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Frankfurt am Main,
2 March 2015

BVI position on ESMA Consultation Paper on MiFID II/MiFIR (ESMA/2014/1570)

BVI[1] gladly takes the opportunity to comment on the consultation paper related to the proposals to the MiFID II/MiFIR regime.

We would like to highlight the following point:

- **Definition of a liquid market for fixed income products:** The calibration of the definition of the liquidity for fixed income financial instruments is totally different compared to equities. The liquidity of fixed income products cannot be determined by intrinsic characteristics captured by reference data or other objective factors. Fixed income products are mainly liquid directly after the issuance up to a few months, but should be considered illiquid during a large part of their life cycle. The trading activity of fixed income products cannot be determined in advance as additional factors such as unpredictable market events play a significant role in the bond market. An inappropriate classification of illiquid fixed income instruments as possible liquid will lead to the unintended consequence that broker/dealers or liquidity providers are not willing to provide prices that will be made public due to the fact that those market participants are exposed to an undue risk. In this respect, it could happen that other market participants are running predatory strategies which are not in favor of institutional or retail investors. As the consequence, institutional or retail investors have to bear higher transaction cost connected with increased market volatility.

  We encourage ESMA to develop a balanced approach for the classification of liquidity for fixed income products taking into consideration the requirements by the buy-side to execute large fixed income block orders with minimal market impact. For that reason, we support a simpler COFIA approach with fewer classes and corresponding issuance sizes which will probably decrease the number of illiquid fixed income products to be classified as liquid. Furthermore, we suggest lowering the SSTI waivers enabling broker/dealers and liquidity providers to further provide prices which do not expose them to an undue risk.

We would like to make to specific answers:

Q38. Do you agree with the proposal to determine on an annual basis the most relevant market in terms of liquidity as the trading venue with the highest turnover in the relevant financial instrument by excluding transactions executed under some pre-trade transparency waivers? Please provide reasons for your answers.

Yes, we agree. The most relevant market in terms of liquidity for the purpose of the reference price waivers should be the trading venue with the highest turnover.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 87 members manage assets in excess of EUR 2.4 trillion in UCITS, AIFs and assets outside investment funds. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients over 21 million households. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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Q41. Do you agree with the classes, thresholds and frequency of calculation proposed by ESMA for shares and depositary receipts? Please provide reasons for your answers.

We agree with the proposals.

Q42. Do you agree with the classes, thresholds and frequency of calculation proposed by ESMA for ETFs? Would you support an alternative approach based on a single large in scale threshold of €1 million to apply to all ETFs regardless of their liquidity? Please provide reasons for your answers.

We do not support ESMA`s proposal to establish large in scale thresholds on the basis of different ADT classes. ADT is an unsuitable measure to define the ETF liquidity due to the fact that the criterion does not take into consideration the liquidity of the underlying financial instruments (e.g. equities, bonds). The calibration of the liquidity threshold for the underlying financial instruments might be difficult to implement as some instruments are not liquid over the whole life cycle (e.g. bonds). The definition of ETF liquidity should also incorporate the liquidity provided by market makers as proposed by ESMA in the Consultation Paper related to the definition of securitized derivatives (p. 113).

Market makers provide their clients (e.g. professional clients, banks) with liquidity that is not incorporated in the calculation of the ADT provided by the trading venues.

The implementation of the proposed large in scale thresholds by the market makers is very complex as the different classes needs to be included in the IT/accounting systems.

Therefore, we support the alternative approach to implement a single threshold of EUR 1 million which should apply to all ETFs regardless of their liquidity. The introduction of the single large in scale threshold is much easier to implement than the large in scale thresholds based on different classes.

- **ESMA`s Technical Advice to the Commission: Liquidity threshold for ETFs (p. 205-208)**

BVI supports the aim to extend further the transparency regime for ETFs. ETFs are already subject to the highest level of standards in terms of investor protection and transparency obligations. ETFs provide investors with many features and advantages at low investment costs. Transparent and liquid ETFs are an essential feature to the decision making process by the investors. We are of the opinion that as many ETFs as possible should be qualified as liquid financial instruments.

We generally support the proposal to define the liquidity threshold for ETFs. However, we are concerned that the criterion “average daily turnover” (ADT) of EUR 500.000,00 is an unsuitable measure for the definition of ETF liquidity due to the fact that the criterion does not take into consideration the liquidity of the underlying financial instruments (e.g. equities, bonds). The calibration of the liquidity threshold for the underlying financial instruments might be difficult to implement as some instruments are not liquid over the whole life cycle (e.g. bonds). The ADT is only derived by a small data set provided by the trading venues and does not incorporate the huge amount of ETF OTC trading.

