has admitted a derivative, subject to the CO, to trading should be thoroughly investigated by ESMA. In this regard, MFA respectfully suggests that ESMA should rely upon data sourced directly from trading venues to determine this question as such data will ultimately give the clearest picture as to which derivative contracts are currently listed or traded on such venues. ESMA should aim to update and refresh this data on a regular basis to ensure that it is not using out-of-date information.

In responding to this question, MFA wishes to note the importance of requiring non-discriminatory access to trading venues for all eligible market participants. If the criterion for a derivative contract to become subject to the TO is that it is "traded on at least one trading venue", and all market participants cannot access that trading venue to trade such derivative contract, then it will be difficult, if not impossible, for such participants to comply with the TO. MFA has discussed the issue of non-discriminatory access to trading venues in greater detail at Q6 below.

<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>

As a threshold matter, MFA respectfully requests ESMA to consider not just the number of market participants trading a class of derivatives when assessing liquidity for the purposes of the TO, but also to consider the presence and availability of ready and willing buyers and sellers in the market. TR data alone may not be sufficient to provide ESMA with the insight it needs to evaluate this criterion, as TR data only has records of executed transactions. Trading venues and market participants themselves should be able to provide data on the number of liquidity providers that provide indicative or firm bids and offers on a routine basis. Although certain products may trade relatively infrequently, a consistent presence of ready and willing buyers and/or sellers for a product may mean there is still a liquid market for the product.

More generally, MFA is concerned by ESMA's reliance on TR data alone when assessing the liquidity of derivative contracts for the purposes of the TO. MFA encourages ESMA to rely upon a broader set of data sources to assist its analysis, such as data from CCPs, CAs and trading venues.

In particular, MFA firmly believes that, given the role of CCPs in the cleared derivatives market, it is axiomatic that CCPs will have additional valuable and necessary data which ESMA will need to assess the liquidity of cleared OTC derivative contracts. By way of example, a number of trading venues will facilitate the trading of swaps that are cleared through a particular CCP and, in order to collate this information, ESMA will be required to request information from each trading venue individually in order to piece together information relating to the particular class of swap. A more expedient and accurate route to this information would be to request it from the CCP itself. Data supplied by a CCP will also be more accurate and definitive than TR data as, in order to function as a CCP, the CCP must have complete details of all transactions that it clears. A failure to rely upon data supplied by CCPs would be a considerable omission in ESMA's analysis of liquidity in the cleared OTC derivatives market. Further, as a small number of CCPs currently clear the vast majority of OTC derivatives volumes, the burden of obtaining such data should be small.

It is important that the data analysed by ESMA for the purposes of assessing which derivative contracts will be subject to the TO is not static data. MFA understands that ESMA intends to review data collated between 1 July 2015 and 31 December 2015. While this is acceptable with regards to the derivatives declared subject to the TO initially, MFA expects the liquidity of derivative contracts and the number of market participants trading certain types of derivative contracts to fluctuate over time. Not all derivative contracts which are considered to be illiquid when the TO is phased-in will be illiquid in two years' time. Consequently, MFA advises ESMA to review data on a rolling basis. To this end, MFA notes with approval that, as stated in paragraph 69 of the DP, once OTFs have started operating, it will consider revising any technical standards as the new OTF category may have an impact on liquidity. MFA encourages ESMA to continually assess liquidity of derivatives subject to the TO generally with a view to ensuring that derivatives which are sufficiently liquid are made subject to the TO.



<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>

As with other numerical criteria for liquidity assessments, MFA encourages ESMA to inform this criterion by obtaining data proactively from a broader array of data sources than just TRs, such as trading venues (*e.g.*, MTFs). MFA urges ESMA to take a comprehensive approach to the assessment of liquidity. We discuss this point further at Q6 below.

With respect to the classes of derivatives specified in Q4 above, MFA respectfully requests that ESMA follow the classes of MAT swaps that are currently subject to the CFTC trading requirement to achieve cross-border harmonisation. Please see the link to the CFTC's list of MAT swaps in response to Q2 above.

<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>

MFA believes it is not necessarily the case that “the more trading venues that offer a class of derivatives, the more liquid that class can be considered.” In fact, in many highly liquid exchange-traded interest rate derivatives markets, all of the activity in a given instrument occurs on a single exchange.

