Deutsches Aktieninstitut

ESMA Consultation on MiFID II / MiFIR

Responses of Deutsches Aktieninstitut e.V., 1 August 2014

Introduction

Deutsches Aktieninstitut[1] welcomes the opportunity to comment on ESMA's consultation and discussion paper on MiFID II / MiFIR. Our responses represent the view of companies using derivatives to mitigate risks relating to their commercial and treasury financing activities and accessing capital markets for financing purposes.

Our comment focuses in particular on the following aspects of the consultation / discussion paper:

- Many derivatives used by non-financial companies in their risk management are illiquid. Transparency requirements for electronic platforms, systematic internalisers and investment firms must meet the specifics of these instruments.

- ESMA should be aware that commodity derivatives, emission allowances and derivatives thereof are widely used by many non-financial companies. The process to comply with the ancillary activity exemption should be as lean as possible. As the implementation of the respective processes to calculate the "ancillary activity thresholds" proposed by ESMA would be too complex and thus inappropriate for most non-financial companies ESMA should introduce an exemption for a "de minimis activity" with an approach easily to be applied. The same holds true for the exemption of risk-mitigating derivatives from the position limit requirements.

- ESMA should clarify that non-financial companies accessing platforms like 360T, Currenex or FX all to conclude derivatives electronically for risk-mitigating purposes are regarded as clients and are therefore not endangered to be classified as investment firms under Art. 2 para. 1 lit. d MiFID II.

- Reporting of positions in commodity derivatives, emission allowances and derivatives thereof should refer to existing reporting requirements, especially EMIR. Regarding derivative transactions the trade repositories should be in the position to inform supervisory authorities or trading venue operator on the positions held by the respective counterparties. Regarding emission allowances the venue operator also manages accounts of their end clients. Therefore, client's positions are known by the operator; a further reporting requirement for end users not necessary.

- Regarding equity markets transparency requirements should be appropriate to facilitate an efficient price discovery process as a prerequisite for corporate financing via stock markets.

For details please refer to our responses. We kindly ask ESMA to take our consideration into account in the consultation process.

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[1] Deutsches Aktieninstitut represents the entire German economy interested in the capital markets. Its about 200 members are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt am Main, Brussels and Berlin.

Discussion Paper: Responses to the questions

Q46: Do you agree with ESMA's opinion that Table 1 of Annex II of Regulation 1287/2006 is still valid for shares traded on regulated markets and MTFs? Please provide reasons for your answer.

In Deutsches Aktieninstitut's view listing on a stock exchange provides access to an important source of capital to finance growth and employment for companies. A prerequisite for the willingness of investors to invest in shares and to provide capital for the company is the ability to sell the shares at any time at fair prices in the secondary market. For this purpose, liquidity and integrity of capital markets is of utmost importance to ensure that a fair price fixing process is available.

Besides respective transparency obligations, for example in the context of major share holdings, trading venues should provide sufficient pre- and post-trade transparency to provide the issuer with the information on where and to what extent the shares were traded. Against the background to sustain a sufficient level of transparency on equity markets, we agree with ESMA's opinion.

Q50: Do you think there is merit in creating a new ADT class of 0 to €100,ooo with an adequate new large in scale threshold and a new ADT class of €100,000 to €500,000? At what level should the thresholds be set? Please provide reasons for your answer.

We support ESMA's proposal, i.e. introducing a new ADT class of 100,000 EUR with a new large in scale threshold and a new ADT class of 100,000 to 500,000 EUR respectively in order to facilitate supporting liquidity and transparency for SMEs.

Q51: Do you think there is merit in creating new ADT classes of €1 to €5m and €5 to €25m? At what level should the thresholds be set? Please provide reasons for your answer.

Yes, we agree with the new ADT classes as mentioned in the question. The suggested thresholds of 200,000 EUR and 300,000 EUR are appropriate and should not be decreased.

Q52: Do you think there is merit in creating a new ADT class for 'super-liquid' shares with an ADT in excess of €100m and a new class of €50m to €100m? At what level should the thresholds be set?

Yes, we agree with the new ADS class for 'super-liquid' shares. The suggested thresholds of 650,000 EUR and 500,000 EUR respectively are appropriate.

Q60: Do you agree with ESMA's opinion that stubs should become transparent once they are a certain percentage below the large in scale thresholds? If yes, at what percentage would you set the transparency threshold for large in scale stubs? Please provide reasons to support your answer.

Yes, we agree, as transparency requirements for stubs will improve the price discovery process and will hence increase market efficiency. Therefore, stub orders should be made transparent as far as technically possible.

Q63: Do you agree that the proposed list of transactions are subject to conditions other than the current market price and do not contribute to the price formation process? Do you think that there are other transactions which are subject to conditions other than the current market price that should be added to the list? Please provide reasons for your answer.

Yes, we agrees. No other transactions should be added to the list.

Q103: Do you agree with the proposed approach? If you do not agree please provide reasons for your answers. Could you provide for an alternative approach?

As Deutsches Aktieninstitut represents the view of non-financial companies using derivatives almost exclusively for risk-mitigating purposes it is important to explain why transparency requirements must meet the specifics of those non-financial companies and why a proper definition of liquid markets is very important.

The transparency requirements for non-equity markets (Art. 8-10 MIFIR) are very likely to concern electronic execution platforms like 360T, Currenex or FXall, which are frequently used by non-financial companies. Providers of these platforms will apply for authorization as MTF or OTF. Nevertheless, it must be borne in mind that these platforms do not facilitate multilateral trading comparable to stock trading via exchanges, but solely alleviate bilateral trading which otherwise would have to be executed by phone. In addition, the requirements for post-trade transparency must be met by every investment firm, i.e. every banking counterparty of non-financial end users irrespective of whether the trade is executed on a platform or not (Art. 20 MiFIR).

