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Discussion Paper – The trading obligation for derivatives under MiFIR

Dear Sirs,

IHS Markit is pleased to submit the following comments to the European Securities and Markets Authority ("**ESMA**") in response to its Discussion Paper ("**DP**") on *The trading obligation for derivatives under MiFIR*.

IHS Markit¹ (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 key business and government customers, including 80 percent of the Fortune Global 500 and the world's leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

IHS Markit's derivatives processing platforms are widely used by market participants, Trading Venues and brokers to increase operational efficiency, reduce cost, and ensure legal certainty. Globally over 2,000 firms use the various IHS Markit trade processing platforms that process, on average, 90,000 derivative transaction processing events per day. IHS Markit's trade processing platforms form an important element of derivatives workflows, particularly in the credit, interest rate, equity, and foreign exchange asset classes. In September 2015, IHS Markit acquired DealHub², enhancing its trade processing offerings in the foreign exchange ("FX") asset class, including regulatory reporting.

¹ See www.ihsmarkit.com for more details

² Markit Completes Acquisition of DealHub, Sept. 4, 2015,

<http://www.businesswire.com/news/home/20150904005095/en/Markit-Completes-Acquisition-DealHub>

Markit trade processing platforms also facilitate firms' compliance with several regulatory requirements across jurisdictions. Specifically, the MarkitSERV platforms facilitate the electronic confirmation of a significant portion of derivatives transactions worldwide, submit them for clearing to 16 clearinghouses globally, and, for many counterparties, report derivatives details to trade repositories in the United States, Canada, Europe, Japan, Hong Kong, Singapore, and Australia, as well as reporting on behalf of the G15 banks on a voluntary basis as a part of an OTC Derivatives Regulator Forum initiative.

Through its derivatives trade processing platform, IHS Markit has a unique perspective across all types of participants in the OTC derivatives markets that operate across regulatory regimes. We share in common with ESMA the common goal of stable, fair and liquid OTC derivative markets. We present our comments in that common spirit.

Comments

The implementation of a Trading Obligation (TO) for OTC derivatives is part of the G20 commitments made in Pittsburgh in 2009.³ These called for "standardised OTC derivative contracts [to] be traded on exchanges or electronic platforms, where appropriate". We understand that the TO is "appropriate" when market users would benefit from an on-venue trading environment through improved price transparency and risk management.⁴

It is important to appreciate that, for some OTC derivative instruments, a sufficient amount of off-venue trading is necessary to enhance liquidity. This is because the additional transparency associated with on-venue trading for an OTC derivative alerts market participants that transactions have occurred, leaving the liquidity provider to these transactions susceptible to predatory trading from the few firms able to provide a hedge the liquidity provider.

Citing a paper from the Journal of Finance (Brunnermeier and Pedersen 2005) that explores this topic in depth:

"Our analysis shows that if a distressed large investor is forced to unwind his position (i.e., when he needs liquidity the most), other strategic traders initially trade in the same direction. That is, to profit from price swings, other traders conduct predatory trading and withdraw liquidity instead of providing it. This predatory activity makes liquidation costly and leads to price overshooting. Moreover, predatory trading can even induce the distressed trader's need to liquidate; hence, predatory trading can enhance the risk of financial crisis. We show that predation is profitable if the market is illiquid and if the

³ <http://www.g20.utoronto.ca/2009/2009communique0925.html>

⁴ See Section 5.4

<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009DC0332&from=EN>

distressed trader's position is large relative to the buying capacity of other traders. Further, predation is most fierce if there are few predators.”⁵

The risk of predatory trading increases as a function of greater transactional transparency and inversely with the liquidity of the financial instrument⁶ with the number of liquidity providers (and market participants more generally). Predatory trading when it emerges can also, most importantly for ESMA's goals, increase the risk of financial crises. Moreover, predatory trading deters liquidity providers from meeting end user demand for hedging transactions, raising the cost for non-financial and financial end-users from being able to cost-effectively reduce their commercial risks. In contrast, for products that have a low risk of predatory trading (i.e. liquid products), the centralised trading environment would facilitate liquidity formation by enhanced transparency reducing the barriers to trading in the product.

In short, illiquid products' liquidity suffer as they are subjected to centralised trading and transparency requirements of the sort provided by a TO while liquid products' liquidity is enhanced by centralised trading and greater transparency. We therefore welcome ESMA's effort to distinguish products that have a high risk of predatory trading and keeping these products outside the scope of the TO. We appreciate and support ESMA's efforts to analyse the liquidity of derivatives classes. We believe that the thresholds should be determined in a way such that, as foreseen in the level 1 legislation,⁷ illiquid and non-standardised derivatives would not be subject to the TO. This could be done through careful analysis of trade data and prudent assumptions where trade data is limited or lacking.