Separately, the success of the TO depends on, amongst other things, market participants being able to access sufficient pools of liquidity on-venue to adequately fulfil their trading needs for a given class of derivatives. Please see our response to Q6 for a further discussion of the importance of all eligible market participants having non-discriminatory access to trading venues.

<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>

It is possible that only one venue need trade a derivative in order for it to be subject to the TO. Nevertheless, this criterion raises the question as to whether all eligible market participants have non-discriminatory access to that trading venue to trade the derivative. Unless all eligible market participants are permitted access to a venue, then it will be difficult for ESMA to ensure a successful and orderly implementation of the TO as not all market participants subject to the TO will be able to trade on the venue. Currently, there is a two-tiered market system whereby exclusive groups of traditional dealers execute trades with one another on interdealer venues, while other market participants (many of whom are MFA members and other end-users of derivatives) are only able to trade bilaterally or on a limited number of dealer-to-customer venues. In light of this two-tier market structure, MFA believes that the minimum number of trading venues on which a derivative contract is trading is relatively insignificant (provided that such derivative is traded by a sufficient number of market participants to label it as being “sufficiently liquid”). The question of threshold significance is, if only a single trading venue offers a given instrument, whether or not all eligible market participants who wish to trade that derivative have access to that one trading venue offering the derivative for trade.

At present there is a real threat that by not taking safeguards to ensure that all eligible market participants have access to all trading venues, ESMA will prevent a considerable number of buy-side market participants from being able to access the most beneficial pricing and pools of liquidity on the full range of trading venues available in the market. In the spirit of the TO which aims to boost liquidity and foster competition in the OTC derivatives market, MFA encourages ESMA to take immediate action on this matter and facilitate the emergence of “all-to-all” markets prior to the TO coming into force.

If the issue of ensuring non-discriminatory access to trading venues is not addressed in a timely manner, such as by issuing Level 3 Q&As to further define the non-discriminatory access requirements for MTFs and OTFs, then it will be necessary to ensure that classes of derivatives are traded on more than one trading venue in order to be subject to the TO.

As discussed briefly in response to Q4, when it comes to assessing the criteria relating to the liquidity of a derivative, MFA encourages ESMA to take a holistic approach rather than viewing each criterion as a linear hurdle that must be passed before assessing the next criterion. While MFA considers the CFTC’s MAT determinations approach to be insufficiently prescriptive for SEFs, because it provides considerable discretion to SEFs in applying one or more MAT factors to a particular derivative, ESMA should adopt an element of the CFTC’s approach by setting TO criteria that are indicative rather than rigidly dispositive. Consequently, ESMA should not dismiss a derivative as illiquid simply because it is, for example, traded on fewer than three trading venues, if a notably high number of market participants trade such a derivative. Ultimately, MFA is of the view that if the derivative fails to meet a single criterion, this



should not end ESMA’s liquidity assessment of the derivative by definitively excluding it from the TO where such derivative is otherwise standardised and sufficiently liquid based on other indicative criteria.

<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>
[TYPE YOUR TEXT HERE]
<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>

MFA notes that the concept of a market maker being subject to a “binding written agreement or an obligation to provide liquidity” is a concept applicable to other markets but is not relevant to trading venue participants making a market for OTC derivatives on trading venues. Although traditional dealers will join trading venues, such as Tradeweb or Bloomberg, as “market makers” for OTC derivatives, to our knowledge, such venues do not have market-making schemes whereby dealers are under a binding written agreement or an affirmative obligation to provide liquidity on such venues. MFA understands that revenue sharing arrangements may be offered to such market participants as an incentive for their market making activities, but such arrangements would not appear to constitute the “binding written agreement” to provide liquidity that ESMA refers to.

MFA presumes that the intention behind this criterion is to capture market participants who are market makers in the course of their business and not as a result of a binding agreement or obligation. Consequently, MFA urges ESMA to re-construe this language and consider the number of liquidity providers (*i.e.*, those market participants on the trading venues who are quoting one- or two-way markets for the relevant derivatives in the course of their business rather than under a “binding written agreement or obligation”).

