ICI Global's Responses to ESMA's Consultation Paper on Implementing Regulations for MiFID II/MiFIR

Introductory Comments

ICI Global[1] appreciates the opportunity to provide comments on the Consultation Paper issued by the European Securities and Markets Authority ("ESMA") on draft regulatory technical standards and implementing technical standards for the implementation of the revised Markets in Financial Instruments Directive ("MiFID II") and Regulation ("MiFIR"), particularly as they relate to the fixed income and derivatives markets. Our members include regulated funds in jurisdictions around the world (collectively, "Regulated Funds").[2] To employ these non-equity instruments in the best interests of Regulated Fund investors, our members have a strong interest in ensuring that these markets are highly competitive and efficient.

ICI Global members generally support the goal of providing greater oversight of the fixed income and derivatives markets. In this regard, ICI Global appreciates the opportunity to provide input to ESMA on its deliberations, which will have a major impact on the capital markets and their participants, including Regulated Funds and their investors. We understand that ESMA believes it would be most helpful for market participants to respond to the specific questions that are posed in the Consultation Paper rather than to submit a narrative comment letter. We provide below our answers to certain of those questions. In addition, we believe the following overarching principles should guide ESMA in developing its rules:

- First, we strongly believe that a one-size-fits all approach to reform of the financial markets does not work. The fixed income and derivatives markets are vastly different from the equity markets, and the regulatory approaches that have worked well in the equity markets may not be appropriate in these other markets. In fact, imposing features of the equity markets on the fixed

[1] The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.2 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment [1]funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] For purposes of this letter, the term "Regulated Fund" refers to any fund that is organized or formed under the laws of a nation, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. Generally, such funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (e.g., leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). Examples of such funds include: US investment companies regulated under the Investment Company Act of 1940 ("Investment Company Act"); "Undertakings for Collective Investment in Transferable Securities," or UCITS, in the European Union; Canadian mutual funds; and Japanese investment trusts.

income and derivatives markets without fully analyzing their potential impact may cause significant damage to the liquidity and efficiency of these markets.

- Second, we urge ESMA to adopt a regulatory approach that is flexible and able to adapt to changing conditions. In particular, we are concerned about classifying certain instruments as "liquid" based on what may be limited (and perhaps questionable) data that is specific to a particular point of time and can only be amended through a lengthy legislative process.

- Third, given the global nature of the financial markets, we urge the EU regulators to coordinate with international regulators to develop a global approach – with coordinated outcomes – for regulating the markets. Only a global approach will avoid fragmentation and prevent the opportunity for regulatory arbitrage.

Q57. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer for SFPs and for each of type of bonds identified (European Sovereign Bonds, Non-European Sovereign Bonds, Other European Public Bonds, Financial Convertible Bonds, Non-Financial Convertible Bonds, Covered Bonds, Senior Corporate Bonds-Financial, Senior Corporate Bonds Non-Financial, Subordinated Corporate Bonds-Financial, Subordinated Corporate Bonds Non-Financial) addressing the following points:

1. **Would you use different qualitative criteria to define the sub-classes with respect to those selected (i.e. bond type, debt seniority, issuer sub-type and issuance size)?**
2. **Would you use different parameters (different from average number of trades per day, average nominal amount per day and number of days traded) or the same parameters but different thresholds in order to define a bond or a SFP as liquid?**
3. **Would you define classes declared as liquid in ESMA's proposal as illiquid (or viceversa)? Please provide reasons for your answer.**

ICI Global is concerned about the potential impact on investors arising from the proposed definition of a liquid market in the context of fixed income instruments. Applying full transparency requirements to genuinely illiquid bonds could result in a number of negative consequences for investors, particularly if disclosing prices of such bonds to the public results in fewer brokers willing to make prices. In addition, where prices are made public, firms running predatory-like strategies end up profiting at the expense of the investor in these bonds. Both of these scenarios could translate into higher costs for investors and increased market volatility. As such, we have several recommendations discussed below to alleviate the potential negative impact on investors.

Under the proposals set out in the Consultation Paper, ESMA would treat as liquid bonds that trade on at least 200 days a year, record at least 400 trades a year and in relation to which €100,000 of nominal is traded per day. ICI Global considers that in order to be treated as liquid, instruments should be traded at least every day. ESMA's current test would ignore uneven distributions of trading over time; in particular, throughout the year there may be certain higher periods of liquidity, and other periods where there is very little trading activity. It would be counterproductive to apply full transparency to transactions in bonds during periods of low liquidity given the likely increase to the

cost of hedging or offsetting transactions resulting from the absence of any post-trade transparency deferral period. This could simply serve to drive further liquidity from the market. Although ESMA indicates that the large in scale and size specific to the instrument ("SSTI") deferral periods will mitigate the risk of mischaracterising transactions as liquid, this would only be true for transactions meeting the large in scale and SSTI thresholds (and, for SSTI transactions, meeting the additional condition of one of the counterparties trading on its own account).

This result should preferably be avoided by setting a higher threshold to liquidity for bonds (i.e. requiring that instruments be traded each day in order to be considered liquid), and/or putting in place a shorter calibration period (e.g. calibration of the liquidity assessment every month rather than once every twelve months).