The transparency requirements for derivatives could seriously interfere with the risk management strategy of non-financial companies. This would be the case especially in narrow markets where the "order book" could contain one individualized derivative only or post-trade transaction details are made public. It is important for ESMA to understand that OTC derivative markets – including transactions executed on MTFs or OTFs – function different from markets for securities and in particular for shares: There are no fully fungible, standardized transactions and usually no "order books" in the classic sense. Transactions are requested by individual customers when required. A secondary market is not existing: If the customer wants to get out of the position, it will not be transferred to someone else, but closed out.

The peculiarities of OTC derivative markets should be reasonably reflected by the transparency regime. Even if transaction data is to be published anonymously, conclusions might be drawn on the identity of transaction partners which would cause inter alia serious confidentiality problems. For certain instruments or maturities only very few potential customers would come into consideration. In the worst case competitors could have an insight into the risk strategy of the company concerned. The consequence would be that companies would again prefer phone trading in order to preserve confidentiality. This would significantly increase the costs of risk management for the real economy.

In addition, transparency might distort price mechanisms especially in narrow markets: If an order has been split into smaller buckets (which is a common practice for larger or illiquid transactions), orders executed at a later stage will become remarkably more expensive. The reason for this is that it is unlikely that a "bespoke" derivative is demanded by various end-users at the same time. The supply side can therefore conclude that the split orders can be attributed to one and the same end-user. As a result, prices will increase which makes risk management more expansive.

The same problem arises with the transparency requirements for systematic internalisers (Art. 18 and 19 MIFIR). Furthermore, systematic internalisers are forced by MiFIR to publish non-discriminatory quotes. Regarding derivative transactions the consequence would be that for a particular instrument identical quotes must be provided for all end-users, regardless e.g. of the creditworthiness or the specifics of the business relationship. As a result the basis of the prices for derivatives will be the counterparty with the worst creditworthiness. Therefore, prices for derivatives will increase especially for those customers with a good credit standing due to the obligation to publish non-discriminatory quotes.

Therefore, we very much welcome that the pre-trade transparency obligation does not apply to those derivative transactions of non-financial counterparties which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity (see. Art. 8 para. 1 MiFIR). We also welcome that a waiver is foreseen which refers to derivatives that are not obliged to be cleared / traded under Art. 9 para. 1 lit. c MiFIR and Art. 18 para. 2 MiFIR. It is crucial that competent authorities are commonly adopting this waiver – across the EU. Otherwise, the level playing fields would be distorted if certain EU jurisdictions refuse to grant the exemption and an additional implementation of processes might result in an additional administrative burden for companies.

Nevertheless, for the sake of clarity it would be helpful if ESMA explicitly mentioned these very important exemptions in its paper. Furthermore, as the level-1-text does not provide the same exemptions for post-trade transparency, we ask ESMA to cautiously calibrate the respective regime especially regarding the definition liquid markets.

According to the question raised we agree with ESMA-preference option 3, a combination of option 1 (minimum number of transactions within a specific time period) and option 2 (number of trading days on which at least one transaction occurred). Instruments resp. classes of instruments should not be regarded as liquid unless they are traded many times a day (20 to 30 times).

Q104: Do you agree with the proposed approach? If you do not agree please provide reasons. Could you provide an alternative approach?

The options provided by ESMA are linked to the criteria "average transaction size" which should be considered for the definition "liquid market". Option 2 takes only into account the average trade volume within a given time span. Therefore, option 1 (average value of transactions) seems to be more logical as it is not clear how the average size of the transaction is reflected in option 2.

Q106: Do you agree with the proposed approach? If you do not agree please provide reasons. Could you provide an alternative approach?

ESMA details the requirement that the average size of the spread should be considered as aspect of liquidity. ESMA proposes to use end-of-day-spreads which is an inappropriate concept for liquidity. It should be better referred to the average spread during one trading day.

Furthermore, especially regarding "bespoke" derivatives which are used in particular by non-financial companies in their risk management spread data is not publicly available and must be inquired bilaterally by phone. This strongly indicates that the respective instrument is illiquid. Therefore, ESMA should consider the instrument for which spread data is not available publicly as illiquid per se.

Q107: Should different thresholds be applied for different (classes of) financial instruments? Please provide proposals and reasons.

Yes, different thresholds should be applied for different asset classes, such as bonds, derivatives etc. Regarding derivatives at least settings for classes like FX, interest, commodity, equity and credit should be distinguished.

Q109: How could the data necessary for computing the average spreads be obtained?

For more liquid instruments spread data is available publicly (e.g. provided by the operator of Regulated Markets, MTFs or OTFs) and for other, illiquid instruments spreads have to be required bilaterally by phone. If the latter is the case ESMA should treat those derivatives as illiquid per se (see our answer to Q106).

Q110: Do you agree with the proposed approach? If you do not agree please provide reasons for your answer. Could you provide an alternative approach?

ESMA proposes that the four criteria for a liquid market are weighed equally and all criteria must be met. We agree with that option.

Q113: Should the concept of liquid market be applied to financial instruments (IBIA) or to classes of financial instruments (COFIA)? Would be appropriate to apply IBIA for certain asset classes and COFIA to other asset classes? Please provide reasons for your answers

As derivatives are instruments with a variety of different characteristics (regarding underlying, maturity, volume etc.) the COFIA is more appropriate. Nevertheless, classes should be sufficiently granular in order to guarantee that only similar instruments will be assembled. The aim should be to define classes which are homoge-

nous. Bearing that in mind the classification proposed by ESMA on pages 133-136 should apply the "other potential sub-categories" when considering classes of instruments as liquid / illiquid. Otherwise this approach would not be granular enough.

Q115: Do you have any proposals on how to form homogenous and relevant classes of financial instruments? Which specifics do you consider relevant for that purpose? Please distinguish between bonds, SFPs and (different types of) derivatives and across qualitative criteria (please refer to Annex 3.6.1).

For derivatives the tables on pages 133-136 point into the right direction (including the sub-categories maturity, underlying, volume etc.).

