ICMA
International Capital Market Association

ICMA suggestions for ESMA Q&A

October 2016

I. MiFID II

Question 1: How will ESMA control targeted execution locations for large trades, based on whether a supplementary deferral regime of 4 weeks is in place or whether the deferral period is for 48 hours? How will ESMA ensure deferral regime consistency?

Background: Individual competent authorities determine whether they want a supplementary deferral regime of 4 weeks or the basic deferral period of 48hours. The concern is that market participants may select a country in which to execute specific transactions (such as larger sizes) based on the deferral regime being applied.

***Suggested answer*:** ICMA considers that ESMA may want to harmonise the interpretation of deferral periods and come to an understanding with NCAs across the EU that all jurisdictions should have the same deferral period and it should be 4 weeks, in order to take into account illiquid/large trades.

Question 2: Regarding SI new issue obligations for firms, what constitutes a 'class of bonds'? Do senior/subordinated/convertible bonds from same issuer (or issuer group) constitute different "classes"? Please clarify.

Background: ICMA understands that as a systematic internaliser (SI), the requirement is for that SI firm to be an SI for that bond issuer (or issuer group) for all new issues, regardless of currency. There is confusion as to how wide the scope is for new issue obligations for SI firms.

Suggested answer: ICMA considers that since the new issue is regardless of currency it should also be regardless of debt seniority, senior or subordinated. However, convertible bond new issues are out of scope for SI new issue obligations.

Question 3: OTF and SI categorisation

Question 3 - Part 1: How would you categorise a broker who conducts the following activity: A broker conducting activity on a voice basis finding a buyer and a seller in an instrument, does not execute the first leg contingent on the second leg and uses their own capital; they are however acting to achieve zero risk at the end of the day (unlike the typical business model of a market maker or SI) by closing out the trade (flattening out the risk by end of day).

-Would the broker be an OTF, SI or neither?

Background: Many brokers are confused as to whether their day-to-day trading activity will be classified as an SI or OTF or neither. The worry is that MiFID 2 and MIFIR will enter into force in 2018 and the clarification from their regulators may come too late for them to take the necessary business decisions (if they need to take any).

Suggested answer: ICMA considers this a case of, 'neither'. The broker is categorised as an 'investment firm'. They are not a 'venue' (OTF) because they are not operating a multilateral system. The business activity is classified as OTC and should be monitored versus the Systematic Internaliser [SI] threshold.

Question 3 - Part 2: Can ESMA provide guidance as to how they would classify the following hybrid business activity: A firm carries out contingent riskless principal trades as an ad-hoc ancillary service to market making or SI activity.

-Does ESMA consider this permissible?

Background: ICMA considers a firm acting as an intermediary (e.g. IDB) operating entirely in an agency/introductory manner an OTF. While a market maker in a firm trading off-venue, is OTC/SI. The concern is, there are ambiguous interpretations of hybrid models. The analysis and understanding across the EU of these hybrid business models is contradictory.

Suggested answer: ICMA considers the appropriate answer to be 'yes' this is permissible activity, as long as the contingent riskless principal trading does not constitute a multilateral system (Recital 19 of the EC Delegated Regulation of 25.4.2016 makes clear that this is the case).

II. Market Abuse Regulation (MAR) Investment Recommendations/ MAR (cross border regulatory guidance)

Question 1: Who are the 'intended recipients' of Investment Recommendations? Is it possible that professional investors could 'opt out' of the MAR Investment Recommendation scheme (as it seems to be aimed more at retail investors)?

Background: The question of 'intended audience' and resultant disclosures address the professional setting in which professional investors (buy-sides) participate in the market. In a professional setting, ICMA considers MAR Investment Recommendation disclosures unnecessary. There is a concern for global buy-sides. In the US, professional Investors can "opt-out" of a similar Investment Recommendation scheme. Professional investors would like to have the same treatment in the EU. Otherwise, global buy-sides (investors) will be opting out in the US (under FINRA) and opting in, in the EU. ICMA considers this unfair to global asset managers. An example is a global fund manager who "opts-out" of this regime in the US as they are a professional client and are now having to "opt-in" in Europe. Not easy (and quite disordered) for global professional investors to implement.

***Suggested answer*:** Capability is the key. If the recipient is a professional investor (and has the credentials to prove this is the case), they are capable and qualified and therefore do not have to receive the disclosures. Similar to the US, they can 'opt out'. If the recipient of the investment recommendation is a retail or non-professional, then full MAR Investment Recommendation tracking and disclosure requirements are required.

Question 2: What is the actual instrument scope of MAR IR?

Background: What happens when one asset class affects another? For example, trade ideas may involve wide ranging information and instruments. Firms must decide whether a trade idea is an investment recommendation under MAR. For example, a firm's takes a view on the euro interest rate curve (the view is that it will flatten). This view can be expressed in a number of different ways: 1. Buy a 10yr government bond and sell a 2yr government bond (could possibly be on the run bonds or off

the run and could be different sovereign issuers…), 2. Receive a 10yr swap and pay a 2yr swap, 3. The view could also be expressed in futures such as; 'buy Bunds – sell Schatz'. 4. Alternatively, the view could be expressed through options: OTC Options, Traded Options or swaptions.

Basically, the 'trade idea' could be any combination of any of the views listed above, with the firm making the recommendation not specifying any particular instrument(s) to express that view.

Suggested answer: If the investment recommendation does not have a specific ISIN or product identifier, then it does not qualify as an investment recommendation under MAR.

Question 3 (MAR- Cross border regulatory guidance): Could ESMA please give EU Market participants comprehensive direction on how to implement a compliance regime that meets both the SEC and the EU Insider knowledge rules? In particular, how should firms implement rules that are contrary on either side of the Atlantic? How are global firms protected?

Background (insider trading knowledge): When there is suspected insider knowledge in the US (under the SEC), the trade is continued until completion. While in the EU (under ESMA) when there is suspected insider knowledge, the trade is halted immediately.

Suggested answer: Market participants would like joined-up EU and US regulatory guidance taking into account both the SEC and ESMA contrary rules so that firms going forward, are prepared and protected.