ICI Global would agree that issuance size does have a substantial bearing on liquidity in the bond markets. However, we note ESMA's statement that its methodology, which is based on issuance size, is able to classify correctly (as liquid or illiquid) "85% to 99.7%[7] of instruments, depending on the given class." ICI Global submits that the potential for 15% of instruments to be incorrectly categorised as liquid for the purposes of transparency could be very problematic in preserving current levels of trading in the fixed income markets. Categorising liquid instruments as illiquid would deny them the post-trade transparency deferral period contemplated in the Level 1 text of MiFIR, which is vital in allowing for effectively offsetting risk. We would note in this context that the need to foster liquidity in the corporate bond markets is an issue which has recently been highlighted during discussions on the proposed EU Capital Markets Union.

We would therefore suggest that in "borderline" cases where there is some uncertainty about the result of the liquidity test, ESMA takes a cautious approach and treats the relevant instruments as illiquid. We note that a less granular approach to applying the liquidity thresholds proposed by ESMA, involving fewer classes and correspondingly higher issuance sizes, would in fact be preferable to the test as currently applied given that it would minimise the number of less frequently traded instruments categorised as liquid.

Finally, please see below our response to Q.61, which recommends that the draft RTS should simply include a framework for assessing liquidity rather than incorporating the tables which are currently set out in Annex III of RTS 9, and which could instead be published on ESMA's website or in some other publicly accessible place. This would provide a flexible framework for assessing liquidity determinations and thresholds for large in scale and SSTI transactions without needing to go through the time-consuming process of passing new regulatory technical standards to change those determinations and thresholds.

Q58. Do you agree with the definitions of the bond classes provided in ESMA's proposal (please refer to Annex III of RTS 9)? Please provide reasons for your answer.

ICI Global disagrees with this approach for the reasons stated in our response to Q.57.

Q61. Do you agree with ESMA's proposal for the definition of a liquid market? Please provide an answer for each of the asset classes identified (FRA, Swaptions, Fixed-to-Fixed single currency swaps, Fixed-to-Float single currency swaps, Float -to- Float single currency swaps, OIS single currency swaps, Inflation single currency swaps, Fixed-to-Fixed multi-currency swaps, Fixed-to-Float multi-currency swaps, Float -to- Float multi-currency swaps, OIS multi-currency swaps, bond options, bond futures, interest rate options, interest rate futures) addressing the following points:

1. **Would you use different criteria to define the sub-classes (e.g. currency, tenor, etc.)?**
2. **Would you use different parameters (among those provided by Level 1, i.e. the average frequency and size of transactions, the number and type of market participants, the average size of spreads, where available) or the same parameters but different thresholds in order to define a sub-class as liquid (state also your preference for option 1 vs. option 2, i.e. application of the tenor criteria as a range as in ESMA's preferred option or taking into account broken dates. In the latter case please also provide suggestions regarding what should be set as the non-broken dates)?**
3. **Would you define classes declared as liquid in ESMA's proposal as illiquid (or vice versa)? Please provide reasons for your answer.**

ESMA's approach to assessing liquidity

As noted in ICI Global's response to the ESMA Discussion Paper, the COFIA approach is likely to be simpler to apply in practice than ESMA's alternative IBIA approach. This appears to be borne out by the tables set out in Annex III of RTS 9, which allow for a straightforward assessment of which sub-classes of instrument are liquid or illiquid and the large in scale and size specific to the instrument ("SSTI") thresholds. Because the tables of asset or sub-asset classes (assessed under the liquidity criteria), rather than the liquidity criteria, are built into the RTS, altering the characterisation of a sub-class of derivatives as either liquid or illiquid or the large in scale or SSTI thresholds would require adopting a new RTS. Drafting and implementing another RTS would be a time-consuming process given scrutiny periods built into the passage of EU legislation.

We, therefore, recommend that the draft RTS include the framework (criteria) for assessing liquidity rather than the results of those assessments (tables) in Annex III of RTS 9. We believe the asset or sub-asset classes should be reassessed based on these criteria on a yearly basis. The updated tables of assets or sub-asset classes then should be published separately (e.g., on ESMA's website). This approach will allow for a more accurate characterisation of instruments as "liquid" or "illiquid" and calibrations of large in scale and SSTI thresholds based on periodic assessments without the need for new or amended RTS. ESMA also should ensure that it has in place an effective strategy for monitoring the ongoing liquidity of instruments so that it can consider changing their liquidity profile for the purposes of transparency as soon as possible where there are indications that it is likely to change.

Finally, we note that under draft RTS 9, ESMA is proposing to treat as illiquid "derivatives subject to the clearing obligation but for which ESMA has determined that they shall not be subject to the trading obligation." This contrasts with the wording of Article 9(1)(c) of MiFIR, which simply provides for a

pre-trade transparency waiver for "derivatives which are not subject to the trading obligation specified in Article 28." In particular, the caveat relating to the clearing obligation is not present in the Level 1 text. Moreover, the Level 1 text does not require a determination to have been made by ESMA regarding the trading obligation. We do not believe it is necessary for ESMA to limit the scope of the waiver in this manner and nor is there a clear mandate for it to do so.

Treatment of interest rate derivatives

In the Consultation Paper, ESMA used two different approaches to assess liquidity for different classes of interest rate derivatives depending on whether the data came from trading venues or from trade repositories. ESMA included the results of the two different analyses in Annex III of draft RTS 9. Although we understand that ESMA used two sets of data because there were certain data quality issues on the trade repository side, we are concerned that the Consultation Paper does not fully explain the differing methodologies and how the different methodologies were developed. For example, ESMA does not explain the rationale for the different thresholds (the average number of trades per day and average notional amount per day) that are applied to the various sub-classes.