MFA also notes that this criterion is fluid and will be affected by the achievement of reforms in the global OTC derivatives markets. In particular, non-discriminatory access by all market participants to all trading venues would encourage alternative forms of liquidity provision



such that any participant can “make” or “take” prices. Thus, the number of liquidity providers for a given product may increase over time. By contrast, the current two-tier market perpetuates dealers’ control of liquidity and entrenches their role as exclusive “price makers”, which could suppress the number of liquidity providers and result in a steady impairment of liquidity over time.

<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>

MFA agrees with the ratio approach as trades in smaller notional amounts carried out frequently are likely to be liquid. On this note, and as an overarching point for ESMA to consider, MFA would like to stress the importance of ESMA reviewing the liquidity of derivatives subject to the TO and CO on a rolling basis as MFA expects the number of asset classes (and subsets thereof) and their liquidity will fluctuate over time. The liquidity of a derivative may improve over time and it is only by regularly assessing changes in liquidity that ESMA can subject derivatives previously considered to be illiquid to the TO. Conversely, derivatives made subject to the TO should not necessarily be made subject to the obligation permanently, given that levels of liquidity can diminish. MFA wishes to reiterate its point made in response to Q3 above that ESMA should inform its proposed ratio approach by seeking relevant data from a broad range of sources, not just TRs, but also CCPs, CAs and trading venues.

<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>

MFA wishes to reiterate a point which was of particular concern to its members in a previous ESMA consultation paper on the transparency obligation regarding the average size of spreads and the use of proxies. Please see MFA response to Q88 of ESMA’s consultation paper on MiFID II/MiFIR: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf. Although the relative width of a bid-ask spread is indicative of a derivative contract’s liquidity, MFA believes that ESMA should appreciate that by virtue of movement onto a trading venue, trading in a derivative contract may become more competitive and more liquid and, therefore, may lead to bid-ask spread compression.



This on-venue liquidity enhancement was supported by a recent report by the Bank of England that assessed the impact of the CFTC MAT regime on interest rate swaps traded on SEFs under the regime. Please see Staff Working Paper No. 580 "Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act" (Evangelos Benos, Richard Payne and Michalis Vasios) January 2016: <http://www.bankofengland.co.uk/research/Documents/workingpapers/2016/swp580.pdf>.

The Bank of England found that following the implementation of the U.S. MAT regime, the liquidity of interest rate swaps rose once they were subjected to mandatory trading on SEFs. Consequently, the difficult question is whether the derivative is liquid as a result of being declared subject to the TO or if it was liquid in its own right prior to such declaration. As a result of this ambiguity, MFA respectfully requests that ESMA give this criterion a lower weighting.

With regards to average size of spreads, MFA agrees with ESMA that reliable data is difficult to obtain for products not already traded on a trading venue.

<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>

MFA supports ESMA's proposal of using information on spreads provided by trading venues. MFA believes that data from CCPs will not be of use in obtaining information on the average size of spreads.

Additionally, MFA would like to reiterate its point that ESMA should be looking at all available data and information on a rolling basis so that when the liquidity of a derivative fluctuates, it can be removed from the TO and *vice versa*.

<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>

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<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>
[TYPE YOUR TEXT HERE]
<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>

MFA understands that ESMA is currently proposing to set the post-trade LIS threshold for interest rate swaps and credit default swaps under MiFIR at the higher percentage of the transactions corresponding to the 60th trade percentile or 70th trade percentile, respectively. MFA supports ESMA’s proposed approach as it ensures that the LIS threshold for the TO is narrower than the transparency regime (which sets the LIS threshold at the higher of the 90th trade percentile, 70th volume percentile or a “threshold floor”) and, therefore, derivatives that are exempt for the purposes of the transparency regime, under the LIS exemption, will always be exempt for the purposes of the TO.

In spite of this, MFA urges ESMA, as far as possible, to coordinate with the U.S. on the CFTC’s determination of minimum block trade sizes in the post-implementation period. ESMA has noted in its DP that during the CFTC’s post-implementation period, the CFTC intends to exempt block trades from the execution requirement on SEFs or DCMs where a transaction has a notional or principal amount greater than the 67th volume percentile for that category of swaps.

While MFA supports the thresholds proposed by ESMA for the sake of aligning the transparency regime and the TO, MFA encourages ESMA to set LIS thresholds that are consistent with the CFTC’s determination of minimum block trade sizes. MFA acknowledges that ESMA’s current proposed threshold is not dramatically higher or lower than the CFTC threshold. However, for ease of trading where market participants trade the same derivative contract in the U.S. and EU, MFA believes market participants in both jurisdictions would be better served if ESMA would set post-trade LIS thresholds that are the same or similar to the CFTC’s minimum block trade sizes. Achieving such consistency would ensure that market participants are either required to trade a class of derivatives on-venue in both jurisdictions or neither jurisdiction.