Q122: Do you agree with the description of voice trading system? If not, how would you describe a voice trading system?

As OTC derivatives are typically agreed on by phone the definition of voice trading system should not be too broad as otherwise every investment firm would be captured. Therefore, it should be made clear that "voice trading systems" have to fit into the definitions of Regulated Markets, MTF or OTF (please see our answer to Q124).

Q124: Do you think that the information to be made public for each type of trading system provides adequate transparency for each trading system?

We see the need for clarification. Publication requirements for "actionable indication of interests" should be appropriately limited taking into consideration that in a lot of cases prices are requested for information purposes only, e.g. to roughly assess a realistic price level, or to be used for internal purposes other than concluding derivatives, e.g. valuations. Such price indications have to be close-to-market to serve their purpose. These "ballpark figure" should not need to be published, as they do not directly result in an execution.

Secondly, the information to be published for voice trading systems (bid, offer, volume) seems too detailed. As voice trading is classical OTC, this is the channel where the most illiquid transactions will be traded, due to the size, tenure or underlying. From the view of a non-financial end-user, that degree of detail of highly tailored transactions will only be of interest for a small group of market participants. The relevance for the wider public is very limited. Furthermore, it is exactly the segment of non-financial end users that requires the highest degree of customer protection to make sure hedging operations are not harmed by adverse positioning of traders. At the very least the volumes quoted should remain unpublished.

Lastly, we have another clarification issue. A requirement for all "voice traders" to establish a publicly accessible and electronically readable information channel would be a very costly one if that includes all market players acting on "voice". The price tag would, via deal pricing, mostly been borne by exactly those non-financial end users in need to be protected from such exhaustive requirements. As "classical" voice OTC transactions are highly individual in most cases, the information value for the public (and even other end-users) would be very limited. ESMA should clearly state that this requirements address only those "voice trading systems" which fit the respective definitions and which are therefore registered as Regulated Market, MTF or OTF.

Q128: How do these voice trading systems currently make information public or known to interested parties at the pre-trade stage?

To our knowledge this kind of information is not published currently, but only revealed to the party requesting the quote. We further note that we believe this is fully adequate to protect customer interest, please compare our answer to Q124.

Q129: Do you agree with ESMA's approach in relation to the content, method and timing of pre-trade information being made available to the wider public?

No, please refer to our answer to Q124. We do not believe that information about transactions done through voice trading systems which do not fit the respective definitions and are hence not registered as Regulated Markets, MTFs or OTFs has relevance for the wider public as most transactions will have no resemblance with those traded in retail markets. On the contrast, customers trading through such systems have a high risk of being negatively affected by adverse positioning of professional traders due to such information. Therefore, the definition for voice trading systems must be displayed narrowly.

Q130: Do you agree with the above mentioned approach with regard to indicative pre-trade bid and offer prices which are close to the price of the trading interests? Please give reasons to support your answer

No. The waivers in question are for trading interest which is above the usual market size. Hence, the sensitive information here is not the price, but the volume of such a transaction in connection with the underlying instrument. A requirement to publish all relevant information on the transaction, though with a potentially less accurate price, is in effect fully voiding the use of the waiver per se.

Q131: If you do not agree with the approach described above please provide an alternative

We believe that a waiver should serve the purpose to not disclose information on a transaction to protect the customer requesting a quote from adverse positioning. Please compare our reasoning in the answers to Q130 and Q124. Therefore, if a waiver is granted, there should not be a requirement to publish any detail of the transaction in question.

Q136: Do you support the use of flags to identify trades which have benefitted from the use of deferrals? Should separate flags be used for each type of deferral (e.g. large in scale deferral, size specific to the instrument deferral)? Please provide reasons for your answer.

No, please see also answer to Q135. Waivers should protect interests of customers, e.g. non-financial companies hedging exotic or above-average size positions, and should not be revealed by a flag system. Such information will not be very valuable to investors, given the fact the underlying transactions will be tailored to the non-financial's requirements. We further believe that the ideas of ESMA about the time horizons of the waivers in question are too tight, e.g. for cases where transactions are split in several tranches. The result will in many cases be that the required transaction volume will not be done when the waiver terminates. A flag system would increase the vulnerability of the initiating customer to adverse positioning by traders.

Q139: Do you agree that securities financing transactions should be exempted from the post-trade transparency regime?

Yes. We do not consider such transactions to be derivatives, but liquidity operations.

Q141: Do you agree with the proposed text or would you propose an alternative option? Please provide reasons for your answer.

No, we do not agree with the text, since the approach proposed by ESMA refers too much on the transparency regime with regard to shares / equity. The approach should better reflect the specifics of derivative instruments used by non-financial companies in their risk management.

ESMA should acknowledge that many instruments are only considered being liquid up to a certain volume; therefore the border between large in scale transactions (LIS) and illiquid instruments is blurred. Taking this into consideration, trades executed above the LIS thresholds should be regarded as illiquid applying the same deferral regime.

Both, LIS and illiquid transactions will take longer to be executed. Sometimes they are being broken down into tranches (which often will still be LIS) and executed one after the other, a process that could take from several hours to several days, in rare cases even weeks, depending on the degree to which the required position deviates from those that are average for the respective underlying. Hence, the deferral period for LIS / illiquid instruments is much too short to circumvent the problems mentioned above in our answer to Q103. Therefore, the volume of the trade should be published several days after the execution and not t+1. We think that t+5 would be justified.

Furthermore, with regard to illiquid instruments ESMA proposes that other details of the transactions besides the volume (e.g. the price of the transaction) should be made public at the end of the trading day at the latest. ESMA should be aware that these details are also relevant against the background described above (see our answer to Q103), i.e. confidentiality and the impact on the pricing process. If the underlying itself is illiquid, e.g. an emerging market currency, or an unusual long maturity, the customer is at risk to be taken advantage of by traders even without mentioning the requested volume. A waiver, especially when temporary, should not reveal selective information, or it is superfluous from the very beginning. Therefore, these details should not be published during the deferral period, which is also the approach chosen by the U.S. CFTC. Otherwise, the level playing field between the U.S. and the European industry would be challenged.