Moreover, although it is appropriate that a generally higher threshold to liquidity should be applied in relation to the trade repository data given the types of products covered by this data set (many of which will at present be traded "OTC" according to the EMIR definition of "OTC derivatives"), the tests applied by ESMA would not ensure that derivatives classified as "liquid" were traded at least every day. For example, one of the liquidity thresholds applied to trading venue data was the requirement for an average of one trade per day, while an initial threshold of "number of days traded greater than or equal to 80% of the available trading days in the period" was applied to the trade repository data. Neither of these tests would ensure that instruments were being traded each day; in particular, the "average of one trade per day" test applying to trading venue data would ignore factors such as seasonality (e.g., the possibility that trading may be concentrated around certain times of the year with little liquidity during other periods). In our view, an instrument should be trading at least every day to be considered liquid.

Q70. Do you agree with ESMA's proposal with regard to the content of pre-trade transparency? Please provide reasons for your answer.

As a general comment, ICI Global supports ESMA's efforts to adapt pre-trade transparency requirements to the type of trading system through which transactions are executed. In particular, it is vital that pre-trade transparency requirements are tailored appropriately to request-for-quote ("RFQ") systems and voice trading systems because public disclosure of responses to a Regulated Fund's request for a quote (in an RFQ system) and bids and offers of any members of a trading venue (in a voice trading system) can raise significant issues, including frontrunning and information leakage.

We note that there is still continuing uncertainty surrounding how pre-trade transparency requirements are likely to function in a voice traded environment. We believe that the market would benefit from guidance from ESMA on this issue, drafted in consultation with trading venue operators.

With respect to the way in which ESMA has defined different types of trading systems to set the scope of pre-trade transparency requirements, the definition of voice trading system is in our view generally positive. The definition is broad enough to cover a range of platforms involving voice negotiation (including, for example, those systems where orders are first routed to a broker by telephone, even if execution may later take place via electronic means). We also consider that instant messaging may perform a very similar role to traditional telephone conversations (i.e., where market participants are interacting with brokers). We request that additional guidance (e.g., by way of Recital to the draft RTS) to the definition be provided to make clear that instant messaging may be equivalent to traditional "voice" trading.

ICI Global also supports the wording that now appears in the definition of an RFQ system to the effect that quotes in response to a request must be "executable exclusively by the requesting member or market participant." In our view, a defining feature of an RFQ system is that the requesting participant is the only counterparty able to execute the quote. In addition, the requesting participant would usually be the only counterparty to which the quote is disclosed and disseminating the quote to the market as a whole under pre-trade transparency requirements would fundamentally alter the current features of RFQ systems.

ICI Global, therefore, suggests ESMA amend the proposed definition of an RFQ system to preserve the current features of RFQ execution platforms. We recommend wording along the lines of the definition originally proposed in the ESMA Discussion Paper:

> *a trading system where a quote or quotes are only provided to a member or participant in response to a request submitted by one or more other members or participants, and are executable only by the requesting member or participant. The requesting member or participant may conclude a transaction by accepting the quote or quotes provided to it on request.*

In addition, dealers should be permitted to quote on an indicative basis with the quote being treated as "non-actionable" so that it would not be required to be disseminated to the market generally under pre-trade transparency requirements. The market may benefit from guidance on exactly when quotes given in an RFQ environment will be considered to fall within the category of "non-actionable" indications of interest.

Moreover, ICI Global is extremely concerned by the proposed requirement for RFQ systems to publish pre-trade transparency data on "the bids and offers and attaching volumes submitted by each responding entity." Requiring such a granular level of data to be published could have a highly negative impact on market liquidity and pricing in the fixed income markets given that it could reveal a significant amount of information about individual trading strategies and individual transactions.

We note in this respect that similarly granular pre-trade transparency information would not be required to be published by other types of trading system. For example, for central limit order book

systems, ESMA has proposed only that "the aggregate number of orders and the volumes they represent at each price level, for at least the five best bid and offer price levels" need be made public while for general quote-driven trading systems, "the best bid and offer by price of each market maker" in each instrument would need to be made public, together with "the volumes attaching to those prices." It is clear that the pre-trade transparency data to be published in relation to RFQ systems will be far more granular in nature and that individual bids and offers will be immediately apparent to the market based on ESMA's current proposal. This could lead to other market participants "trading against" the pre-trade data, which will increase the costs of offsetting transactions for dealers operating in RFQ markets and ultimately drive up costs for the buy side, including Regulated Funds. The proposed pre-transparency requirement would put RFQ systems at a significant disadvantage compared to other types of trading systems and risk liquidity moving to other types of trading systems that may not otherwise be most appropriate to achieve best execution.

For fixed income instruments in particular, ICI Global believes that the negative outcomes attaching to pre-trade transparency in an RFQ environment could be substantially mitigated by publishing a composite average of responses in an RFQ system rather than individual bids and offers. We are of the view that this alternative is consistent with Level 1 of MiFIR because publishing an average would provide an adequate indication of "current bid and offer prices and the depth of trading interests at those prices," as required under Article 8(1) of MiFIR. Pre-trade transparency data is intended to provide a reliable indicator of supply and demand (i.e., bid and ask data) rather than being a means of disclosing to the market details of individual transactions that are taking place or are likely to take place.