<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>

MFA agrees with ESMA's intention to align the TO with the transparency regime.

MFA is concerned by the potential misalignment between the two regimes, given ESMA's liquidity assessment for the TO has only been applied to benchmark tenors whereas the transparency regime will apply to classes of derivatives with both benchmark and non-benchmark (*i.e.*, broken) tenors. MFA believes that ESMA can achieve general alignment of the two regimes, as explained below.

MFA is reassured to see that ESMA is attempting to close the gap between the two regimes as shown by its proposals in Paragraphs 109(i) and (ii) of the DP. MFA believes that general alignment can be achieved by first, lowering the thresholds for the liquidity assessment as proposed in Paragraph 109(i) for the TO so that a broader and sufficiently comparable range of benchmark tenors as compared to the tenors of MAT swaps under the CFTC regime become subject to the TO. As a result, both pre-trade transparency requirements and the TO would apply initially to benchmark contracts, but not to non-benchmark tenors. In the future, ESMA could pursue the proposal in Paragraph 109(ii) of the DP if, in coordination with the CFTC, there was a consensus to broaden further the scope of the trading obligations in both jurisdictions to contracts with a broken tenor.

Notwithstanding the fact that ESMA will initially be lowering the threshold for the TO liquidity assessment, ESMA will effectively be aligning the TO and transparency regimes. This alignment would be achieved, because any derivative contracts with non-benchmark tenors which are subject to the transparency regime but not the TO can have their pre-trade transparency requirements waived by CAs in accordance with Article 9(1)(c) of MiFIR by virtue of not being subject to the TO.

MFA would also like to take this opportunity to raise a point it has previously identified to ESMA regarding a CA's power to temporarily suspend the transparency obligation. Please see MFA response to Q84 of ESMA's consultation paper on MiFID II/MiFIR: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf.

MFA understands that ESMA lacks the authority under MiFIR to temporarily suspend the TO. However, MFA urges ESMA to discuss this point with the European Commission and



encourage the Commission to ensure that steps are taken to confer a similar power upon CAs to suspend the TO in order to avoid a situation where there is a temporary suspension of the transparency obligation, but not the TO.

MFA would like to reiterate that while it welcomes the alignment of the transparency regime and the TO, its primary concern is the cross-border harmonisation of the TO with the U.S. MAT regime. On this point, MFA understands that under Article 33 of MiFIR, ESMA can draft RTS designating a trading obligation in another jurisdiction as equivalent to the TO under MiFIR. Permitting a party to satisfy its obligations under MiFIR by complying with the laws of an equivalent regime is important for global consistency and to avoid the compliance challenges posed by conflicting or duplicative requirements.

MFA urges ESMA to exercise its discretion under this Article but remains concerned that this Article may not have its intended effect. In summary, Article 33 provides that where:

- (i) an implementing act on equivalence has been passed in relation to a non-EU jurisdiction; and
- (ii) at least one counterparty subject to an in-scope transaction is established in that non-EU jurisdiction,

then both counterparties will be deemed to have satisfied the TO where they comply with the rules of that non-EU jurisdiction.

A challenge may exist depending upon the meaning of “established” in subparagraph (ii). If such term is too narrowly construed then it would mean that where, for example, an alternative investment fund legally established outside of the U.S. but nonetheless subject to U.S. regulation, transacts with an EU counterparty, then as the fund is not technically “established” in the U.S., the EU counterparty will not be able to satisfy its obligations under MiFIR by complying with the U.S. MAT regime as neither party satisfies sub-paragraph (ii). MFA urges ESMA to interpret the term “established” less literally to ensure that EU counterparties are not required to comply with two mandatory trading regimes. Any other interpretation would defeat the legislative objective of Article 33 and increase compliance costs for European-based market participants.