In addition, ESMA should avoid creating technical standards that would strengthen the market position of trading venues that have a dominant position in providing trading services for certain derivative classes. An inappropriate TO would increase barriers to entry and could limit the

⁵ Predatory Trading, Markus K. Brunnermeier and Lasse Heje Pedersen, *The Journal of Finance*, Aug. 2005, at 1824-1825, available at http://pages.stern.nyu.edu/~lpederse/papers/predatory_trading.pdf. “A well-known example is the alleged trading against Long Term Capital Management's (LTCM's) positions in the fall of 1998. Business Week wrote:

... if lenders know that a hedge fund needs to sell something quickly, they will sell the same asset—driving the price down even faster. Goldman, Sachs & Co. and other counterparties to LTCM did exactly that in 1998.

Cramer (2002, p. 182) describes hedge funds' predatory intentions in colourful terms:

When you smell blood in the water, you become a shark when you know that one of your number is in trouble ... you try to figure out what he owns and you start shorting those stocks ...

Also, Cai (2002) finds that “locals” on the Chicago Board of Exchange (CBOE) pits exploited knowledge of LTCM's short positions in the treasury bond futures market.” Id. at 1825 citing “The Wrong Way to Regulate Hedge Funds,” *Business Week*, February 26, 2001, p. 90.

⁶ “[optimal risk management strategy should depend on the liquidity of the assets and on the positions and financial standing of other large investors. Indeed, JP Morgan Chase and Deutsche Bank recently developed a “dealer exit stress-test” to assess the risk that a rival is forced to withdraw from the market (Jeffery (2003)). Further, risk managers should consider the risk that fund outflows can lead to predatory trading, resulting in losses that could fuel further outflows, and so on.” Id. at 1827.

⁷ Recital 25 and 26 of MiFIR refer to the G20 agreement in Pittsburgh highlighting the need to “move trading in standardised OTC derivative contracts to exchanges or electronic trading platforms where appropriate”

competition and innovation in markets. A lack of competition among trading venues could expose end users to potentially higher transaction costs, as well as higher costs to obtain data and other services related to trading.⁸

Below is a brief summary of the key points:

- (i) ESMA should only consider those derivatives for the trading obligation where primary trading activity is conducted in the EU unless those derivatives are subject to the Trading Obligation in other jurisdictions. This would also help avoid regulatory arbitrage in those derivatives classes.
- (ii) ESMA should ensure that a particular class of derivatives should be voluntarily traded on at least three unaffiliated trading venues before it is considered for the TO. This would ensure effective competition in the Trading Venue landscape, low transaction costs, choice of technology and execution methodologies. It would also disincentivise trading venues to list derivative contracts with the objective of forcing liquidity on these venues at the expense of systemic market liquidity.
- (iii) To appropriately analyse liquidity of derivatives classes ESMA should consider revisions to the raw data set. These include:
 - a. An appropriate methodology to remove duplicate trades. Option 3⁹, which would remove cleared trades, is the most suitable of the listed options but should be improved to better reflect true liquidity by removing trades that arise from compression activity.
 - b. Other refinements such as including block (pre-allocated) trades and removing post-trade allocations would better reflect liquidity.
- (iv) ESMA should consider an appropriate phase-in of the TO to avoid:
 - a. subjecting smaller counterparties to disproportionate burden
 - b. operational bottlenecks

⁸ Recital 28 of MiFIR states:

“The trading obligation established for those derivatives should allow for efficient competition between eligible trading venues.”

⁹ Section 7.1: Overview of the dataset

Questions

Q1. Do you agree that the level of granularity for the purpose of the trading obligation should apply at the same level as the one used for calibrating the transparency regime of non-equity instruments? If not, which level of granularity for the TO would you recommend and why? Would that differ by asset class and type of instrument?

We think that the level of granularity should be specified at a level that ensures that all products considered for the TO are truly liquid and would benefit from centralised trading.

Particular types of derivatives trades have features affecting their liquidity that are more granular than the level of granularity used for calibrating the transparency regime. It is possible that these features are non-standard but the derivatives type is deemed liquid and subject to the transparency requirements because the transparency regime is defined at a higher level of granularity. However, because these non-standard features have a material impact on the price of the product, they should be included in the calibration of the TO regime. In other words, the TO regime should be more granular than the transparency regime.