Q75. Do you agree with ESMA's proposal? Please specify in your answer if you agree with:
(1) a 3-year initial implementation period
(2) a maximum delay of 15 minutes during this period
(3) a maximum delay of 5 minutes thereafter. Please provide reasons for your answer.

As long as the post-trade transparency deferral regime is set appropriately and calibrated in accordance with our responses to Q57 and Q77, we consider ESMA's focus on the efficient dissemination of transparency data by trading venues to be a positive feature of the proposed framework. However, although an initial maximum delay set at fifteen minutes is appropriate and would harmonise the EU regime with comparable requirements in the United States, we question whether ESMA needs to legislate for a shorter five-minute delay following the proposed implementation period at this point in time. It should be borne in mind that post-trade transparency requirements will apply to more traditional trading systems (e.g., voice systems) which may take some time to achieve a workable solution to the electronic publication of post-trade data.

Thus, while ICI Global supports a move towards more efficient dissemination of transparency data, we suggest that a more flexible approach to achieving this aim would be to monitor on an ongoing basis that trading venues are taking all necessary measures to comply with their obligation to publish post-trade transparency data "as close to real time as technically possible." At the end of the three year period proposed in the Consultation Paper, ESMA could then review whether a mandated move to a five-minute maximum delay is warranted and achievable across all trading venues.

Q77. Do you agree with ESMA's proposal for bonds and SFPs? Please specify, for each type of bonds identified, if you agree on the following points, providing reasons for your answer and if you disagree providing ESMA with your alternative proposal:

> **(1) deferral period set to 48 hours**
> **(2) size specific to the instrument threshold set as 50% of the large in scale threshold**
> **(3) volume measure used to set the large in scale threshold as specified in Annex II, Table 3 of draft RTS 9**
> **(4) pre-trade and post-trade thresholds set at the same size**
> **(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1) provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2) provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed.**

Although ICI Global welcomes ESMA's decision to tailor its liquidity and large in scale assessments to the individual features of different instruments, we consider that bonds and derivatives should be distinguished for the purposes of deferral periods. While 48 hours is an acceptable deferral period for the majority of derivatives, bonds as an asset class are considerably less liquid (we note, for example, ESMA's comment in the Consultation Paper that around half of the bonds it analysed over the year-long look back period did not trade at all). In addition, we note that 48 hours is the maximum permitted period, so certain EU Member States could conceivably choose to set the deferral period lower, resulting in a lack of harmonisation. Rather, ESMA should put in place a harmonised EU-wide deferral period.

ICI Global therefore considers that bonds should have the benefit of longer deferral period, particularly given that there can be a substantial decrease in liquidity between average sized transactions and large in scale transactions. Many transactions can take a month or considerably longer to unwind. Therefore, we would propose setting a deferral period of four weeks during which volume data would be masked. Another way in which ESMA should consider distinguishing between bonds and derivatives is in relation to its decision to set pre- and post-trade transparency thresholds at the same size. While this approach is helpful in simplifying the transparency regime applying to derivatives, in relation to which efficiency in applying the transparency regime is more of a concern given their higher levels of liquidity, we would suggest that pre-trade transparency thresholds for fixed income instruments be considered separately from post-trade transparency thresholds. In particular, we consider that ESMA should focus on ensuring that the SSTI pre-trade transparency waiver applying to voice and RFQ systems functions effectively in relation to fixed income instruments. Given the proposal that RFQ systems publish very specific pre-trade transparency information ("the bids and offers and attaching volumes submitted by each responding entity"), there is a significant concern that an ineffective pre-trade transparency regime could cause predatory firms to exploit transparency data by trading against dealers in RFQ systems, resulting in widened spreads and ultimately in higher costs for end investors. We would suggest in

particular that ESMA lower the SSTI pre-trade transparency waiver threshold from its current level for fixed income instruments, in order to fulfil MiFID II's mandate of protecting liquidity providers (such as the dealers in RFQ systems) from undue risk. In addition, the SSTI waiver threshold should reflect the average retail transaction size for bonds, which is much smaller than the wholesale size (we note in this respect the wording of Article 9(1)(b), which specifically refers to retail investors).

Although, as noted above, we would prefer to see a less granular approach being taken to applying the issuance size-based liquidity test, we note that the same large in scale and SSTI thresholds have been set across very broad asset classes (as they appear in Annex III of RTS 9). For example, ESMA has distinguished only between "European Sovereign Bonds" and "Non-European Sovereign Bonds", and between corporate bonds based only on whether they are senior or subordinated, and whether they have been issued by financial or non-financial entities. Applying the same thresholds across such a broad range of instruments may result in the thresholds being set too high for certain instruments and too low for others.

Please see also our comments in relation to Q.78, where we argue that:

- a "coverage ratio" approach should not be used to set large in scale thresholds;
- use of the SSTI deferral mechanism should not be restricted to entities dealing on own account other than in matched principal trading situations; and
- our preference is for Option 2, which would ensure a yearly recalculation of large in scale thresholds, rather than Option 1.