The definition of ETF liquidity should also incorporate the liquidity provided by market makers as proposed by ESMA in the Consultation Paper related to the definition of securitized derivatives (p. 113). Market makers provide their clients (e.g. end-investor, banks) with liquidity that is not incorporated in the calculation of the ADT provided by the trading venues.

The introduction of the proposed ETF liquidity definition by the market makers is very complex/cumbersome as all thresholds need to be implemented in the IT/accounting systems in order to reflect the thresholds necessary for application of the pre- and post-trade transparency regime.

Q54. Do you agree with the proposed classes and thresholds for large in scale transactions in shares and depositary receipts? Please provide reasons for your answers.

In general, we agree with the proposal. However, the threshold for large in scale transactions should be set an appropriated balance between the needs to protect large institutional equity orders and the requirement to publish these orders in a delayed matter, especially in less liquid shares such as SMEs.

Q55. Do you agree with the proposed classes and thresholds for large in scale transactions in ETFs? Should instead a single large in scale threshold and deferral period apply to all ETFs regardless of the liquidity of the financial instrument as described in the alternative approach above? Please provide reasons for your answers.

We think that as many ETF data as possible should be made available to the public as ETFs are already subject to the highest level of standards in terms of investor protection and transparency obligations. As mentioned in our answer to question Q42, we are not in favour of thresholds based on the ADT criteria. Therefore, we support a single large in scale threshold set at EUR 5 million where the publication for any trade beyond that threshold should occur at the end of the trading day. The introduction of the single large in scale threshold is much easier to implement than the large in scale thresholds based on different classes.

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.

The calibration of the definition of the liquidity for fixed income financial instruments is totally different compared to equities. The liquidity of fixed income products cannot be determined by intrinsic characteristics captured by reference data or other objective factors. Fixed income products are mainly liquid directly after the issuance up to a few months, but should be considered illiquid during a large part of their life cycle. The trading activity of fixed income products cannot be determined in advance as additional factors such as unpredictable market events play a significant role in the bond market.

An inappropriate classification of illiquid fixed income instruments as possible liquid will lead to the unintended consequence that broker/dealers or liquidity providers are not willing to provide prices that will be made public due to the fact that those market participants are exposed to an undue risk. In this respect, it could happen that other market participants are running predatory strategies which are not in favor of institutional or retail investors. As the consequence, institutional or retail investors have to bear higher transaction cost connected with increased market volatility. Therefore, neither the COFIA nor the IBIA approach will deliver a balanced approach classifying fixed income products as liquid/illiquid financial instruments.

We encourage ESMA to develop a balanced approach for the classification of liquidity for fixed income products taking into consideration the requirements by the buy-side to execute large fixed income block orders with minimal market impact. For that reason, we support a simpler COFIA approach with fewer classes and corresponding issuance sizes which will probably decrease the number of illiquid fixed income products to be classified as liquid. Furthermore, we suggest lowering the SSTI waivers enabling broker/dealers and liquidity providers to further provide prices which do not expose them to an undue risk.

- **Structured Finance Products**

(1) If SFP´s become more liquid in the future, debt seniority could be a good criterion to differentiate liquidity.

(2) We would not use any other parameter, but the threshold for average transaction volume is set too low

(3) No, we would define SFP´s as illiquid.

- **European Sovereign Bonds, Other European Public Bonds**

(1) No, we agree with the proposed qualitative criteria.

(2) No, we agree with the proposed parameters.

(3) No, we would define European Sovereign and other European Public Bonds as liquid.

- **Non-European Sovereign Bonds**

(1) In general we agree with the proposed criteria, but for emerging markets a differentiation between active and non-active bonds could be desirable. Only active bonds are liquid.

(2) We would not use any other parameter, but the threshold for average transaction volume is too low.

(3) Most of Emerging Market bonds seem to be illiquid, only active bonds are liquid.

- **Covered Bonds**

(1) No, we agree with proposed qualitative criteria.

(2) No, we agree with the proposed parameters.

(3) Yes, we would define the class of covered bonds as illiquid due to the following reasons:

  - the central bank purchase programs reduced covered bonds free float significantly

- An analysis of MarktAxess illustrates that in 2014 covered bond with an issuance size above 750 MM EUR each missed the liquid criteria.

- **Senior Corporate Bonds Financial, Senior Corporate Bonds Non-Financial, Subordinated Corporate Bonds Financial, Subordinated Corporate Bonds Non-Financial**

(1) Debt seniority is a good criterion to differentiate liquidity, but the proposed sizes/ limitations do not take into account the magnitude of the difference in liquidity, especially in difficult trading environments. Issuance size is only a proxy for distribution of bond and activity of market participants.