Some examples of fields that are relevant for appropriate granularity of the TO regime are Day Count Fraction Basis, Floating Rate Option, Roll Types and Frequencies, Unadjusted period end dates (coupons). Customization of these types of fields impact the price or rate of that transaction and trades with non-standard fields should be removed from the dataset used to determine whether a trade type is liquid for the purposes of the TO.

If it is helpful, we would be happy to further explain our thinking in a meeting as a follow-up to this comment letter

Q4: In your view, what should be the minimum total number of market participants to consider the following classes of derivatives as sufficiently liquid for the purpose of the trading obligation?: i) OTC interest rate derivatives denominated in EUR, USD, GBP and JPY; ii) OTC interest rate derivatives denominated in NOK, PLN and SEK; iii) Credit default swaps (CDS) indices? Should you consider that this assessment should be done on a more granular level, please provide your views on the relevant subsets of derivatives specified in 1.-3.

To ensure the stability of derivative markets, ESMA should take a cautious approach and maintain a buffer over and above the minimum of two market participants established under Draft RTS 4. This is needed as the process to remove the trading obligation for a particular class of derivatives if market conditions require it is likely to take some time.

Under MIFIR, ESMA is obliged to submit to the “Commission draft regulatory technical standards to amend, suspend or revoke existing regulatory technical standards whenever there is a material change”¹⁰. The process of submitting the draft RTS to the Commission to revoke existing TO RTS for a particular class of derivatives is time consuming. During this time market conditions might deteriorate to the detriment of market participants. Therefore, to mitigate the risks of small changes affecting the functioning of derivative markets and allow

¹⁰ MiFIR, Article 32(5)

time to revoke the TO, ESMA should establish a sufficiently high threshold of market participants trading a class of derivatives before it is subject to the TO.

As a general rule, we would recommend a minimum number of 50 market participants for a given product before it is subject to the TO. Table 7 of the DP highlights that, for all domestic EU currencies, tenor points where average number of trades exceed 10 per day have greater than 50 participants. We believe that it is only at this level of participants that a market can be said to have a sufficient and diverse enough number of potential suppliers and demanders of liquidity while having confidence that small changes in the number of market participants would not jeopardise liquidity.

For foreign currency IRS or other products with a focal point outside of Europe the situation would be different to that of products primarily traded in Europe. We would strongly recommend that ESMA coordinate its action with the primary regulator of those foreign products' markets. In ESMA's analysis, the number of distinct counterparties trading JPY in the EU falls short of 50. However, JPY IRS is primarily traded in Japan and there is also a TO for JPY IRS in place by the Japanese FSA.¹¹ Therefore JPY IRS¹² is likely to be liquid with less market participants as it is not the main market and this analysis should not be considered a guide to liquidity of European products. Furthermore, if ESMA imposed a TO for a product in a third country currency not subject to the TO in its home jurisdiction, there is a high risk that trading would leave Europe as firms could seek to avoid potential predatory trading and regulatory burden in Europe

Q5: Do you agree with this approach? Do you consider alternative ways to identify the number of trading venues admitting to trading or trading a class of derivatives as more appropriate?

To be considered for the trading obligation a particular derivative contract should be actively traded on multiple unaffiliated trading venues. Should ESMA use "admitted to trading" as a criterion indicative of liquidity it would create incentives for trading venues to admit derivatives to trading on their venues which were not sufficiently liquid with the objective of forcing liquidity onto their own venues. This could result in harm to end-users and the public in the form of reduced liquidity or higher trading for that product, as explained in our introduction above.

Q6: On how many trading venues should a derivative or a class of derivatives be traded in order to be considered subject to the TO?

¹¹ DP at 16.

¹² The Japan FSA TO for JPY IRS applies only to three tenors for JPY LIBOR (5y, 7y and 10y) for interest rates (6M frequency) and clearable at the Japan Securities Clearing Corporation (JSCC). Furthermore, it is only applicable to market participants that have a gross notional outstanding in derivatives of more than JPY 6 trillion.

We agree with ESMA when it states that “the more trading venues offer for trading or trade a class of derivatives, the more liquid that class can be considered”¹³ and would recommend that a class of derivatives should be actively traded on at least three unaffiliated trading venues before it is subject to the TO.