Q78. Do you agree with ESMA's proposal for interest rate derivatives? Please specify, for each sub-class (FRA, Swaptions, Fixed-to-Fixed single currency swaps, Fixed-to-Float single currency swaps, Float -to- Float single currency swaps, OIS single currency swaps, Inflation single currency swaps, Fixed-to-Fixed multi-currency swaps, Fixed-to-Float multi-currency swaps, Float -to- Float multi-currency swaps, OIS multi-currency swaps, bond options, bond futures, interest rate options, interest rate futures) if you agree on the following points providing reasons for your answer and, if you disagree, providing ESMA with your alternative proposal:

(1) deferral period set to 48 hours

(2) size specific to the instrument threshold set as 50% of the large in scale threshold

(3) volume measure used to set the large in scale and size specific to the instrument threshold as specified in Annex II, Table 3 of draft RTS 9

(4) pre-trade and post-trade thresholds set at the same size

(5) large in scale thresholds: (a) state your preference for the system to set the thresholds (i.e. annual recalculation of the thresholds vs. no recalculation of the thresholds) (b) in the case of a preference for a system with no recalculation (i.e. option 1), provide feedback on the thresholds determined. In the case of a preference for a system with recalculation (i.e. option 2), provide feedback on the thresholds determined for 2017 and on the methodology to recalculate the thresholds from 2018 onwards including the level of granularity of the classes on which the recalculations will be performed (c) irrespective of your preference for option 1 or 2 and, with particular reference to OTC traded interest

rates derivatives, provide feedback on the granularity of the tenor buckets defined. In other words, would you use a different level of granularity for maturities shorter than 1 year with respect to those set which are: 1 day- 1.5 months, 1.5-3 months, 3-6 months, 6 months – 1 year? Would you group maturities longer than 1 year into buckets (e.g. 1-2 years, 2-5 years, 5-10 years, 10-30 years and above 30 years)?

Large in scale thresholds

The Consultation Paper does not provide much detail on how the large in scale thresholds have been set. It appears, however, that under Option 1 the intention is for the large in scale threshold to be the greater of: (i) a pre-determined floor based on expert judgement; and (ii) a threshold meeting the policy objective of capturing at least 90% of trades below the large in scale threshold. The same threshold would apply under Option 2, albeit only for the first year, after which the thresholds would be re-calculated according to the three steps outlined on page 229 of the Consultation Paper.

ICI Global is concerned that a "coverage ratio" approach to defining large in scale thresholds would always result in a certain percentage of transactions being subject to full transparency requirements (at least where they fall within a sub-class of instruments classified as "liquid") regardless of whether this level is appropriate based on empirical analysis. ICI Global recommends deleting the second part of Option 1 and providing for a threshold "based on expert judgement." If the requirement for at least 90% of trades to fall below the large in scale threshold, however, is retained, we urge ESMA to adopt an initial phase-in period during which the threshold is set lower. A phased-in implementation would help to avoid suddenly moving a significant amount of trades into full transparency. A sudden movement could otherwise cause potential difficulties for market participants seeking to adjust their trading and hedging practices to the new transparency regime. A phase-in also would be in line with the approach taken by the Commodity Futures Trading Commission ("CFTC") in implementing "block trade" sizes (where an initial block size of 50% of total notional was implemented prior to the introduction of the higher threshold of 67%). We recommend a requirement that would result in 50% of trades to fall below the large in scale threshold during the initial phase-in period.

In addition, ICI Global considers Option 2, which would ensure a yearly recalculation of thresholds, to be preferable to Option 1. In our view, it is essential that the transparency regime keeps pace with changing market conditions. Classes of instruments should not be subject to full transparency requirements on the basis of outdated information.

Size specific to the instrument thresholds

ICI Global acknowledges that setting the SSTI thresholds as a percentage of the large in scale thresholds will provide for simple implementation by the trading venues and market participants. Because ESMA does not explain the rationale for setting the SSTI threshold at 50% of the large in scale threshold across all instruments, it is difficult to assess whether ESMA has proposed an appropriate level.

We also note that the Consultation Paper includes a new proposal for the SSTI waiver/deferral regime to be "restricted to market participants trading on own account other than matched principal." ESMA has not provided any reason for this proposal, which did not appear in the previous Discussion Paper. We acknowledge that the SSTI waiver is intended to be set at a level above which liquidity providers would be subject to undue risk and that liquidity providers do generally deal on own account. However, this proposed condition for the SSTI waiver/deferral is not a feature of the Level 1 text (which in fact refers to other "relevant market participants" who may be "retail or wholesale investors"). We recommend ESMA remove this condition.

Q84. Do you agree with ESMA's proposal with regard to the temporary suspension of transparency requirements? Please provide feedback on the following points:

(1) the measure used to calculate the volume as specified in Annex II, Table 3

(2) the methodology as to assess a drop in liquidity

(3) the percentages determined for liquid and illiquid instruments to assess the drop in liquidity. Please provide reasons for your answer.

ICI Global supports ESMA's proposal to apply a simpler test to the suspension of transparency requirements (i.e., based solely on quantitative criteria) than what was originally proposed in the Discussion Paper (based on qualitative arguments as well as quantitative criteria). In our view, national competent authorities should have the power to implement emergency suspensions to transparency requirements quickly and efficiently in circumstances where transparency has become damaging to trading conditions (e.g., following a sudden drop in liquidity). The inclusion of a requirement for the submission of detailed qualitative arguments could have interfered with this ability.