Q143: Do you agree that the maximum deferral period, reserved for the largest transactions, should not exceed end of day or, for transactions executed after 15.00, the opening of the following trading day? If not, could you provide alternative proposals? Please provide reasons for your answer.

As stated in our answer to Q141 we propose that orders which are above the LIS-threshold should be considered as illiquid instruments and should be treated as such under the post-trade transparency regime. We suggest using t+5.

Q144: Do you consider there are reasons for applying different deferral periods to different asset classes, e.g. fixing specific deferral periods for sovereign bonds? Please provide arguments to support your answer.

The deferral periods should take properly into consideration the characteristics of the asset. The deferral regime should acknowledge that many derivatives are illiquid instruments. ESMA should also note that the transparency regime regarding shares does not suit the particularities of non-equity markets.

Q145: Do you support the proposal that the deferral for non-equity instruments which do not have a liquid market should be until the end of day + 1? Please provide reasons for your answer.

No, the deferral period should be longer. We think that t+5 would be appropriate (please see our answer to Q141).

Q146: Do you think that one universal deferral period is appropriate for all non-equity instruments which do not have a liquid market or that the deferrals should be set at a more granular level, depending on asset class and even sub asset class. Please provide reasons for your answer.

No. Liquidity for fungible, standardized products traded on electronic venues differs from liquidity for OTC derivatives, which are much more individualized thereby strictly limiting the group of potential counterparties interested in the transactions. Speaking of derivatives, also in this category liquidity will differ significantly by product category, e.g. rates or currency, and even subcategory, e.g. USD or INR. It would certainly be sensible to come up with a more granular approach.

Q147: Do you agree with the proposal that during the deferred period for non-equity instruments which do not have a liquid market, the volume of the transaction should be omitted but all the other details of individual transactions must be published? Please provide reasons for your answer.

No, see our answer to Q141. If an underlying itself is illiquid, e.g. an emerging market currency, or an unusually long maturity, the customer is at risk to be taken advantage of by traders even without mentioning the requested volume. Hence, ESMA should be coherent with U.S. regulation. CFTC transparency regime does not require the publication of certain characteristics within the deferral period.

Q154: Do you agree with the proposed approach? If no, which indicator would you consider more appropriate for the determination of large in scale thresholds for orders and transactions?

Yes, please refer to our answer to Q104.

Q155: Do you agree that the proxy used for the determining the large in scale thresholds should be the same as the one used to assess the average size of transactions in the context of the definition of liquid markets? Please provide arguments.

Yes, this would be appropriate in terms of consistency.

Q156: In your view, which option would be more suitable for the determination of the large in scale thresholds? Please provide arguments.

As the LIS should be compared with the normal market seize, the determination of the LIS thresholds should refer to the mean or the median of the distribution of the overall trading size for each class.

Q159: Do you agree that the large in scale thresholds should be computed only on the basis of transactions carried out on trading venues following the implementation of MiFID II? Please, provide reasons for the answer.

Yes, we agree from an operational standpoint. Given the data on trading venues should be available in electronic format, it would be easier to extract the relevant values.

Q160: Do you think that the condition for deferred publication of large in scale transactions currently applying to shares (transaction is between an investment firm that deals on own account and a client of the investment firm) is applicable to non-equity instruments? Please provide reasons for your answer.

No. As we also mentioned in other answers, in our opinion it is not appropriate to apply rules relating to a fungible, fully standardized asset traded mainly electronically to other instruments like OTC derivatives, where market structures and procedures are very different. We do not see a compelling reason to apply this proposal across all asset classes. Therefore, as mentioned in our answer to Q141 trades which are above the LIS-thresholds should be regarded as illiquid.

Q215: Are there any elements that have not been considered and / or need to be further clarified here?

We miss a clear statement that non-financial companies which access electronically platforms like Currenex, FX all or 360T to conclude derivative transactions for risk-mitigating purposes are classified as user / clients and are therefore not endangered to be classified as investment firm according to Art. 2 para. 1 lit. d MiFID (see our answer to Q172 in the consultation paper and Q465 in the discussion paper). Such a statement would be helpful to avoid misinterpretations of the Level 1 text.

Q465: What are the advantages and disadvantages of the two alternative approaches mentioned above (taking into account non-EU activities versus taking into account only EU activities of a group)? Please provide reasons for your answer.

We strongly advocate to take only into account EU-activities as this approach would be in line with the scope of MiFID which is restricted to the EU. Otherwise, many difficulties would arise. Taking into account non-EU-activities would e.g. mean that a non-EU-subsidiary could be required to be licensed according to MiFID. This however could contradict legislation of the respective jurisdiction where the subsidiary is domiciled. In addition, it is unclear how the competent national authority or ESMA would seek to enforce MiFID in the respective third country. Last but not least, the approach to consider only activities on EU-level would be much simpler for companies. We are asking ESMA to keep in mind the already strong increase in administrative burden from other recent regulation initiatives of the EU, especially EMIR. Furthermore, we would like to make a general remark on the interaction of the two exemptions in Art. 2 para. 1 lit. d and Art. 2 para. 1 lit. j as discussed by ESMA on p. 386-393. For many non-financial companies the exemption set forth in Art. 2 para. 1 lit. d is highly important, e.g. for their risk management with FX or interest derivatives. As explained in our answer to Q103 it is common practice among non-financial companies to use electronic platforms like FX all, 360T or Currenex to efficiently enter into those hedging contracts with banks that are very standardized.