Competition is a key objective of MiFIR and the legislation looks to promote efficient competition between trading venues. Generally we have observed that products under TOs in jurisdictions trade on far more than three unaffiliated trading venues and we believe it is imperative that ESMA set a minimum threshold of three unaffiliated trading venues to ensure that trading venues are not able to exploit market position. Recital 28 of MiFIR states that “The trading obligation established for those derivatives should allow for efficient competition between eligible trading venues”. In its preparatory work, the European Commission stated that “A system based on competition between different trading venues (OTC, exchanges and MTFs), is also advantageous in terms of market efficiency as long as it subjects all venues to adequate transparency and organisational requirements that ensure fair competition”.¹⁴

We believe that applying a trading obligation to a class of derivatives that only trades on one or two venues creates risks that ESMA should avoid, for example:

1. An opportunity for venues to abuse their dominant position and increase trading fees. These increased costs would be passed onto commercial end users, reducing their ability to hedge real economy risks. This is particularly true where a significant proportion of trading in a class of derivatives currently takes place, albeit voluntarily, on only a single venue as there would be no possibility to move trading off venue after a trading obligation was in place.
2. A single dominant venue would limit market participants’ choice of technology and execution methodologies. These should be encouraged to promote broad participation and therefore more liquid markets. Each trading venue supports particular types of execution and offers its members differentiating technology for trading and connectivity.
3. In addition, ESMA, in its analysis, should also be careful when considering venues where a particular class of derivatives is admitted to trading but where little or no actual trading takes place. ESMA would risk calibrating liquidity incorrectly should it consider admitted to trading venue as sufficient criteria. Similarly, ESMA should be mindful that if a class of derivative subject to the TO is de-listed from other trading venues so that it only trades on one or two trading venue(s), then ESMA should review the TO for that class of derivatives.
4. Trading venues would be incentivised to list derivative contracts if it means that these derivatives would be considered for the TO in order to increase their odds of gaining a share of market liquidity and at the expense of market liquidity as a whole.

The risks enumerated above are also present when a particular class of derivatives trades only on two venues and, of course, if one venue stops trading a monopoly position is created.

¹³ DP Para. 84

¹⁴ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009DC0332&from=EN>

Therefore, to mitigate these risks, ESMA should establish that there should be voluntary trading on at least three unaffiliated trading venues in a particular class of derivatives before it is subject to the TO.

Q13: Do you agree with the suggested approach? If not, what approach would you recommend?

We agree with ESMA that the analysis of the type and number of market participants, average frequency and average size of transactions can help estimate the impact of the trading obligation on the liquidity of a class of derivatives and the commercial interest of non-financial end users.

However, ESMA should specify the frequency with which it would conduct such analysis and also set in advance the framework under which it would consider revoking or amending the trading obligation for a particular class of derivatives. This would create much needed certainty for the non-financial end users and the broader market in general and confidence that unforeseen negative consequences will be dealt with. Elements of such a framework might include that:

1. ESMA should regularly review the attributes that determine the TO for each of the class of derivatives.
2. ESMA should put in place a mechanism that would trigger a review of the TO should there be a material change in the conditions that determine the TO. At the minimum, such a review should be triggered should any of the thresholds determined by ESMA as part of this consultation, be breached.
3. There should be a mechanism for market participants to communicate evidence that highlights material change in the attributes that determine the TO.
4. ESMA should study liquidity during episodes increase of market volatility to ascertain what products remain liquid.

Q15. How highly should ESMA prioritise the alignment of the TO with transparency? What would be the main consequences for the market if some instruments are covered by transparency and not by the TO or vice versa? If the two are not fully aligned, would a broader scope for the TO or for transparency be preferable, and why? In case of a broader or narrower scope for the TO (compared with transparency), how should the two liquidity thresholds relate to each other?

For the first part of this question please refer to our response to Q1

Q16: Do you agree with the proposed methodology to eliminate duplicated trades or would you recommend another approach? Do you agree with selecting Option 2?

We do not agree with the proposed methodology to eliminate duplicated trades. We believe that Option 3, with some improvements, would be the most efficient way of removing duplicate and non-price forming trades.

Please see our response to Q.18.

Q18: Do you agree with the reasons mentioned above or is there another explanation for the significant number of trades outside of benchmark dates?

As stated in our answer to Q16, we believe that Option 3, with some improvements, would be the most efficient way of removing duplicate and non-price forming trades. ESMA has stated that it prefers Option 2 “because it removes a number of records that is in between Option 1 and Option 3” and as “contrary to Option 3 it is not based on solely one field but takes into account a combination of fields”.¹⁵ However, we believe ESMA should base its methodology on soundness of methodology and not simply on the number of actual trades removed. Of the three options considered by ESMA, we believe that Option 3, with some improvements, would be the most efficient way of removing duplicate and non-price forming trades.