ICI Global notes, however, that national competent authorities have no equivalent "emergency" power to temporarily suspend the derivatives trading obligation. Suspending transparency requirements without also suspending the trading obligation could, as noted in our response to ESMA's previous Discussion Paper, leave market participants in the difficult position of being forced to trade through trading venues on the basis of little or no market data. We recognize that ESMA does not have a clear mandate to address this point as part of Level 2. In our view, it is vital that the issue be addressed by EU regulators prior to the introduction of the trading obligation.

Q88. Are there any other criteria that ESMA should take into account when assessing whether there are sufficient third-party buying and selling interest in the class of derivatives or subset so that such a class of derivatives is considered sufficiently liquid to trade only on venues?

General approach

ICI Global welcomes the flexible approach taken by ESMA in the Consultation Paper with respect to the factors that it proposes to take into account when assessing whether there is sufficient third-party

buying and selling interest in a class of derivatives or subset of any such class such that it is sufficiently liquid to be made subject to the trading obligation under Article 28 of MiFIR.

In particular, ICI Global supports ESMA's statement in paragraph 27 of the Consultation Paper that any application of the liquidity test to a specific class of derivatives or a subset of any such class should be appropriate to the specific characteristics of such class or sub-class. Therefore, ESMA intends to assess which specific liquidity factors are relevant on a case-by-case basis and to apply the liquidity factors based on different weightings as relevant to the particular class or sub-class of derivative.

In our view, Recitals (2) to (4) of the draft RTS addressing the liquidity factors ("RTS 11") accurately describe the difficulties associated with a rigid imposition of the liquidity factors on each class or sub-class of derivatives, which would not take into account the particular features of that class or sub-class. We believe that the potentially wide range of products that may be evaluated for the trading obligation and the constantly evolving derivatives markets necessitate a flexible approach in applying the liquidity factors.

ICI Global also supports the thoughtful approach that ESMA has taken with respect to aligning the criteria for determining whether there is a "liquid market" under MiFIR's transparency regime with the criteria for considering whether an instrument is "sufficiently liquid" to be subject to the trading obligation. We support ESMA's determination that the thresholds should not necessarily be the same for both regimes (an approach we had recommended in response to the Discussion Paper), given the different consequences that follow from a class of derivatives being considered "liquid" in each context. In addition, we wanted to reiterate the comment that we made previously in the Discussion Paper that it should never be the case that the trading obligation is imposed on a class of derivatives that is not also subject to transparency requirements because such a situation would give rise to numerous difficulties to market participants that would be required to comply with the trading obligation in the absence of reliable market data. Accordingly, we note that it would be appropriate for higher thresholds to apply to liquidity assessments made in connection with the trading obligation.
We offer the following comments on the liquidity factors contained in RTS 11:

Average size of trades

ICI Global agrees with ESMA's suggestion with respect to the average size of trades liquidity factor. ESMA will consider (i) the notional size divided by the number of trading days over a specified period; and (ii) the notional size divided by the number of trades, but the approach described in (i) is ESMA's preferred approach. As noted in our response to ESMA's previous Discussion Paper, a methodology that focuses solely on the calculation described in (ii) might ignore uneven distributions of transactions over time. However, it is nonetheless important to give some consideration to such calculation because this figure will give a more accurate assessment of the average size of each transaction executed during the relevant period. We support ESMA's intention to preserve flexibility when applying the liquidity factors.

In this regard, we note that if the application of the average size of trades factor to a particular class of derivatives indicates that liquidity is concentrated in transactions below a certain size, then transactions exceeding such size should not be regarded as sufficiently liquid to be subject to MiFIR's trading obligation. Subjecting large in scale transactions to the trading obligation may result in these transactions receiving a lower quality of execution. As noted in paragraph 23 of the Consultation Paper, the CFTC has addressed this issue by specifying block sizes above which trades can be executed off venue. As discussed in our response to the Discussion Paper, ESMA should use its power to determine whether a class of derivatives is only liquid for transactions below a certain size pursuant to Article 32 of MiFIR to exclude large in scale transactions from the scope of the trading obligation.

Average frequency of trades

ICI Global supports ESMA's suggested approach for the average frequency of trades liquidity factor under which ESMA will set thresholds for both a minimum number of trades over a specified period of time and a minimum number of days on which trading took place over a specified period of time. We note that ESMA has stated in paragraph 29 of the Consultation Paper that the intention is to provide for flexibility in RTS 11 so that alternative approaches for calculating this factor may be taken into account, including, for example, the number of trades per day and the nominal size per day.

We agree with ESMA that it is necessary to preserve such flexibility. In particular, we consider that the number of trades per day is an important element in determining whether a class of derivatives is sufficiently liquid. ICI Global believes that an instrument must be trading a minimum number of times per day and every day to be considered liquid. As noted in our response to the Discussion Paper, under the current MiFID regime, a share is only classified as liquid if it is traded daily.
In this regard, we suggest that an amendment be made to the opening sentence of RTS 11 to clarify that the criteria set out at Article 2 do not constitute an exhaustive list of the factors that ESMA will take into account when assessing this factor. We suggest the following wording for this purpose:
In relation to the average frequency of trades, the elements that ESMA shall take into consideration include the following elements:
We also think it would be appropriate to make a similar change to Articles 3, 4 and 5 of RTS 11.