Alternative qualitative criteria could be:

- Rating classes: High Yield debt is more illiquid than Investment-Grade debt
- Maturity: Short dated bonds are more liquid than long-dated bonds
- Age of transaction: Aged bonds trade rarely, just issued bonds show a high turnover (on-the-run versus off-the run transactions; price of bonds far away from par =coupon at market rates).
- Placement of issue: Small or wide participation of retail investors, placement between institutional investors: global or regional focus, many or just a few investors.
- Market impact: Estimated price impact of certain trading sizes e.g. 10MM EUR

(2) Average transaction volume is much too low for corporate bond markets that are dominated by institutional investors. Trace shows that average transacted volumes are around 500.000 USD and ticket size in Europe should be similar. If the total position size of the biggest holders of a bond are taken into account even that is low. For example a 5MM EUR position could take 10 days to be transacted which is not liquid. Price between small and large transaction vary significantly. Therefore average transaction volume needs to be higher, i.e. 5MM or more.

Alternative parameters could be:

- Transacted volume per month relative to issue size

(3) General considerations

- Institutionally driven OTC-markets (most bonds have 100k EUR minimum denominations), i.e. if strategic transactions are conducted the size that needs to be traded exceeds the other side of the market by a wider margin usually.
- Larger Sizes (above 1 to 5MM EUR) cannot be traded without causing a significant market impact.
- No continuous pricing, i.e. event driven price “jumps”, e.g. expected downgrades or other event risks.
- Liquidity varies with market conditions, i.e. a liquid bond and market segment can become very illiquid soon.
- In difficult market environments liquidity is even more difficult in subordinated bonds than with senior bonds.

We would consider senior and sub-ordinated financial and corporate bonds as illiquid for the following reasons.

- Just a few bonds in the investment universe account for most transactions, i.e. trading is concentrated in a few bonds and primary bonds short after issuance.

- Even in the most liquid bonds we would not be able to change exposure in relevant sizes (10MM EUR or more) without (significant) market impact. In cases of fundamental distress the market impact is even more pronounced and trading possible in small sizes (1x1) only. Therefore, it can last days or weeks to adjust positions. Furthermore, there is no liquidity if liquidity is needed most, i.e. in negative market circumstances.

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.

Please see our answer to question 57. In general, we agree with the definition of the bond classes, with two assessments:

- for corporate and financial bonds a differentiation between Investment-Grade- and High-Yield-Bonds could be useful, the difference in liquidity between these is higher than the difference between financial- and non-financial bonds
- for covered bonds the "best practices" of EBA could be added to the proposed definition.

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

We disagree with ESMA´s proposal to make public the content of the pre-trade transparency reports related to fixed income products. A publication of the price setting arrangements before the transaction is executed will limit the operational capability and the competitive environment of commonly used RFQ trading systems. If every trading participant in a RFQ system will obtain a notice of the price setting arrangements of other requested competitors, no trading participant is interested to price fast and aggressive. We expect a reduced market liquidity and quality of price settings.

Well established RFQ trading systems provide a multitude of useful pre-trade-information (quotes, sizes, axis, composite quotes, click-to-trade quotes) that offers sufficient transparency in liquid instruments and order sizes below LIS and SSTI. Therefore, we expect that the proposed requirements of the pre-trade transparency should avoid a negative impact on market liquidity.

Q71. Do you agree with ESMA's proposal with regard to the order management facilities waiver? Please provide reasons for your answer.

The waiver is nearly useless related to fixed income products. Relevant continuous trading facilities do not exist for fixed income cash products. Therefore, it does not make sense to hold orders in order management facilities.

Q72. ESMA seeks further input on how to frame the obligation to make indicative prices public for the purpose of the Technical Standards. Which methodology do you prefer? Do you have other proposals?

Related to fixed income products, trading venues such as Bloomberg, TradeWeb or MarketAxess publish composite bids and offers permanently. These composite quotes reflect an average of all available quotations in the market. If there is an IOI above the SSTI the trading venue could amend the composite quote in a way that it is close to the price of trading interests.

Q73. Do you consider it necessary to include the date and time of publication among the fields included in Annex II, Table 1 of RTS 9? Do you consider that other relevant fields should be added to such a list? Please provide reasons for your answer.

It is not necessary to add any other field related to the fixed income products. However, all relevant information are included.

Q74. Do you agree with ESMA's proposal on the applicable flags in the context of post-trade transparency? Please provide reasons for your answer.

All relevant flags are included related to the fixed income products.

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 5 minutes thereafter. Please provide reasons for your answer.