If Option 3 was adopted but with non-price forming trades removed from the population of original bilateral transactions it would be the superior option. This would happen if all trades that have resulted from a trade compression cycle, all allocation trades in favour of the block trade (also known as bunched order / pre-allocation) and all non-standard trades due to customized fields were removed.¹⁶ ESMA should also note that, according to EMIR technical standards, firms are required to report the original bilateral transaction before the cleared trade. Therefore removing all cleared trades under Option 3 would remove the unnecessary duplicated trades

Q19: Does this result reflect your assessment of liquidity in fixed-float IRS? If not, please explain on which subclasses you disagree and why.

We would like to bring ESMA’s attention to some elements of the data considered by ESMA where it establishes the products to be subject to the trading obligation:¹⁷

1. **Days traded.** In its analysis ESMA considered a 6 month period from 1st July 2015 to 31st December 2015 and established the minimum number of days traded as 80% of the total number of traded days (104 days). This implies a total number of trading days at 130.¹⁸ In the data analysis, of the 30 tenor points considered in ESMA’s analysis across currencies, 20 tenor points are shown to be traded for more than 130 days. While we acknowledge that there might be certain US/Asia overnight trades (where the trade date could be a Saturday or Sunday for one of the parties) and trading on Sundays in certain parts of the world (such as Israel) we believe these events to be the exception. Therefore, we recommend that ESMA reassess all tenor points to remove data where trading occurs on Saturdays, Sundays or European holidays to eliminate erroneous data. This will avoid the counting of outlier trades

¹⁵ Pg. 43

¹⁶ The “Compression” field in Table 2 of the Commission implementing regulation is to be populated with ‘Y’ if the contract to be reported results from compression.

<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R1247&from=EN>

¹⁷ Pg. 48

¹⁸ This is not considering the bank holidays in various jurisdictions in Europe where no trading activity takes place

which does not represent a real day of trading liquidity for a particular class of derivatives. This will also remove weekend compression activity¹⁹ that does not represent actual liquidity.

2. **Nature of post-trade data.** For its analysis of number of trades and average number of trades ESMA is using data from trades which are already allocated (post-trade post-allocation data) as that is the only data required under EMIR reporting. We believe that data from execution activity, before they are allocated, is an appropriate reflection of liquidity rather than data from allocated trades. However, ESMA does not have access to pre-allocated trade data since they are not reported to Trade Repositories (TRs). ESMA also does not have the necessary data to distinguish trades resulting from package transactions since this information is not reported to TRs. An instance of a particular class of derivatives being part of a package transaction should not be counted towards average number of trades since it is not a true reflection of liquidity for that class of derivatives. To account for these discrepancies ESMA should increase the threshold of average daily number of trades to avoid applying the TO to illiquid products that appear more liquid due to this data issue.

Q20: What thresholds would you propose as the liquidity criteria? What minimum number of counterparties would you consider appropriate for introducing the TO?

Please refer to our response to Q 19 for the first part of this question and our response to Q 4 for the second part of this question.

Q21: What further specifications (e.g. payment frequency, reset frequency, day count convention, trade start type) would you consider necessary for specifying the trading obligation for fixed-float IRS? How would you determine these additional specifications?

Please refer to our response to Q1.

Q22: Does this result reflect your assessment of liquidity in OIS? If not, please explain on which subclasses you disagree and why.

We think the costs, in terms of compliance controls, for market participants to comply with a TO for OIS that only applies to 3 month EUR OIS outweighs any benefits. This compliance cost is particularly severe for non-financial counterparties and hence ESMA should delay the introduction of the TO on the OIS asset class until such time as more benchmark tenors satisfy the 10 trades per day threshold. This will help firms manage costs of building infrastructure that support the trading obligation of the OIS asset class. Furthermore, the average number of trades for the EUR 3M OIS is only marginally above the threshold of 10 trades per day (even including post-allocation data and compression data) suggesting that the OIS asset class as a whole is not liquid enough to be subject to the TO.

¹⁹ Compression activity is often bulk processed on a weekend

In general, a TO that applies to a single tenor point of a product is especially unlikely to see enhanced liquidity because a different trading protocol for just one point on the tenor curve for OIS is unlikely to create a centralised market for OIS trading – quite the contrary, it would likely bifurcate liquidity in OIS between off-facility OIS and the single tenor point for OIS subject to the TO, subjecting those that trade in TO OIS to more risk of predatory trading.