Average size of spreads

We are concerned by Article 5(2) of draft RTS 11, which provides that, in respect of the average size of spreads liquidity factor, where spreads are not available ESMA shall consider using a proxy to assess this factor. In our view, a lack of availability of spreads for a specific class of derivatives suggests that there is insufficient liquidity in such class of derivatives. We note in this context the difficulties that ESMA found in assessing liquidity based on spread data for the purposes of the transparency regime.

Q89. Do you have any other comments on ESMA's proposed overall approach?

Flexible approach towards assessment period

ICI Global strongly supports ESMA's decision not to introduce hard timeframes for the assessment period within RTS 11. ESMA will instead allow for flexibility in determining this period to account for the features of the specific class of derivatives being assessed and the data available for such class. We agree with ESMA's statement in Recital (7) of draft RTS 11 that it is not possible to determine a homogeneous observation period for all the derivatives that could be covered by the trading obligation, particularly given the fact that overall liquidity in a class of derivatives may be influenced by seasonal factors.

Article 33 of MiFIR

ESMA has noted in paragraph 18 of the Consultation Paper that respondents to the Discussion Paper raised concerns that a cross-jurisdiction trade could be subject to different rules in different jurisdictions and that consequently there is a need for alignment and for market participants to be able to comply with a single set of rules. In paragraph 35.iii. of section 3.11 of the Consultation Paper, ESMA noted that whether a class of derivatives is subject to a trading obligation in another jurisdiction is a "useful proposal on the factors it should consider when assessing the anticipated impact of the trading obligation on liquidity."
In this regard, we wanted to draw ESMA's attention to a difficulty in connection with the application of Article 33 of MiFIR, which is intended to ensure that market participants are not subject to different, and potentially contradictory, rules in different jurisdictions. Article 33 provides that if the European Commission adopts an implementing act declaring that the trading obligation in another jurisdiction is, essentially, equivalent to MiFIR's trading obligation, then a pair of counterparties that would otherwise be required to comply with Article 28 of MiFIR are deemed to have satisfied their obligations under Article 28 by complying with those equivalent rules, provided "at least one of the counterparties is established" in that other jurisdiction.

The requirement that one of the counterparties is established in the jurisdiction that issued the equivalent rules could be problematic in situations in which an entity is subject to such equivalent rules but is not legally established in the relevant jurisdiction. For example, a Cayman entity may be classified as a "US Person" pursuant to CFTC rules and subject to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). However, if the European Commission adopts an implementing act under Article 33 declaring the Dodd-Frank Act's trading obligation equivalent to MiFIR, then transactions between Cayman established "US Persons" and their European established dealer counterparties cannot benefit from Article 33 because neither entity is established in the United States. As a result, both Article 29 and the Dodd-Frank Act trading obligation could apply to the relevant transaction.

This outcome is clearly contrary to the intention behind Article 33 and could have a very negative impact on cross-border trades involving non-EU entities and European counterparties. Accordingly, we urge ESMA to interpret Article 33 broadly, such that an entity is considered to be established in a jurisdiction if it is subject to the relevant rules of that jurisdiction. We suggest that ESMA add a recital to this effect to RTS 11 or consider other ways of addressing this issue.

Need for a proportionate phase-in

ICI Global believes that it is very important that ESMA adopts a proportionate phase-in when introducing the trading obligation for any class of derivative. Market participants will need time to update their systems and procedures to comply with the trading obligation. Similarly, trading venues that do not currently provide a market for the relevant class of derivatives would benefit from an appropriate phase-in period that would give them the opportunity to admit such class of derivatives for trading.

Given that a trading obligation for a class of derivatives may be introduced following the adoption of technical standards introducing a clearing obligation for that class of derivatives, it is important that the phase-in periods for the trading obligation and the clearing obligation are aligned. Mandatory trading with respect to a class of derivatives should not apply to a market participant prior to such market participant being subject to mandatory clearing with respect to that class of derivatives. We therefore encourage ESMA to align carefully the phase in periods between the two regimes.

As noted in our response to the Discussion Paper, we expect that ESMA's power under Article 32(4) of MiFIR to declare a class of derivatives subject to a trading obligation in the absence of such class of derivatives being subject to the clearing obligation to be used infrequently, if at all. It is highly unlikely that a class of derivatives that is not subject to mandatory clearing will be sufficiently liquid to be suitable for the trading obligation.

Factual approach to trading venue test

We reiterate a point of concern to ICI Global arising under the Discussion Paper (which was not discussed fully in the Consultation Paper).

Article 32(2)(a) of MiFIR provides that, for the trading obligation to take effect, the relevant class of derivatives "must be admitted to trading or traded on at least one trading venue." Accordingly, ESMA will need to obtain data on which classes of derivatives are being traded or have been admitted to trading on trading venues. We were concerned that, in the Discussion Paper, ESMA sought respondents' views as to whether ESMA should ask trading venues to notify it as to whether they consider a class of derivatives suitable to be subjected to a trading obligation.

As noted in our response to the Discussion Paper, in ICI Global's view, the requirement in MiFIR that a class of derivatives be admitted to trading or traded on a trading venue is simply a question of fact.