(3) a maximum delay of 5 minutes thereafter. Please provide reasons for your answer.

Please see our answer to question Q57. The implementation of an appropriate timing of post trade information for non-equities, especially for the fixed income instruments should be carefully calibrated and not be rushed. A possible publication delay of 5 minutes after the transaction is too ambitious as buy side clients executing large fixed income orders could be put at a disadvantage as other market participants could detect their portfolio strategies thereby profiting at the expense of the end-investors. Furthermore, a possible publication delay of 5 minutes could have also effects on the liquidity meaning that banks, broker/dealers or liquidity providers could be much less willing to provide quotes to the market due to arbitrage opportunities. Therefore, a publication delay of 15 minutes could be more appropriate taking into account the requirements by the buy side to execute large fixed income orders on behalf of the institutional investors. A deferred publication will also protect liquidity providers. The liquidity providers should have an opportunity to unwind the position before the trade is published.

Q76. Do you agree that securities financing transactions and other types of transactions subject to conditions other than the current market valuation of the financial instrument should be exempt from the reporting requirement under article 21? Do you think other types of transactions should be included? Please provide reasons for your answers.

We agree with the proposal related to fixed income securities financing and fixed income primary markets transactions. The publication of those transactions does not contribute to the price discovery process.

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.

Please see our answers to the questions Q57. We agree with the proposal that the deferral period should be set at 48 hours leaving sufficient time for the publication of data while in the same time protecting the publication of large fixed income orders for the buy-side clients. Furthermore, we agree with a size specific to instrument threshold set as 50% of the large in scale threshold. The setting of the LIS threshold with the scope of total nominal value of traded debt instruments is reasonable. However, as mentioned in our answer to Q70, we disagree with the proposal of the pre-trade transparency regime due to negative effects on market liquidity. SSTI and LIS thresholds should only be used for post-trade transparency. An annual recalculation of the thresholds seems to be the favorable option as it reflects betters the changing market conditions. The threshold calculation methodology starting at 2018 are plausible.

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.

We generally appreciate the possibility to temporary suspend the transparency requirements related to the fixed income products. The use and measure of average daily turnover is comprehensible. The methodology to assess a reduction in liquidity does not come up with a massive decline in liquidity. We believe a consideration of 7 days in relation to average weekly volume is more suitable in these cases.

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

We generally agree with the proposed definition of OTC derivative contracts that should be economically equivalent to commodity derivatives which are traded on a trading venue.

We think that the definition of "economically equivalent" that is used by the CFTC in the US is appropriate for the purpose of defining the contracts that are not traded on a trading venue for the position limits regime of MiFID/MiFIR.

We know that the U.S. CFTC position limit proposal excludes contracts that are based on diversified commodity indices because they determine that such contracts do not "involve a separate and distinct exposure to the price of a referenced contract's commodity" price. We are of the view that the position limits under MiFID/MiFIR should also not apply to such OTC contracts. We think that the position limits under MiFID/MiFIR will only apply to single commodity futures contracts traded on EU-registered trading venues and economically equivalent (I.e., look-alike) OTC contracts. We encourage ESMA that market participants have a clear understanding that position limits will only apply to single commodity futures contracts and economically equivalent (i.e., look alike) OTC contracts. Furthermore, commodity index contracts are used as an important investment strategy 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 the institutional/retail investor. Therefore, we encourage ESMA to make clear that OTC contracts that are based on prices of multiple different commodity futures comprising an index are excluded from the scope of the regulation.

Q213. Which of the formats specified in paragraph 2 would pose you the most substantial implementation challenge from technical and compliance point of view for transaction and/or reference data reporting? Please explain.

In securities transactions most of our members use ISO15022 and FIX. ISO 150022, however, does not cover securities reportings.

In addition, we would like to take the opportunity to express our view that ISO 20022 would be the most appropriate standard.

Overall we believe that ISO 20022 offers the best potential for cost-effective and future-proof implementation. It has a strong methodology and model for defining and structuring financial data, and an open governance process that ensures a level playing field for standardisers and users. It also offers expert international scrutiny of submitted content. ISO 20022 is now being implemented in a growing number of markets, which results in increasing opportunities for automation and interoperability. We believe ISO 20022 brings following benefits:

- ISO 20022 is the standard used for messaging by strategic initiatives such as the Single Euro Payments Area (SEPA), in the ECB's Target 2 Securities initiative, the upcoming migrations of Target 2 and EBA EURO1/STEP1
- ISO 20022 enables higher levels of automation and interoperability across payments and securities, reducing overall industry costs and lowering barriers to entry; basing MiFID II /MiFIR Transaction reporting and Reference data on ISO 20022 will enable us to reuse our investment in supporting the standard
- ISO 20022 can easily cater for future additional/new regulatory reporting functionalities including changes to MiFID II /MiFIR reporting components
- ISO 20022 is an open standard which can be freely implemented, with an open governance process and no single entity that controls it; it has an established process for maintenance and evolution
- ISO 20022 is being adopted globally in the financial industry: Central banks and market infrastructures across the world are increasingly using the standard, with around 70 payments and securities clearing and settlement systems implementing ISO 20022
- ISO 20022 standards have been developed across many financial business processes including retail and wholesale payments, foreign exchange, clearing, collateral management, settlement, asset reconciliation and transaction reporting

Q221. Do you agree with ESMA's approach for deciding whether financial instruments based on baskets or indices are reportable?

We generally agree with ESMA`s proposal that all financial instruments based on indices which include in their composition at least one component of which is admitted to trading or traded on a trading venue should be reported to the regulators.

In this context, however, according to the proposal made by the EU Commission on the regulation on indices/benchmarks[2], index providers are not required to make the index sufficiently transparent to the public as the EU Council and the ECON deleted Article 16 of the stated draft regulation. The reporting entities will not have a legally insured access to the composition of the baskets/indices and are therefore unable to be compliant with the reporting obligation under MiFIR.

Asset managers are already subject to extensive transparency requirements and conditions under which investment funds and in particular UCITS may use financial indices as benchmarks. The ESMA Guidelines on ETFs and other UCITS issues in addition to the disclosure requirements in UCITS KIID for indices used as performance evaluation tools are very concrete examples of that. In light of the growing importance of indices and increased transparency requirements, including the regulatory reporting of an underlying index imposed to the end users, as foreseen in the EMIR and MiFID/MiFIR transaction reporting, it is necessary to foresee corresponding transparency requirements to be imposed to and information to be provided by index providers. This goes in particular in terms of clear summary information disclosing an index's objectives and its key construction principles, complete information on the index construction and calculation methodology, and historical data on constituents and weights.

Such information is required to allow investors to screen indices against their stated investment objectives and constraints, to calculate track records independently, both in terms of risks and performance, to gauge the systematic character of methodologies and understand how discretion is exercised, and to perform quantitative analyses to assess indices' relevance and suitability. Opacity

[2] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013PC0641&from=DE.

typically increases the scope for conflicts of interest to play out as abuse and, worse, practically denies the public the ability to assess the relevance and suitability of indices and to manage their risks properly. Opacity should therefore not be tolerated by regulators as a blanket protection against intellectual property infringements.

Therefore, we encourage ESMA to take into account in their analyses the above mentioned shortcomings related to the insufficient disclosure of data for the indices provided by the index provider and if necessary develop guidelines/opinions as soon as the regulation on indices/benchmarks does not contain an Article considering sufficient disclosure requirement for indices to the public.

Q222. Do you agree with the proposed standards for identifying these instruments in the transaction reports?

Please see our answer to question 221.

Q224. Do you anticipate any significant difficulties related to the implementation of LEI validation?

No. The operative structure of the LEI is fully operative before the obligation to report transactions under MiFIR starts. We strongly support the usage of the LEI in MiFIR transaction reporting. A regulatory implementation of the usage of the LEI in the MiFIR reporting will extend the coverage of the LEI in the (financial) industry and will enhance the supervisory convergence and ensure the high quality, reliability and comparability of data, supporting the Competent Authorities strategic objective to increase the overall efficiency of the supervisory system by promoting effective exchange of information.

We strongly recommend ESMA to ensure in their supervisory practise that all reporting entities have valid LEIs in place before the reporting obligation starts in order to avoid any difficulties of the identification of counterparties as experienced with the introduction of the EMIR reporting obligation.

Q238. Do you agree with ESMA proposed approach to the use of instrument code types? If not, please elaborate on the possible alternative solutions for identification of new financial instruments.

We strongly support the use of globally accepted identifiers for all financial instruments and trades/counterparties in all reporting regimes (e.g. EMIR, MiFID/MiFIR). Identification of the counterparties to the trade or the underlying entities should be based exclusively on the LEI. In particular, the required identifiers should be available on a license and fee free basis. Primarily ISO standards should be considered for this purpose. For that reason, the ISIN based on the ISO standard 6166 should be considered as the primary identification for financial instruments. The ISIN standard covers a broad range of financial instruments including also either exchange traded and OTC derivatives. We disagree to apply also the AII. The AII is not an ISO standard and should therefore not be used to identify financial instruments. The AII is restricted to exchange traded derivatives, all of which may be covered by ISIN.