Q23: What thresholds would you propose for the liquidity criteria? What minimum number of counterparties would you consider appropriate for introducing the TO?

Please see our response to Q4.

Q24: What further specifications (e.g. payment frequency, reset frequency, day count convention, trade start type) would you consider necessary for specifying the trading obligation for OIS? How would you determine these additional specifications?

Please see our response to Q1.

Q25: Do you agree that due to the specificities of the FRA-market, FRAs should not be considered for the TO? Do you agree that the majority of FRAs transactions serve post-trade risk reduction purposes rather than actual trades.

We agree that FRAs should not be subject to the TO.

Q30: Do you agree with the proposed application dates? If not, please provide an alternative and explain your reasoning.

We believe that the proposed application dates of the TO will be burdensome for the industry given that they would have to be on the same day as the CO for derivatives comes into effect for some classes of derivatives. We believe that ESMA should phase-in the requirements for the non-financial market participants who are infrequent users of derivatives and do not have the necessary infrastructure to implement the clearing and trading obligation on the same date. ESMA has recently published a report proposing to postpone the implementation date of the clearing obligation under EMIR of Category 3 counterparties.²⁰ This should instruct ESMA's approach on the implementation of the trading obligation for such counterparties

Q31: Do you consider necessary to provide for an additional phase-in for the TO for operational purposes and to avoid bottlenecks? If yes, please provide a proposal on the appropriate length of such a phase-in for the different categories of counterparties and explain your reasoning.

²⁰ https://www.esma.europa.eu/sites/default/files/library/2016-1565_final_report_on_clearing_obligation.pdf

We believe that ESMA should seek to avoid operational bottlenecks by providing an appropriate phase-in period. Under proposed rules Category 1, 2 and 3 counterparties would be required to on-board on to Trading Venues on 3rd Jan 2018 for G4 IRS and Category 1 and 2 counterparties for EEA IRS and Credit derivatives. In some cases the same counterparties would be required to on board for all asset classes on the same day. Smaller counterparties (mainly Category 3 and 4) which will be subject to the clearing obligation after 3rd Jan 2018 will be required to on-board on to Trading Venues on the same date and possibly across asset classes. Given that some of the smaller counterparties conduct only a few trades a year, the rules will put a disproportionate burden on these users.

Q34: Do you agree that package transactions that are comprised only of components subject to the TO should also be covered by the TO or should the TO only apply to categories of package transactions that are considered liquid? If not, please explain.

We believe that package trades should not be subject to the TO. There are only two jurisdictions (USA, Japan) where TOs are live today and both these jurisdictions have exempted package trades from the TO.

Please see our response to Q35 for reasons why package trades should not be subject to the TO.

Q35: How should the TO apply for package transactions that include some components subject to the TO, whereas other components are not subject to the TO?

We believe that if ESMA must implement a TO regime for packages, it should apply only if the following conditions are satisfied:

1. **All components are subject to the TO:** We believe that TO should apply to a package trade only if all its components are subject to the TO. This is because Trading Venues are unlikely to be able to offer liquidity on a package trade where one or more of the components are not subject to the TO.
2. **Trading venue should offer the whole package as a single transaction:** Even if all components to a package trade are subject to the TO, the package should only be subject to the TO if the Trading Venue offers the whole package as a single transaction. This would ensure that market participants are adequately protected should one of the components of the package fail to clear. For example, suppose a market participant wishes to transact a package with individual components subject to the TO, for example, EUR IRS 1y, EUR IRS 2y and EUR IRS 3y. If the Trading Venue offers this package as a single transaction then should EUR IRS 1y fail to clear and EUR IRS 2y and 3y clear successfully the transaction would be considered void. This is because the market participant is only interested in trading the package as a whole. However, if the Trading Venue does not offer the package as a whole but only offers simultaneous execution of the EUR IRS trades consider in the example, then the market participant would be obliged to honour the EUR IRS 2y and 3y trades and potentially be exposed to hedging risks.

These conditions offer adequate protection to market participants who trade packages to hedge complex risks. However, since these conditions are hard to satisfy other jurisdictions²¹ have exempted package trades from the TO and we strongly recommend that ESMA should implement the TO for packages only if all the conditions above are satisfied.

We hope that our above comments are helpful. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact us (Harsh Agarwal at harsh.agarwal@ihsmarkit.com).

Yours sincerely,
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²¹ US CFTC and Japan FSA