Although it may be appropriate for ESMA to gather data from trading venues regarding which derivatives fall within this category, it would not be appropriate for ESMA to specifically ask trading venues to notify it of which classes of derivatives the trading venues believe should be subject to a trading obligation. Trading venues have a vested economic self-interest in derivatives being declared subject to mandatory trading, which may influence their views on the classes that should be subject to the trading obligation. Accordingly, ICI Global strongly believes that the determination of the classes of derivatives subject to the trading obligation should not be initiated by trading venues. ESMA, rather than the trading venue, should take the lead on this process with appropriate industry input. Trading venues (along with other market participants) will have an opportunity to comment on whether particular classes of derivatives should be subject to mandatory trading during the public consultation process.

Q90. Do you agree with the proposed draft RTS in relation to the criteria for determining whether derivatives have a direct, substantial and foreseeable effect within the EU?

ICI Global welcomes the approach taken by ESMA in aligning the draft technical standards setting out the criteria for determining whether a derivative has a direct, substantial and foreseeable effect within the European Union with the equivalent technical standards under EMIR. The market is now familiar with the set of circumstances in which the EMIR regime applies to derivative contracts between two third country entities and, accordingly, will find it easier, and less costly, to implement MiFIR if these circumstances are consistent.

Q91. Should the scope of the draft RTS be expanded to contracts involving European branches of non-EU non-financial counterparties?

As noted in our response to Q90, ICI Global would not support any expansion of the draft technical standards, given that such expansion would conflict with Article 28(5) of MiFIR, which provides that where "possible and appropriate, the regulatory technical standards referred to in this paragraph shall be identical to those adopted under Article 4(4) of [EMIR]".

Q183. Do you have any comments on the proposed framework of the methodology for calculating position limits?

ICI Global agrees with ESMA's proposed baseline of 25% of deliverable supply for physically settled spot-month contracts. We also support the flexibility granted to national competent authorities to adjust the baseline by +/- 15%. However, for non-spot months and financially-settled contracts, we believe that the baseline should be based on aggregate open interest and not on estimated deliverable supply. It may not always be possible to estimate accurately deliverable supply for non-spot months limits, particularly over longer periods of time. Deliverable supply may, for example, be subject to substantial and unpredictable fluctuations based on broader geopolitical considerations.

We note that it is difficult to assess whether the figure is suitable for all commodity asset classes without seeing the deliverable supply and open interest estimates. However, ESMA may consider a

methodology that is similar to the CFTC's approach, which would set the non-spot month limits at 10% of estimated aggregated open interest up to the first 25,000 open interest, and a marginal increase of 2.5% of the average all-months combined aggregated open interest above 25,000 contracts.

Q188. Do you consider the methodology for setting the spot month position limit should differ in any way from the methodology for setting the other months position limit? If so, in what way?

Recital 127 of the MiFID II Directive provides that positions limits are to be implemented "to prevent market abuse, including cornering the market, and to support orderly pricing and settlement conditions including the prevention of market distorting positions." In light of this goal, ICI Global encourages ESMA to focus on manipulation and market disruption around contract settlement.

Given the greater volatility around the expiration of spot month contracts and the fact that this is where futures converge with the underlying physical commodity cash prices, ICI Global believes that the position limits regime should focus its efforts on the spot month. The use of estimated deliverable supply as a baseline for spot month limits relating to physically-settled transactions is appropriate (although, as noted in our response to Q183, aggregate open interest would be a more appropriate baseline for financially-settled contracts and other months limits relating to physically-settled contracts).

As a general comment, we would anticipate higher limits being set in relation to non-spot months because they will need to take into account the open interest in all months. Thus, it is vital that the position limit methodology allows for sufficient flexibility for national competent authorities to alter their approach in relation to spot and other months limits.

Q202. Do you agree with the proposed draft RTS regarding the aggregation of a person's positions?

ICI Global supports ESMA's decision to limit aggregation to corporate parent/subsidiary relationships and not to apply aggregation more broadly (e.g., to different investment funds managed by a common investment manager). This approach is fully in line with Article 57 of the Level 1 text, which refers to limits being set "on the basis of all positions held by a person and those held on its behalf at an aggregate group level." We believe it follows from Article 57(1) that in cases of an investment manager advising multiple investment funds, position limits shall apply to positions held individually by the investment funds. We support ESMA's proposals regarding the aggregation of positions in accordance with the provisions of Directive 2013/34/EU on the annual financial statements and related reports. The aggregation of positions should include positions held by an investment fund and any subsidiary of that investment fund but not the positions of any other investment fund advised by the same investment manager.

Q204. Do you agree with the proposed draft RTS regarding the criteria for determining whether a contract is an economically equivalent OTC contract?

ICI Global agrees with ESMA's approach of aligning the definition of "economically equivalent" with the definition of economic equivalence used by the CFTC.

We further note that the CFTC position limit proposal specifically excludes contracts that are based on diversified commodity indices on the basis that such contracts do not "involve a separate and distinct exposure to the price of a referenced contract's commodity" price. ICI Global urges ESMA to carve explicitly such contracts out of the EU position limits regime by making clear that commodity derivative contracts that are based on prices of multiple different commodity futures comprising an index are specifically excluded from the scope of the position limits regime. Commodity index contracts are used by index tracking funds to provide all types of investors with portfolio diversification options and as a long term hedge against inflation. Commodity index funds also enhance liquidity and facilitate greater price discovery for commercial end-users. Trading in such instruments should not be hindered unnecessarily by the application of position limits.