<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>



MFA is encouraged to note that ESMA recognises the problematic nature of using TR data to assess market liquidity and agrees that, if ESMA relies on TR data to make its assessment, then such data will need to be cleaned. However, MFA does not support ESMA’s proposed approach to cleaning such data by only taking into account reports relating to the client-facing leg of cleared transactions for the purposes of assessing liquidity and omitting the clearing member-to-CCP leg (Option 2 as set out in the DP). MFA urges ESMA to reconsider this choice. Option 2 does not effectively assess the liquidity of a cleared derivative because it ignores the fact that clearing members can enter into “house” or proprietary trades on their own account. This will have the opposite effect of the intended outcome by purging too many trades from the TR data and therefore would result in a deflated view of market liquidity.

Given the issues with the cleaning of TR data, MFA would like to reiterate the importance of sourcing data directly from CCPs. In particular, a CCP’s records should be able to distinguish between clearing member-to-CCP transactions entered into for the purposes of a client cleared trade as opposed to proprietary/own account trades. MFA believes that CCPs will be able to provide ESMA with the most accurate information required for assessing the liquidity of cleared derivatives.

MFA is concerned by ESMA’s proposed approach described in paragraph 116 of the DP. MFA understands that there is trading activity on MTFs with regards to cleared IRS and CDS OTC derivative contracts. If the intent of the approach described in paragraph 116 is to exclude any such derivative contracts executed on MTFs from the dataset considered by ESMA for the purposes of the liquidity assessment, then this will not provide an accurate view of the liquidity of the products. Consequently, MFA would encourage ESMA to ensure that cleared IRS and CDS OTC derivative contracts executed on MTFs are not inadvertently excluded by ESMA’s proposed approach to gathering data described in paragraph 116 of the DP.

<ESMA_QUESTION_MIFID_TO_16>

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

<ESMA_QUESTION_MIFID_TO_17>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]



<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>

MFA is concerned by the assessment of liquidity which ESMA has carried out in relation to fixed-float IRS products. Under the CFTC MAT regime, spot-starting fixed-floating EUR, GBP, and USD IRS products with a tenor of 2, 3, 4, 5, 6, 7, 10, 15, 20 and 30 years have been deemed liquid. By stark contrast, under the TO ESMA is proposing that only GBP IRS with tenors of 5, 10 and 30 years are liquid.

Considering that the main market for GBP fixed-float IRS is located in the EU and it is a much deeper market than in the U.S., MFA finds it difficult to understand how the U.S. regime can deem these tenors to be liquid, and ESMA cannot. In addition to other concerns raised about the data used by ESMA, MFA is concerned that ESMA is not considering liquidity on a global basis. MFA considers that if a fixed-float IRS denominated in GBP with a tenor of 4 years is liquid enough to be subject to the U.S. MAT regime, then it should also be liquid enough to be subject to the TO under MiFIR. MFA therefore urges ESMA to reconsider its assessment of liquidity and carry out a review of global market liquidity by seeking data from both EU and non-EU trading venues.

MFA is keen to ensure cross-border harmonisation between the U.S. and EU regimes for the benefit of market participants that trade the same derivatives contracts in both jurisdictions. Accordingly, MFA is concerned that, as ESMA is not coming to the same conclusions as the CFTC when assessing the liquidity of the same products, then ESMA may be looking at incorrect or incomplete data and therefore, may be effectively using the wrong “yard stick” in its assessments. MFA encourages ESMA to consult with the CFTC and to reconcile discrepancies in assessments prior to finalising the TO.

<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>

[TYPE YOUR TEXT HERE]

<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>
[TYPE YOUR TEXT HERE]
<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>

MFA has previously suggested to ESMA that once the CO was in place for a certain class of derivatives, then there would be no need for a staggered phase-in of the TO for such class of derivatives. Please see MFA response to Q89 of ESMA's consultation paper on MiFIDII /MiFIR: https://www.managedfunds.org/wpcontent/uploads/2015/03/ESMA_CP1.pdf.

Instead, all counterparties subject to the CO for that class of derivatives should be subject to the TO at the same time in order to avoid a mismatch between some market participants being required to trade on-venue earlier than others. In spite of this, MFA is supportive of the proposed phase-in dates set out in the DP in Table 10 in the sense that they match the phase-in of the CO, thus ensuring that no derivative entered into by a market participant will



be subject to the TO prior to the mandatory clearing obligation applying to such market participant.