In this context, we would like to highlight that the EU Commission launched formal proceedings against S&P in 2009, investigating whether the fees being charged by S&P for databasing ISINs based on CUSIP numbers were in breach of EU competition law.

The Commission took the preliminary view that S&P is abusing its dominant position by requiring, as the sole-appointed National Numbering Agency (NNA) for US securities, financial institutions and information service providers (ISPs) to pay licensing fees for the use of the ISINs in their own databases. The Commission also took the preliminary view that this behaviour amounts to unfair pricing and constitutes an infringement of Article 82 EC Treaty. The Commission settled the case in 2011.

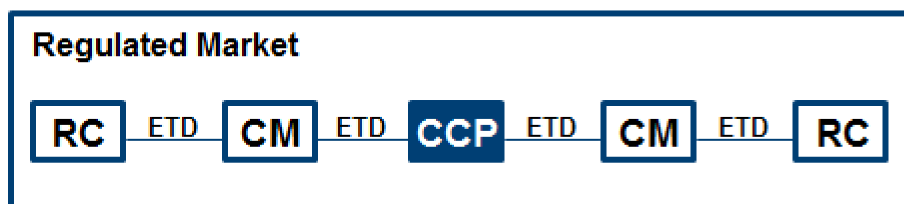
In that respect, we encourage ESMA to ensure that all identifier used in regulatory reporting should be available on a license and fee free basis. ESMA should clearly ensure the use of an IP and copyright free identification code, which is not the case with AII. The license and fee free use of US ISINs may have to be agreed with S&P. S&P has allowed the license and fee free use of CUSIP (USISINS) identifier in SEC reporting.

Q244. **Do you agree with the proposed draft RTS? Do you believe it addresses the stakeholders concerns on the lack of indirect clearing services offering? If not, please provide detailed explanations on the reasons why a particular provision would limit such a development as well as possible alternatives.**

We think that the proposed RTS could cause legal uncertainty which is relevant for German market participants (e.g. German management companies). German market participants require legal certainty that they can further access ETDs as MiFIR comes into force and if or not Article 30 para. 1 of MiFIR has impact on their business.

According to Article 29 para. 1 of MiFIR, the operator of a Regulated Market (**"RM"**) shall ensure that all transactions in derivatives that are concluded on that RM are cleared by a CCP. This requirement is mentioned as "clearing obligation" in Article 29 para. 2 (a) of MiFIR and covers Exchange Traded Derivatives (**"ETD"**), while the clearing obligation for OTC derivatives is laid down in Article 4 of EMIR.

The graphics below shows the chain of "*transactions in derivatives that are concluded on a RM*" (**"CCP"** means Central Counterparty; **"CM"** means Clearing Member; **"RC"** means a Client that is registered as a client at the RM and therefore captured by the rulebook of the RM). It is our understanding that all of these transactions are subject to the obligation set out in Article 29 para. 1 of MiFIR.



Under current market practice only a minority of market participants are represented in the above mentioned clearing structures due to the following reasons:

a) not all market participants (e.g. German management companies) fulfill the requirements for participating at least as RC;
b) the number of transactions in derivatives on a exchange does not justify the costs for "onboarding" on that exchange;
c) it is not possible to cover all ETD required by just accessing two or three exchanges, instead of this a access to numerous RM is required.