According to this constellation we see two potential problems. First, FX all, 360T or Currennex etc. might be classified as MTF or OTF in future. Second, non-financial end users reach the platforms electronically, as this is the most efficient access technically possible. This kind of access is not relying on an investment firm's trading code or some other anonymous means of trading. Nevertheless, Art. 2 para. 1 lit. d restricts the exemption to those persons who are not a member / participant of MTFs and who are not having direct electronic access. Overall, this means that it is very important for non-financial companies that they can use the platforms mentioned above without bearing the risk to be required to license as investment firm, e.g. because they are treated as a "member / participant" of a MTF or because the access to the platforms is performed electronically.

Therefore, it should be clarified that non-financial companies are only users / clients of these platforms with the intention to efficiently enter into derivative contracts for risk management purposes. Hence, they should not be covered by the scope of MiFID II according to Recital 20 and Art. 2 para. 1 lit. d. This would be in line with the IOSCO "Principles for Direct Electronic Access" which obviously refer to "professional" traders like hedge funds or proprietary trading groups (see page 5 of the IOSCO report). Otherwise, non-financial companies would be forced to conclude all of their transactions non-electronically, which would contradict the aim of the legislator to promote platform trading.

Q467: Do you consider there are any difficulties concerning the suggested approach for assessing whether the ancillary activities constitute a minority of activities at group level? Do you consider that the proposed calculations appropriately factor in activity which is subject to the permitted exemptions under Article 2(4) MiFID II? If no, please explain why and provide an alternative proposal.

First of all, it is important to state that many non-financial companies, irrespective of size, use commodity derivatives in order to safeguard their planning processes and to unbundle these from fluctuations in commodity prices. Many of them are also required to hold emission allowances due to the respective EU legislation.

The "capital employed approach" does not fit the business model of non-financial companies, who do not have to comply with capital requirements like CRD IV / CRR. The notion to employ capital for parts (or even portfolios) of the treasury business is a matter of the financial world as it mainly relates to the context of own fund requirements for banks, insurers etc. As the main activity of non-financial companies is – by definition – of operative nature (e.g. car manufacturing, engineering etc.) they are not familiar with the approach to employ capital for certain treasury activities like hedging or intra-group transactions. Hence, even the theoretical employment of capital to such activities would be a significant additional administrative burden that does not serve any operative purpose for them.

A process as described by ESMA would also not be justified from a supervisory perspective for the significant number of companies which are using commodity derivatives almost exclusively for hedging purposes. Consequently, they are far away from the proposed thresholds. Therefore, we think that an exemption from the obligation to calculate the respective thresholds is justified for such a "de minimis activity". The required approach should be simple enough that even SME companies can comply with it, as commodity derivatives are used in hedging by companies of all sizes.

The indicator to evidence that the company is far away from exceeding the thresholds should be easy to apply, e.g. the (notional) value of the respective activities minus the privileged transactions (in particular risk-mitigating derivatives and intra-group transactions) compared with the total turnover of the group. The "de minimis activity" should also not include those emission allowances activities which are exempted under Article 2 para. 1 lit. e MiFID II as these instruments are not kept for trading purposes but in order to oblige with the requirements of the EU Emission Trading System.

Besides this, the calculation method proposed by ESMA is too complex and should be replaced by an approach which could be easier to apply for those companies which could not benefit from the "de minimis" exemption proposed above. The starting point should be the capital employed for the activity in the instruments concerned (commodity derivatives, emission allowances or derivatives thereof). From this activity the capital employed for the privileged transactions (hedging, intra-group transactions and transactions to fulfill liquidity provisions) should be deducted. The remaining capital is the capital employed for the ancillary activity which should be compared with the capital employed for the main activity, i.e. the group wide capital minus the capital employed for the ancillary activity. Furthermore, following the approach as described would be in line with the approach chosen by ESMA to calculate the second criteria – i.e. the size of the trading activity compared with the overall market activity of the asset class. Furthermore, as mentioned above emission allowances which are exempted under Article 2 para. 1 lit. e MiFID II should not be considered as ancillary activity and should hence be regarded as privileged transactions as well like e.g. the hedging derivatives.

Q468: Are there other approaches for assessing whether the ancillary activities constitute a minority of activities at group level that you would like to suggest? Please provide details and reasons.

Yes, we suggest a simplified approach in order to take appropriate into consideration specifics of the majority of non-financial companies. Please see our answers to Q467.

Q469: How should "minority of activities" be defined? Should minority be less than 50% or less (50 - x)%? Please provide reasons.

It should be defined as proposed by ESMA: Less than 50%. The approach should be easy to administer for non-financial companies.

Q470: Do you have a view on whether economic or accounting capital should be used in order to define the elements triggering the exemption from authorisation under MiFID II, available under Article 2(1)(j)? Please provide reasons.

For reasons of simplicity and availability of definitions accounting capital should be used.

Q472: Do you agree with the above assessment that the data available in the TRs will enable entities to perform the necessary calculations?

ESMA discusses two options: Companies willing to benefit from the exemption should calculate their positions in the relevant instruments for their own or should receive the data by the TRs. Both options should be included in the standards, as not all companies have direct access to repository data due to reporting delegation.

The grouping of data according to the commodity classes defined by ESMA should be provided by TRs or centrally by the competent authorities. The difficulty could be that a TR has only record of the transactions reported to it, but not of the ones reported to other TRs. In that case, the aggregation of data and calculation of the market size per commodity class should be done centrally by the national authority.

Q475: How should the volume of the overall trading activity of the firm at group level and the volume of the transactions entered into in order to hedge physical activities be measured? (Number of contracts or nominal value? Period of time to be considered?)

It is more reasonable to consider the nominal value instead of the number of contracts as the former is more meaningful. The number of contracts is not a sufficient indicator of the overall size of the activity.

Q477: What difficulties could there be regarding the aggregation of TR data in order to obtain information on the size of the overall market trading activity? How could these difficulties be addressed?

The aggregation of data from different TRs is challenging due to different data formats as well as different requirements of additional information by TRs. The aggregation can only be handled by a central institution.

Q478: How should ESMA set the threshold above which persons fall within MiFID II's scope? At what percentage should the threshold be set? Please provide reasons for your response.