Although MFA supports ESMA's proposed earliest application dates in Table 10, MFA expects that certain market participants will disagree with these phase-in dates on the basis that smaller market participants will find it more difficult to adjust their internal systems on time and complete the on-boarding process at trading venues. However, the outcome of ESMA's recent consultation on the CO for financial counterparties with a limited volume of activity has resulted in ESMA proposing that the phase-in date for Category 3 entities subject to the CO is postponed by up to two years for IRS and CDS contracts declared subject to the CO. This additional delay will provide such counterparties further time to prepare for both the CO and the TO.

MFA wishes to point out that the CFTC's trade execution requirement for MAT swaps has been in effect since February 2014. A large number of market participants (including MFA members) will trade in-scope derivatives in the U.S. and the EU. Consequently, these market participants will already be subject to mandatory trading on-venue in the U.S. and so they have effectively had a "dress rehearsal" for the EU regime and therefore should have no difficulty in meeting the deadline for the TO. With regards to smaller market participants (*e.g.*, those falling within Category 3 or 4), MFA considers that the extended phase-in given to such participants, as set out in the DP (as likely amended given ESMA's apparent willingness to delay the CO for Category 3 entities), is more than sufficient. If ESMA permits a further phase-in for smaller market participants, the mismatch between counterparties required to trade on-venue and those that are not yet subject to the TO could affect the liquidity of certain derivative contracts and inhibit competition amongst market participants.

In spite of the views expressed above, if ESMA chooses to delay the TO, MFA encourages ESMA to have the same start date for the TO for both Category 1 and Category 2 entities. Such a start date could be six months (but no later than nine months) following 3 January 2018.

<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>

[TYPE YOUR TEXT HERE]

<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>
[TYPE YOUR TEXT HERE]
<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>

MFA has previously requested that ESMA should consider package transactions separately from outright transactions. While certain types of package transactions are very standardised and liquid, and thus may be appropriate for inclusion within the scope of the trading obligation, others are not, even where they include one or more instruments that when executed on a stand-alone or outright basis may individually be liquid enough to be subject to the trading obligation. Please see MFA response to Q89 of ESMA’s consultation paper on MiFID II/MiFIR: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf.

To facilitate ESMA’s consideration of package transactions in the interest rate asset class, MFA provides below a non-exclusive list of examples of package transactions in that class:

- Swap Curves: packages of two swaps of differing tenors;
- Swap Butterflies: packages of three swaps of differing tenors;
- Swap Spreads: U.S. or non-U.S. government securities versus swaps typically with similar tenors;
- MBS Basis: TBAs (Agency MBS) versus swaps;
- Invoice Spreads: Treasury-note or Treasury-bond futures versus swaps;
- Cash/Futures Basis: Eurodollar futures bundles versus swaps;
- Delta-Neutral Option Packages: caps, floors, or swaptions versus swaps; and
- Unwind (or offset) Packages: Replacing legacy swaps with new swap instruments with an equivalent risk profile.

The components or legs of a package transaction are priced or quoted together as a single economic transaction. For certain more common package transactions, there are liquid markets and existing on-screen/electronic trading capabilities. Markets for other package transactions that are either customized or involve non-benchmark products are more bespoke in nature and thus less liquid.

By allowing market participants simultaneously to price and execute multiple instruments of a single overall economic transaction, package transactions improve pricing and decrease transaction costs for the following reasons:

- A single package transaction will have a significantly tighter bid-offer spread than each stand-alone instrument, reflecting the fact that the package transaction has significantly lower market risk than an outright swap transaction.
- Separately executing each stand-alone instrument (within a package) would require paying the bid-offer on each leg as though they are each outright transactions, resulting in a cumulative bid-offer that is a multiple of the bid-offer of a package transaction.
- There is more efficient risk transfer and hedging, because a market participant exchanges the net risk of the package with a single counterparty, rather than the outright risk on each instrument within the package with different counterparties.
- There is no “legging risk”, which refers to the risk that the market moves between the time the first instrument is executed and the time any subsequent instrument of a transaction is executed.

In particular, it is important to note that package transactions do not represent the “tying” or “bundling” of different products in a way that obfuscates the pricing of each. Rather, they are distinct products in their own right. While correlated to their component instruments, package transactions are more efficient mechanisms of risk-transfer, with resulting advantageous pricing.

