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November 22, 2016

ESMA Issues a Consultation Paper on Package Orders for Purposes of the Pre-Trade Transparency Requirements

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November 21, 2016

TO: Derivatives Markets Advisory Committee
Equity Markets Advisory Committee
ICI Global Trading & Markets Committee
International Committee
Securities Operations Advisory Committee RE: ESMA Issues a Consultation Paper on Package Orders for Purposes of the Pre-Trade Transparency Requirements

The European Securities and Markets Authority (ESMA) recently published a consultation paper and draft regulatory technical standards (RTS) on package orders for purposes of the pre-trade transparency requirements under the Markets in Financial Instruments Regulation (MiFIR).^[1] A “package order” refers to an order priced as a single unit for purposes of executing an exchange for physical or a package transaction.^[2] These draft RTS would provide standards to facilitate implementation of MiFIR provisions that allow competent authorities to waive pre-trade transparency obligations applicable to operators of trading platforms for package orders that do not have a liquid market.

Appendix 1 to this memorandum—including as an attachment—contains the questions on which ESMA seeks feedback. Comments on the Consultation Paper are due on January 3, 2017. **ICI Global will hold a member call to discuss whether to comment on the Discussion Paper on Monday, December 5 at noon (ET). Please contact Helenia Walker at helenia.walker@ici.org to receive dial-in information for the call.**

Background on the EU Transparency Regime for Package Orders

The European Union’s transparency regime for financial transactions includes measures designed to enhance the availability of information both before and after execution. In general, MiFIR requires post-trade information related to package transactions to be made public with respect to each component. MiFIR, however, authorizes competent authorities to grant a deferral from post-trade transparency requirements in certain circumstances, and ESMA has implemented this authority in prior RTS.^[3] The RTS that authorize post trade deferrals of transparency requirements do not include relief from the pre-trade

transparency regime for package transactions because MiFIR did not contemplate any exceptions from pre-trade transparency requirements for package transactions when these RTS were produced.

In legislation delaying the implementation of the Markets in Financial Instruments Directive II (MIFID II) earlier this year, European authorities amended MiFIR to allow for a more tailored application of pre-trade transparency obligations to package orders. The amendments to MiFIR permit competent authorities to waive pre-trade transparency requirements for a package order that meets one of the following conditions:[\[4\]](#)

- At least one component of the package is a financial instrument for which there is not a liquid market, unless there is a liquid market for the package order as a whole;
- At least one component of the package is large in scale compared with the normal market size, unless there is a liquid market for the package order as a whole; or
- All components of the package are executed on a request-for-quote or voice system and are above the size specific to the instrument.

To ensure the consistent application of those waivers that require the absence of a liquid market for the package as a whole, MiFIR charges ESMA with establishing a methodology for determining those package orders for which a liquid market exists. In making this liquidity determination, Article 9(6) of MiFIR requires ESMA to consider whether packages are standardized and frequently traded. The RTS proposed in the Consultation Paper would implement this provision.

ESMA Proposes A Two-Step Process to Determine Whether a Package Order Has a Liquid Market as a Whole

The RTS proposed in the Consultation Paper would establish a two-step process to identify package orders that have a liquid market as a whole. First, ESMA would deem a package to have a liquid market if the package is composed of derivatives, at least one component of the package is subject to the trading obligation, and the remaining components are subject to the clearing obligation. Packages not deemed liquid under the first test would be subject to a two-part inquiry to further assess liquidity. Part one of this inquiry would assess general factors that could suggest the package has a liquid market and part two would consider asset class-specific indicia of liquidity. ESMA notes that this approach could create “a level of uncertainty...about whether some packages are going to have a liquid market as a whole.”[\[5\]](#) In other words, the RTS would not specify which packages would be considered illiquid or liquid. ESMA, however, indicates that it could publish in the future a non-exhaustive list of specific types of package orders considered liquid.[\[6\]](#)

Step One: At Least One Component Subject to the Trading Obligation, All Other Components Subject to Mandatory Clearing

The first test that ESMA proposes to use to determine whether a package order has a liquid market leverages the regulator’s work on the trading and clearing obligations for derivatives. ESMA proposes that a package would have a liquid market if any component in the package is subject to the trading obligation and all remaining component(s) are subject to the clearing obligation. Because ESMA has proposed to apply the trading obligation only to classes of derivatives that are subject to the clearing obligation, any package transaction composed only of instruments subject to the trading obligation also would be deemed to have a liquid market.[\[7\]](#)

ESMA implies that this proposal would align the treatment of package orders in the

European Union with those in the United States because, the US Commodity Futures Trading Commission provides no exemption from its trading obligation or pre-trade transparency requirements for package orders where: (1) all components are subject to the trading obligation; or (2) one component is subject to the trading mandate and all other component(s) are subject to mandatory clearing.[\[8\]](#)

Step Two: A Two-Part Inquiry

Package orders that are not deemed to have a liquid market under step one would face additional scrutiny to determine if they have a liquid market. ESMA proposes that the liquidity of these packages would be assessed using general and asset class-specific criteria. Any package that is deemed liquid under both sets of criteria would be considered to have a liquid market.