Those companies which benefit from the "de minimis activity exemption" proposed in our answer to Q467 should not be required to calculate the "trading activity threshold", as they already proved that they are not really engaged in a trading activity in the respective transactions.

For those companies which cannot benefit from the "de minimis activity exemption" the approach proposed by ESMA should be reconsidered. The cliff effect proposed by ESMA would mean that a breach of one threshold in one asset class triggers the necessity of a MiFID-license for every other asset class. This seems inappropriate, as the trading activity in the other asset classes could be very low, or non-existent. Furthermore, the thresholds should carefully take into consideration the systemic relevance of the position. It should be coherent with the first test, either "capital employed" or an alternative assessment method. Therefore, the threshold should be defined as follows: The overall trading activity of the group should not exceed 50 per cent of the overall trading activity in the respective market.

Q480: Are there other elements apart from the need for ancillary activities to constitute a minority of activities and the comparison between the size of the trading activity and size of the overall market trading activity that ESMA should take into account when defining whether an activity is ancillary to the main business?

The proposal of ESMA to capture firms with a relatively high level of trading activity when compared to that of MiFID-licensed firms is not justified. Recital 20 only states that those non-financial companies dealing in financial instruments in a "disproportionate manner" should be required to be licensed as investment firm. The definition of "disproportionate manner" was adequately reflected in the thresholds mentioned in the level 1 text and is detailed further by ESMA above (minority of activity and size of the trading activity). Additional thresholds are not mandated by the level 1 text and should therefore not be proposed by ESMA. The idea of ESMA to simply compare the level of financial activities of non-financial companies with those of financial companies already classified as investment firms (as given on page 401) is inadequate and should be abandoned.

Q481: Do you see any difficulties with the interpretation of the hedging exemptions mentioned above under Article 2(4)(a) and (c) of MiFID II? How could potential difficulties be addressed?

As a matter of consistency it is crucial to link the hedging exemption to the already existing definition under EMIR. Introducing an additional one would only create confusion.

Q482: Do you agree with ESMA's proposal to take into account Article 10 of the Commission Delegated Regulation (EU) No 149/2013 supplementing EMIR in specifying the application of the hedging exemption under Article 2(4)(b) of MiFID II? How could any potential difficulties be addressed?

Yes, see our answer to Q481.

Q485: Should the (timeframe for) assessment be linked to audit processes?

According to Art. 2 para. 1 lit. j MiFID II persons who benefit from the ancillary activity exemption shall annually notify their competent authority that they intend to do so. Upon request they should provide competent authorities with the reasons for the exemption.

As the provision of the reasons on an annual basis is not mandatory, an additional, costly audit process which certifies the "ancillary activity exemption" is not justified. We remind ESMA of the fact that also under EMIR a non-financial does not have to provide audit confirmation for its statements concerning its status with regard to clearing thresholds. The auditor will only confirm that overall compliance with EMIR seems warranted according to a company's respective processes and setup. It would not be proportionate to install an audit obligation for the ancillary activity exemption from a supervisory perspective, especially not for those companies which are far away from the proposed thresholds and should hence rather benefit from a "de minimis activity exemption" as suggested in our answer to Q467.

Furthermore, as the data on commodity derivatives and emission allowances derivatives of every company using these instruments is available in the trade repositories (according to the reporting requirement under EMIR), the competent authorities could easily verify the statements made by the non-financial companies. For emission allowances competent authorities can use data which is delivered by the trading venue operator under the new position reporting regime (see also our answer on Q535). Therefore, competent authorities have already access to the relevant information necessary to monitor statements made by the companies. There should not be another parallel auditing regime.

Q487: Which approach would be practical in relation to firms that may fall within the scope of MiFID in one year but qualify for exemption in another year?

We agree with the approach proposed by ESMA to refer to the three year rolling average. We also share the view of ESMA that the approach chosen in EMIR does not fit the needs of MiFID. A daily calculation of the respective positions is very burdensome and not justified especially as the relation between the trading activity of the company and the trading size of the overall market may significantly vary on a day by day consideration.

Q490: Do you agree that the competent authority to which the notification has to be made should be the one of the place of incorporation?

Yes, we agree.

Furthermore, we repeat our proposal that ESMA should define a "de minimis activity" for those companies which are far away from exceeding the thresholds. Those companies should not be required to calculate the thresholds (see our answer to Q467).

Q491: Do you agree with ESMA's proposal to link the definition of a risk-reducing trade under MiFID II to the definition applicable under EMIR? If you do not agree, what alternative definition do you believe is appropriate?

Yes, we agree. It is very important that definitions should be coherent amongst the different legislations. Otherwise, duplication of costs for the implementation of different processes for the compliance of different legislations would be the result. This should be avoided.

Q492: Do you agree with ESMA's proposed definition of a non-financial entity? If you do not agree, what alternative definition do you believe is appropriate?

Yes, we agree, as the definition of non-financial entities is linked to the respective definition under EMIR (see our arguments provided in our answer to Q491).

Q495: Do you agree with the approach to link the definition of economically equivalent OTC contract, for the purpose of position limits, with the definitions used in other parts of MiFID II? If you do not agree, what alternative definition do you believe is appropriate?

Yes, for reasons of coherence we agree with the proposal of ESMA to link this definition with definitions used in other parts of MiFID II.

Q497: Do you believe that the definition of "economically equivalent" that is used by the CFTC is appropriate for the purpose of defining the contracts that are not traded on a trading venue for the position limits regime of MiFID II? Give reasons to support your views as well as any suggested amendments or additions to this definition.

No, we favour option 1 to link the definition to definitions already available under EMIR (see our answer to Q495).

Q500: Do you agree with ESMA's proposals on aggregation and netting? How should ESMA address the practical obstacles to including within the assessment positions entered into OTC or on third country venues? Should ESMA adopt a model for pooling related contracts and should this extend to closely correlated contracts? How should equivalent contracts be converted into a similar metric to the exchange traded contract they are deemed equivalent to?