Based on their demonstrated market utility, package transactions play a meaningful role in ensuring an efficient, deep and liquid market for IRS and credit products. Ensuring that market pricing of IRS products is efficient (versus inefficient or even distorted) provides a necessarily sound and fundamental basis that is crucial for sovereign and corporate bond issuance as well as the wide variety of consumer credit products that are linked to interest rates.

MFA is generally supportive of trading of package transactions on-venue, but ESMA must ensure that trading venues and other market participants develop the necessary infrastructure to process package transactions as a whole on-venue. MFA encourages ESMA to consult with the CFTC to develop a coordinated phase-in of the TO as applied to various types of package transactions, beginning with benchmark swap spreads as well as swap curves and swap butterflies that include instruments that are subject to the TO, followed by a progressive, data-driven, phased expansion to cover additional types of package transactions, as



well as those that include component instruments that are both in-scope and out-of-scope of the TO.

To assist ESMA in its consideration of a proper phase-in, MFA would like to bring to the attention of ESMA the continuing CFTC no-action relief for certain types of package transactions.

CFTC staff responded to industry concerns by issuing a series of no-action letters starting in February 2014 that provided relief from mandatory trading of certain swaps executed as part of package transactions. The no-action relief period has been extended repeatedly for certain categories of package transactions to provide CFTC staff with time to analyse further the technological, operational, and jurisdictional issues for mandatory trading of package transactions, including the appropriate grouping of such transactions for a phased implementation approach to the CFTC's trade execution requirement.

Under the CFTC's phased implementation approach, the most liquid and standardized types of package transactions, such as swap curves and butterflies that are comprised exclusively of benchmark swaps, are now subject to the trade execution requirement. More complicated types of package transactions, even where some components are not yet MAT or clearable, continue to be subject to extended no-action relief from CFTC staff in order to phase-in the trade execution requirement for MAT swaps executed as part of such package transactions. More specifically, the categories of package transactions for which extended no-action relief applies until 15 November 2017 are those in which at least one individual swap component is MAT and therefore subject to the CFTC's trade execution requirement; and one of the following applies:

- (1) at least one individual component is a bond issued and sold in the primary market (MAT/New Issuance Bond Package Transactions);
- (2) all other components are contracts for the purchase or sale of a commodity for future delivery, *i.e.*, futures contracts (MAT/Futures Package Transactions);
- (3) at least one individual swap component is subject to the CFTC's exclusive jurisdiction, but not subject to the clearing requirement under the U.S. Commodity Exchange Act section 2(h)(1)(A) and § 50.4 of the CFTC's regulations (MAT/Non-MAT Uncleared Package Transactions);
- (4) at least one individual component is not a swap (MAT/Non-Swap Instruments Package Transactions)—this category specifically excludes U.S. Dollar Swap Spreads; MAT/Futures Package Transactions, MAT/Agency MBS Package Transactions; and MAT/New Issuance Bond Package Transactions; or



(5) at least one individual swap component is a swap over which the Commission does not have exclusive jurisdiction (MAT/Non-CFTC Swap Package Transactions).

The purpose of this most recent extended no-action relief is two-fold: (i) to enable market participants to continue to execute certain package transactions; and (ii) to enable the CFTC staff to consider potential permanent solutions for these categories of package transactions.

MFA believes that the real lesson learned from the U.S. implementation experience under the CFTC MAT regime is that the liquidity criteria for on-venue trading of any package transaction should be applied at the product or transaction level (*i.e.*, for the package as a whole), rather than basing liquidity assessments at the instrument level for an individual component derivatives leg that meets the liquidity criteria.

MFA was encouraged to see that, in its recent consultation on package orders subject to the transparency regime, ESMA acknowledged the need to assess whether there is a liquid market for the package order as a whole. MFA encourages ESMA to adopt a similar liquidity assessment of a package transaction as a whole for the purpose of the TO.

MFA would like to respectfully remind ESMA that Article 32 of MiFIR envisages ESMA, where appropriate, consulting with third-country competent authorities before submitting draft RTS in relation to the TO. MFA recommends that ESMA use this opportunity to consult with the CFTC to resolve any foreseeable impediments to the trading of package transactions on-venue before the implementation of the TO.

<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>

Please see MFA's response to Q33 above.

<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>

Please see MFA's response to Q33 above.

<ESMA_QUESTION_MIFID_TO_35>