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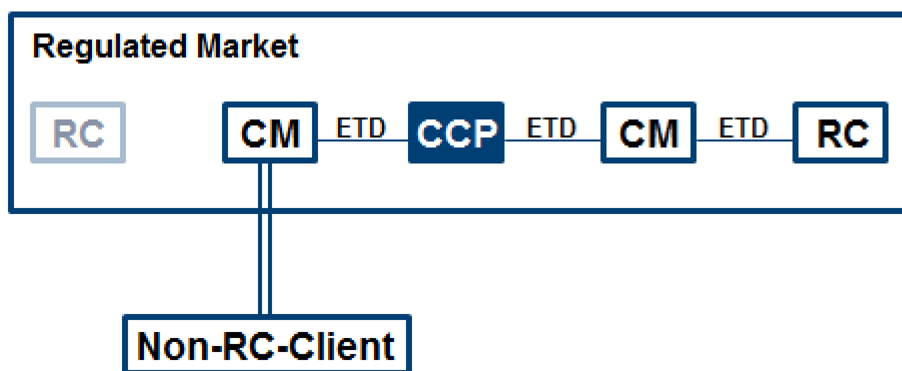
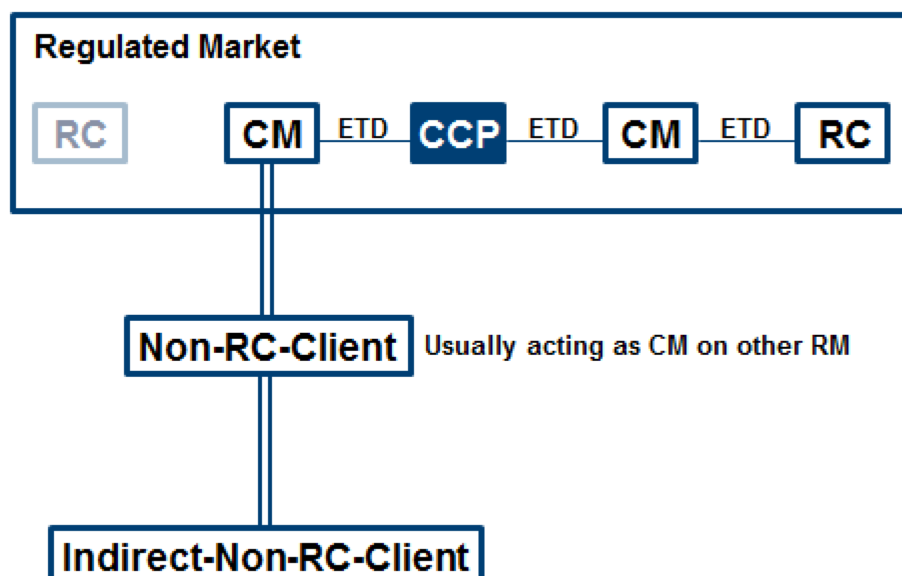
For that reason, market participants who are neither CM nor RC at the relevant RM access ETDs via contractual brokerage agreements (in Germany: Kommissionsgeschäft) or undisclosed agency transactions (**“Non-RC-Client”**). Under this model, a Non-RC-Client asks a CM (the “commission merchant”) at the relevant RM to execute an ETD with the CCP.

After the execution the CM is obliged to forward to the Non-RC-Client whatever the CM receives under the ETD agreed. At this moment, a CM is obliged to either make a payment or to provide collateral to the CCP. The CM has a claim for reimbursement against the Non-RC-Client. The Non-RC-Client is obliged to pay an execution fee to the CM that has entered into an ETD with the CCP.
The graphic below shows how the Non-RC-Client obtains access to ETDs:



Prior to the executing of the order of a Non-RC-Client, the CM and the Non-RC-Client establish a procedure for the necessary transfers between both parties (e.g. the transfer of Variation Margin, the CM has received from the CCP to the Non-RC-Client or the fulfillment of a reimbursement claim of the CM against the Non-RC-Client at the same time, the CCP requires the provision of Variation Margin from the CM). Establishing the respective procedures is laborious. Furthermore, the CM is also contacted by its Non-RC-Client in cases where the CM does not maintain a clearing membership at a particular exchange. In that case the CM is requested by its Non-RC-Client to become a Non-RC-Client by itself and asks another CM who maintains a clearing membership at the relevant exchange to execute the ETD instructed by the indirect Non-RC-Client to the Non-RC-Client (**“Indirect-Non-RC-Client relationship”**). The graphic below how the Indirect-Non-RC-Client gains access to ETD:



The provision set out in Article 29 para. 1 of MiFIR" applies to derivatives. In light of the nature of the arrangements between a CM and a market participant who is not a RC respectively a market participant and its client, one could have doubts that the contractual relationships for the provisions of a derivative, marked in the above graphics with "||" qualify as derivative contracts within the meaning of EMIR.

Article 29 para. 1 of MiFIR refers to transactions in derivatives "*concluded on that regulated market*". The above graphics show that if the relationship, marked in the above graphics with "||"should be considered as derivatives would lead to the consequence that those are not subject to the clearing obligation set out in Article 29 para. 1 MiFIR.

However, qualifying the relationships, marked in the above graphics with "||"as derivatives, would lead to the question whether or not those derivatives qualify as ETD or OTC derivatives. Since the relationships, marked in the above graphics with "||" are outside the RM, one could argue that these relationships are OTC derivatives and subject to EMIR. Therefore, the risk mitigation techniques and clearing obligations might apply. Since the Non-RC-Clients and Indirect-Non-RC-Clients, as the case may be, pay a fee for execution, find themselves as party to an OTC derivative is likely to create the assumption that directly agreed OTC derivative would create less costs (no execution fee to be paid) than ordering an ETD.

A qualifying the relationships marked in the above graphics with "||"as derivatives could lead to the unintended consequence that huge volumes of transactions could move away from the RM to the OTC market.