General Indicia of Liquidity

ESMA proposes two general criteria that could be applied to gauge the liquidity of a package order regardless of the asset class or classes of the instruments comprising the package. First, ESMA believes a package order may have a liquid market if all components of the package are standardized. ESMA believes that the components of a package transaction would be standardized if they are admitted to trading or traded on a regulated market, multilateral trading facility, or an organized trading facility and there is a high level of standardization of the contractual terms of the components of the package.[\[9\]](#) Second, ESMA proposes that a package order would be considered liquid only if each component that is a derivative is available for clearing through a central counterparty. ESMA states that linking the liquidity of a package to clearing would be helpful because requiring pre-trade transparency for package orders composed of uncleared and cleared derivatives “might give rise to technical issues.”[\[10\]](#)

Asset-Class Specific Liquidity Standards

If the general indicia of liquidity suggest that a package order might have a liquid market, ESMA proposes to apply additional, asset class-specific criteria to further examine the liquidity of the package. A package that meets the criteria below would be deemed to have a liquid market as a whole. These criteria would apply to package orders where all components are interest rate derivatives, equity derivatives, credit derivatives and commodity derivatives.

Asset Class A Package Would Be Liquid As A Whole If: Interest Rate Derivatives

- The package order has no more than three components;
- The notional currency of the derivative components is in euros (EUR), US dollars (USD), or British pounds (GBP); and
- All derivative components of the package order have an unbroken tenor of 2, 3, 4, 5, 6, 7, 8, 9, 10, or 30 years +/- five days.

Equity Derivatives

- The package order has no more than four components; and
- The notional currency of the derivative components is in EUR, USD, or GBP.

Credit Derivatives

- The package order has two components;[\[11\]](#)

- The package order's derivative components have the same underlying index;
- The notional currency of the derivative components is in EUR, USD, or GBP; and
- The package order moves from the latest off-the-run index series into the current on-the-run index series.

Commodity Derivatives

- The package order has two components;
- The notional currency of the derivative components is in EUR, USD, or GBP; and
- The package order moves from a contract expiring on a particular date into another contract with a different expiry date.

Package orders of all other classes of derivatives—including securitized derivatives, contracts for differences, and emission allowance derivatives—would not be considered to have a liquid market.^[12] ESMA does not propose criteria for determining whether a liquid market exists for a package order composed of transactions in different asset classes. ESMA requests feedback on the treatment of these “cross-asset class packages.”^[13]

ESMA Requests Input to Conduct a Cost Benefit Analysis

ESMA poses a number of questions aimed at gathering compliance costs and other costs and benefits associated with the draft RTS for particular firms and trading venues as well as for the industry as a whole. These questions are attached to this memorandum along with all other questions presented in the Consultation Paper.

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[Attachment No. 1](#)

[Attachment No. 2](#)

endnotes

^[1]European Securities and Markets Authority, Consultation Paper, Draft RTS on package orders for which there is a liquid market (Nov. 10, 2016) , *available at* https://www.esma.europa.eu/sites/default/files/library/2016-1562_cp_package_orders_mifir.pdf (Consultation Paper).

^[2] See Article 2(49) of MiFIR. Article 2(50) of MiFIR defines “package transaction” as either: (1) an exchange for physical; or (2) a transaction involving the execution of two or more component transactions in financial instruments that meets the following three criteria: (a) the transaction is executed between two or more counterparties; (b) each component of the transaction bears meaningful economic or financial risk related to all the other components; and (c) the execution of each component is simultaneous and contingent upon the execution of all the other components.

^[3] These RTS permit competent authorities to grant such a deferral to package transactions that meet one of the following criteria: (1) one or more components of the

package are financial instruments that do not have a liquid market; (2) one or more of the components of the package are transactions in financial instruments that are large in scale compared with the normal market size; or (3) the transaction is executed between an investment firm dealing on its own account other than on a matched principal basis and another counterparty, and one or more of the components of the package are transactions in financial instruments that are above the size specific to the instrument. See Article 8(1)(d) of Commission Delegated Regulation (EU) .../... supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances, and derivatives (Jul. 14, 2016), *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1464_annex_i_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf.

[4] See Article 9(1)(e) of MiFIR.

[5] Consultation Paper at 18.

[6] Appendix 2 to this memorandum—included as an attachment—reproduces a table that ESMA presents in the Consultation Paper to provide examples of the package categories that it expects would have a liquid market based on the methodology described in the paper. ESMA notes that the table is illustrative only and does not provide a full list of the package categories that have a liquid market as a whole. See Consultation Paper at 23.

[7] Consultation Paper at 22. ESMA is presently working to implement the trading obligation for derivatives. See ICI Memorandum No. 30313 (Oct. 14, 2016), *available at* <https://www.iciglobal.org/portal/site/ICI/menuitem.e5ad730a13d808bfaf8db010b52001ca/?vgnextoid=9e6b7caf014c7510VgnVCM100000650210acRCRD&vgnnextchannel=36566702fa782310VgnVCM1000005b0210acRCRD&vgnnextfmt=default>.

[8] Consultation Paper at 22.

[9] See Consultation Paper at 18.

[10] See Consultation Paper at 19.

[11] ESMA includes this criterion in its description of the draft RTS but it does not appear in the draft RTS provided in Annex III of the Consultation Paper. Compare Consultation Paper at 20-21 (describing the asset-class specific criteria for packages composed of credit derivatives) with Consultation Paper at 43 (supplying draft RTS that would establish asset-class specific criteria for these derivatives).

[12] ESMA notes that all FX derivatives are eligible for a waiver from pre-trade transparency requirements because other RTS have determined that these derivatives do not have a liquid market. ESMA notes that it may in the future revisit this determination. See Consultation Paper at 21.

[13] See Consultation Paper at 20.

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