Our answer refers to ESMA's proposal for the notification and approval process regarding the exemption for hedging commodity derivatives (see p. 413-414). As already stated in our answer to Q490 ESMA must bear in mind that many non-financial companies are using commodity derivatives for hedging purposes, and that their administrative capacities are limited. The idea of ESMA to introduce an approval regime for those companies willing to benefit from the exemption for hedging derivatives would be very burdensome. It would be very time consuming as well if – in extreme – every trade must be exempted from the position limit regime before execution. The approval regime proposed by ESMA is also not in line with EMIR, as EMIR requires only a notification by non-financial companies after they exceed the clearing thresholds.

In any case, the declared character of each derivative position – i.e. hedging or not – could be reviewed from the data in the EMIR trade repositories. As an alternative to the ESMA proposal we suggest that it should be up to the non-financial company to define those derivatives which are not acknowledged as risk-mitigating according to EMIR and are hence part of the position limit regime, if they are traded on a trading venue or are economically equivalent. Such "trade labeling" is already a prerequisite for the EMIR reporting process. Therefore, the compliance with this requirement could be monitored by analyzing trade repository data, which the responsible authority could access any time. An additional approval process would be cumbersome and superfluous.

Q535: Do you agree with ESMA's proposed approach to use reporting protocols used by other market and regulatory initiatives, in particular, those being considered for transaction reporting under MiFID II?

Double reporting should be avoided by coherent reporting standards between different regulations, especially regarding EMIR. ESMA should be aware that the compliance with the reporting requirements under EMIR is very burdensome for every market participants. Additional reporting requirements regarding positions in commodity derivatives and emission allowances resp. derivatives should be avoided. Therefore, it is ***not*** necessary that end users should report their positions to the venue operator as these data already exist in EMIR trade repositories. Using repository data directly also helps avoiding any confidentiality issues resulting from passing customer identity information through the trading chain.

According to EMIR commodity derivatives and (after the adoption of MiFID II) derivatives on emission allowances have to be reported to trade repositories. For these instruments ESMA or the venue operator should tap the information already available in the trade repositories. This information is sufficient to calculate and update the respective positions of every end client in the respective derivative instruments. A further reporting requirement for end clients would be absolutely superfluous.

Information on positions in emission allowances is available as well: On the level of the trading venues, as the venue provider manages also the end users accounts. In these cases it should be up to the venue provider to report these positions without requiring end users to provide this information again. Otherwise, the implementation of additional processes would be very burdensome and not justified, as the required information is already available.

Q536: Do you have any specific comments on the proposed identification of legal persons and/or natural persons? Do you consider there are any practical challenges to ESMA's proposals? If yes, please explain them and propose solutions to resolve them.

For the reasons explained in our answer to Q535 a separate reporting of end clients is not necessary. This holds true for the "identification regime" as well.

Q540: Do you agree that position reporting requirements should seek to use reporting formats from other market or regulatory initiatives? If not mentioned above, what formats and initiatives should ESMA consider?

Yes, we fully agree (see our answer to Q535).

Q542: What is your view on the use of existing elements of the market infrastructure for position reporting of both on-venue and economically equivalent OTC contracts? If you have any comments on how firms and trading venues may efficiently create a reporting infrastructure, please give details in your explanation.

We strongly believe that there is no need for an additional reporting infrastructure for purposes of the position management scheme (please see our answers to Q535). All necessary data is already being collected, and most can be found in the EMIR trade repositories. The data should be accessed directly by the relevant authorities or the venue provider. This seems to be the most cost efficient way, would avoid confidentiality issues and would create synergies with regard to data involved.

Q578: In your view, which option (and, where relevant, methodology) is more appropriate for implementation? Please elaborate.

We would like to make a general remark on Art. 26 MiFID II as regards the application of the mechanism how algorithms should be flagged. This flag should be harmonized as well across the EU. The flag applied by the German high frequency law should be considered in this respect as a valid option avoiding unnecessary burden on the industry

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Q74: Do you agree with the proposed costs and charges to be disclosed to clients, as listed in the Annex to this chapter? If not please state your reasons, including describing any other cost or charges that should be included.

Our understanding is that ESMA does not include financing costs of "normal" issuers of shares or corporate bonds as part of the cost ratio provided to the clients. The examples provided by ESMA are not referring to these costs. This is very reasonable as these costs are borne by the issuer and not charged to the client. Nevertheless, for reasons of clarity it would be helpful if ESMA clearly states that costs for the issuer of shares and corporate bonds should not be considered in the cost ratio provided to the client.

Q143: Do you agree with the proposed definition of "regular and continuous" publication of quotes? If not, what would definition you suggest?

No, at the very least not across the whole product spectrum offered by a systematic internaliser. As far as OTC derivatives are concerned, there will not be continued trading of fungible and identical instruments like in shares, as each transaction requested will almost surely only be traded once – by the party requesting the respective quote. There is no need to update this quote unless a new pricing has been requested for the same derivative. Therefore, if the product in question is not a security or a standardized, fungible derivative (e.g. a 5-year standard Single-Name CDS or Index CDS), the obligation to update published quotes should be abolished.

Q167: Which would be your preferred option? Why?

From the perspective of capital market oriented companies short-term investors like high-frequency traders contribute as liquidity provider to the functioning of capital markets. Therefore, also long-term investors benefit from the liquidity provided by high-frequency traders.

Although the integrity of capital markets must be preserved by all means, e.g. by preventing market abuse, a legal framework for high frequency trading must maintain the liquidity provision service of these market participants. Against this background we think that the German High Frequency Trading Act, enacted last year, should be a role model for the details provided by ESMA regarding this issue.

Regarding the definition of what constitutes high-frequency trading we believe that Option 1 is best suited as it is well defined, has absolute criteria and is quite similar to what has been implemented in Germany (please refer to our answer to Q168 as well).