We share ESMA's view in para. 9 of Chapter 9.2 of the CP that "*in the ETD case, a requirement similar to the one of Article 4(3) of EMIR does not exist*". In other words: Differing from Article 4 para. 3 of EMIR, market participants are not obliged to access ETD via a CM, a client or client of a client of a CM. Therefore, as explained above, the current market practice should be maintained and allowed.

ESMA summarizes in para. 9 of Chapter 9.2 of the CP that "*the draft RTS for ETD applies to all clearing arrangements including an indirect client, i.e. a client of a client of a clearing member, but these requirements are not applicable to clients of indirect clients.*"

This summary is too broad. In light of the graphics described above, only a clearing arrangement between a RC and its client (the latter is not shown in the graphics above) would fall under this definition.

With respect to Non-RC-Clients, we think that they are not indirect clients as there is no RC involved. The same applies for the Indirect-Non-RC-Clients. We come to this conclusion because for becoming a RC, one must fulfill much lower requirements as for becoming a CM. This circumstance seems to be the reason why the legislator decided to regulate the relationship between an RC and its client in Article 30 of MiFIR. Otherwise, RC's and CM's would offer clearing services to third parties but parties seeking the safety of clearing would face different risk profiles and therefore not benefit from an equal level of protection.

In the above cases, Non-RC-Clients and Indirect-Non-RC-Clients already benefit from forwarded variation margin contributions. They only face default risk which CCP mitigates by requiring an initial margin. However, this is a small risk which is accepted by entering into OTC derivatives unless a certain threshold (concerning the trading volume) is breached. The CM does not have any default risk concerning Non-RC-Clients and Indirect-Non-RC-Clients at all. Typically the Non-RC-Client provides initial margin by pledging a securities account for the benefit of the CM respectively Non-RC-Client (the

latter in case of the involvement of an Indirect-Non-RC-Client). If the CCP asks for a variation margin contribution, the CM asks its Non-RC-Client for reimbursement at the same amount. Where the chain has one more "chain link", the described mechanism takes place accordingly with the only difference that the second-level reimbursement claim is held by the Non-RC-Client and directed against the Indirect-Non-RC-Client.

It should be mentioned that in Germany the German Code of Commerce (Handelsgesetzbuch) generally protects the customer under a brokerage agreement if the commission merchant becomes insolvent (e.g. if the commission merchant fails forwarding a payment received from the CCP prior going bankrupt, the commission merchant's client would be entitled to request the respective amount from the administrator without any deductions).

In the UK a similar protection is used by requiring the commission merchant (as part of the registration process at FCA) to hold any assets received with respect to the transaction that followed a Client's order (in the example case from the CCP) separate from its own assets.

The mentioned procedure makes clear that the common described market practice does not mean that market participants accessing ETD as Non-RC-Client or Indirect-Non-RC-Client are unprotected against the default auf the commission merchant.

We encourage ESMA to clarify the following:

- the term "Indirect Clearing Arrangements" implies the involvement of a "RC" in the meaning explained above;
- Brokerage agreements and undisclosed agencies considering the execution of an ETD and not involving a "RC" in the meaning explained above are not required to meet the conditions referred to in Art. 30 para. 1.

These clarifications are crucial due to the following:

- The conditions for "Indirect Clearing Arrangements" in the sense of EMIR cannot be fulfilled by the market participants which is the reason why "Indirect Clearing" is not offered related to OTC derivatives.
- Putting brokerage agreements and undisclosed agencies considering the execution of an ETD and not involving any "RC" in the meaning explained above under an equal regime would force market participants to either become a clearing member or the client of a clearing member or the client of the client of a clearing member to able to access ETD. This would mean an obligation by fact of which also ESMA has pointed out that it does not exist under MiFIR (cf. para. 9 of Chapter 9.2 of the CP).
- Since MiFIR does not recognize any clearing threshold, any and all market participants either being a Financial Counterparty or a Non-Financial Counterparty would be forced to comply with an obligation that equals Article 4 para. 3 of EMIR.
- Different from OTC derivatives, it would not be sufficient to access one or two CCPs. Each relevant RM only covers a certain variety of ETD. Maintaining the access to ETD's market participants would force them to "onboard" at 20 to 30 RM's. The implementation of EMIR has shown that onboarding at a CCP respectively CM for clearing is time-consuming and expensive and it would be impossible to access the required number of RM's prior MiFIR comes into force.

Therefore, there is a huge likelihood that putting brokerage agreements and undisclosed agencies considering the execution of an ETD and not involving a "RC" (in the meaning explained above under

an obligation to meet the requirements laid down in Article 30 para. 1 of MiFIR would lead to the unintended effect that trading volumes at RM will significantly decrease respectively move to the OTC market and a high number of market participants will lose access to ETD at all.