Q168: Can you identify any other advantages or disadvantages of the options put forward?

According to our proposal to use the German framework for high frequency trading as a role model (see our answer on Q167) we would prefer Option 1 as this would require somewhat less effort for firms who already comply with existing German requirements. However, we suggest adding the criteria of "proprietary trading" as this is essential when it comes to high-frequency trading. Furthermore, the definition should refer to the fastest connection available: "The participant/member uses the fastest connection offered by the respective trading venue."

Q172: Do you consider it necessary to clarify the definitions of DEA, DMA and SA provided in MiFID? In what area would further clarification be required and how would you clarify that?

Deutsches Aktieninstitut represents non-financial companies using derivatives almost exclusively for risk-mitigating purposes. We miss a clear statement that non-financial companies which access electronically platforms like Currenex or 360T to conclude derivative transactions which are relatively small and / or very standardized

for risk-mitigating purposes are classified as users / clients and are hence not endangered to be classified as investment firm according to Art. 2 para. 1 lit. d MiFID (see our answer to Q103 in the discussion paper). Such a statement would be helpful to avoid misinterpretations of the Level 1 text.

Therefore, for many non-financial companies the exemption set forth in Art. 2 para. 1 lit. d is highly important, e.g. for their risk management with FX or interest derivatives. Regarding to this paragraph and to the definition electronic access we see two potential problems. First, FX all, 360T or Currennex etc. might be classified as MTF or OTF in future. Second, non-financial end users reach the platforms electronically, as this is the most efficient access technically possible. This kind of access is not relying on an investment firm's trading code or some other anonymous means of trading. Nevertheless, Art. 2 para. 1 lit. d restricts the exemption to those persons who are not a member / participant of MTFs and who are not having direct electronic access. Overall, this means that it is very important for non-financial companies that they can use the platforms mentioned above without bearing the risk to be required to license as investment firm, e.g. because they are treated as a "member / participant" of a MTF or because the access to the platforms is performed electronically.

Therefore, it should be clarified that non-financial companies are only users / clients of these platforms with the intention to efficiently enter into derivative contracts for risk management purposes. Hence, they should not be covered by the scope of MiFID II according to Recital 20 and Art. 2 para. 1 lit. d. This would be in line with the IOSCO "Principles for Direct Electronic Access" which obviously refer to "professional" traders like hedge funds or proprietary trading groups (see page 5 of the IOSCO report). Otherwise, non-financial companies would be forced to conclude all of their transactions non-electronically, which would contradict the aim of the legislator to promote platform trading.

Q215: Do you agree with ESMA's approach on specifying contracts that must be physically settled?

From the perspective of our members, non-financial companies using derivatives almost exclusively for risk-mitigating purposes, we agree in general. Nevertheless, some amendments are proposed:

First, regarding commodity contracts which leave one contract partner the choice for earlier termination under pre-specified circumstances it should be clarified that the cash compensation due in that cases are not regarded as cash settlement. This should be acknowledged in the Technical Advice.

Second, the term "unrestricted and unconditional right to physically delivery" is prone for legal uncertainty. It would be better to refer to the wording provided in Recital 10 of MiFID II that the contracts must have an "enforceable and binding obligation to physically deliver which cannot be unwound".

Third, although ESMA considers 'operational netting' in power and gas markets, we notice that there is no explicit reference to such practice in the Draft Technical Advice. Therefore, a right to offset deliveries for operational reasons cannot be understood as right to 'offset transactions' and this should be reflected in the wording of the Technical Advice. This should apply for the right to net payments as well.

Q219: Do you agree that Article 38 of Regulation (EC) No 1287/2006 has worked well in practice and elements of it should be preserved? If not, which elements in your view require amendments?

We believe that Art. 38 of Regulation No 1287/2006 is well established and has provided sufficient guidance to identify the objective characteristics of contracts falling under C.7 of Annex I, Section C of Directive 39/2004/EC. Therefore, we do not agree with most of the changes proposed in the Technical Advice as they may create confusion and legal uncertainty.

Q222: Do you agree that the future Delegated Act should not refer to clearing as a condition for determining whether an instrument qualifies as a commodity derivative under Section C 7 of Annex I?

No, we do not agree, as we think that the clearing condition is an important aspect for the definition "financial instrument" provided in Section C 7. ESMA should also be aware, that EMIR is not the only legislation which refers to the financial instrument definition under MiFID.

Q238: Do you agree that the listed factors and criteria allow ESMA to determine the appropriate reduction of a position or exposure entered into via a derivative?

We believe that factoring in the "purpose of the position (hedging or financial exposure)" in the way of a recital only is too weak a contribution to a decision process that is supposed to determine if a position reduction can be demanded by ESMA. In our opinion it is not appropriate to include derivatives relating to commercial and treasury financing risks in this consideration at all: There should never be a demand to unwind hedging positions, as this would pose the respective company at risk with regard to their underlying exposures. We do not see how increasing the risk positions of market players should contribute to lower overall risk in financial markets.

Q240: Do you agree that some factors are more important than others in determining what an "appropriate reduction of a position" is within a given market? If yes, which are the most important factors for ESMA to consider?

Yes, please refer to our answer to Q238. Risk-mitigating positions should have the most important factor, and not be subject to orders from ESMA for a position reduction.

Q244: What are your views on the proposed approach for legal documentation and portfolio compression criteria?

As a risk mitigating technique portfolio compression is detailed under EMIR and the respective delegated acts. In our view it is absolutely necessary to avoid either duplication of process requirements already established under EMIR, or mismatches between compression rules foreseen for MiFID purposes. Both set of rules must be fully aligned to make sure that especially non-financial companies with certain processes reliefs in EMIR are not being drawn into additional requirements under MiFID.

Q245: What are your views on the approach proposed by ESMA with regard to information to be published by the compression service provider related to the volume of transactions and the timing when they were concluded?

ESMA must make sure the approach taken is corresponding to EMIR rules, please compare our answer to Q244.

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