



## ANNEX I

### **ICE comments in relation to the Consultation published by the Federal Ministry of Finance on the experience and possible need for amendment with regard to the EU Markets in Financial Instruments Directive (“MiFID II” or “the Directive”) and the EU Markets in Financial Instruments Regulation (“MiFIR” or “the Regulation”)**

#### **I. Pre-trade transparency (MiFIR Article 8)**

##### *Background*

The Regulation, applying since 3 January 2018, has introduced a harmonised pre-trade transparency regime for certain financial instruments traded on a trading venue, including derivatives. According to MiFIR Art. 8, trading venues shall publish information about current bid and offer prices and the depth of trading interests at those prices advertised through their systems.

Art. 8 rightly recognises that certain exemptions from the general requirement to publish pre-trade transparency data are necessary to preserve an orderly price discovery process and to allow nascent and niche markets to develop. These exemptions are implemented through pre-trade transparency waivers for transactions above a certain volume threshold (Large in Scale waiver or ‘LIS’) and transactions in certain instruments which are classified as illiquid, regardless of their volumes (Illiquid Instrument waiver or ‘IL’). The implementing Regulation 2017/583 (“RTS 2”) sets out the methodology for calculating LIS thresholds and determining illiquid instruments.

With regards to LIS, the calculation is based on a threshold floor expressed as notional trade value in a given sub-asset class and the trade size below which lies the percentage of transactions corresponding to the trade percentile specified by the RTS for that sub-asset class. The IL thresholds are determined on the basis of the average daily trade notional amount and the average daily number of trades as specified by RTS 2 for a given sub-asset class.

However, this methodology has proven unworkable in practice, in particular with respect to certain commodity derivatives. Calculations based on insufficiently granular sub-asset classes, besides arbitrarily selected and inappropriately calibrated parameters, result in disproportionately low LIS thresholds for highly liquid products and overly high thresholds for developing markets.

Trading venues and market participants are also challenged by the fact that LIS thresholds are set in Euros instead of lots. Using lots has been the standard in the market for similar threshold calculations pre-MiFIR. The circumstance that LIS thresholds are currently based on historical Euro trade values and not the number of traded lots in a particular sub-asset class result in disproportionate LIS thresholds that ignore the actual underlying trading behaviour.



For example, the LIS threshold for highly-liquid *ICE Futures Europe Gasoil Futures* calculated under the current RTS 2 methodology is equal to 10 lots compared to the 100 lots minimum block threshold applied before the introduction of MiFIR. In contrast, in far less liquid products such as *ICE Futures Europe Rotterdam Coal Options*, only trades above 50 lots would be considered LIS as compared to the 5 lots block threshold pre-MiFIR.

Furthermore, the new methodology has led to a significant number of niche and nascent products being incorrectly classified as liquid, and thus becoming subject to significantly broader transparency requirements, which were previously reserved for developed markets.

Excessive LIS thresholds may lead market participants to revert to more bilateral trading outside transparent and supervised venues and not subject to central clearing. This increases market concentration by leading to less competition and ultimately lowers the social welfare gains of an efficient price discovery. Such a development contradicts the G20 objectives to create more transparent and resilient derivative markets.

### *The rationale of exchange-operated trade registration facilities*

As a general principle, ICE believes that financial markets are best served by a high degree of transparency in a multilateral environment. This approach maximises market participation and enables the matching of buying and selling interests in a manner which is conducive to forming competitive prices.

At the same time, and in respect of commodity derivatives markets, there is a need for a calibrated approach to transparency in recognition of the fact that some forms of trading activity cannot easily be accommodated in a fully transparent central order book environment.

ICE has long argued that the MiFIR pre-trade transparency regime does not apply to trade registration. It considers that the regime in its present form is not fit for purpose and poses substantial implementation challenges. In particular, with regards to commodity derivatives markets, the regime risks compromising their vital role in supporting the hedging activity of commercial market participants and in mitigating wider systemic risks by:

- Preventing pre-negotiated trades to be submitted to exchanges, thereby limiting the ability of market participants to hedge their commercial exposures;
- Forcing the trading activity to move away to the OTC space, thereby limiting transparency and undermining the price discovery process as well as limiting the possibility of physical delivery to take place under the exchange rules;
- Limiting the number of cleared trades and therefore increasing systemic risk and market concentration;
- Preventing nascent commodity derivatives markets in Europe from developing.



If pre-trade transparency rules are to be applied to trade registration, the thresholds should be set in such a way as to encourage as much trading volume as possible to be executed through the central order book, taking into account a realistic assessment of the characteristics of the market and the liquidity in this order book.

Registered trades, and their accompanying rules and procedures, should be designed to support and complement orderly markets.

Typically, a market is suitable for the introduction of trade registration where it:

- (i) Offers a way to wholesale market participants in which to create or extinguish substantial positions without introducing disruptively large orders into the central order book. The use of an exchange's trade registration facility in those circumstances enables such participants to avoid an execution delay and/or a price slippage by executing large orders outside the central order book. Such business is executed under the exchange's rules and is subject to specific minimum volume thresholds as well as strict pricing parameters which are designed to ensure that registered trades are concluded at a fair market value;
- (ii) Supports the development of new or nascent on-exchange markets by providing an alternative to OTC trading. This creates a pool of open interest to support the transition of further trading from an OTC environment to an exchange environment;
- (iii) Enables market participants to pre-negotiate substantial trades against markets or settlements that would have otherwise to be traded directly in the relevant period, with the associated commercial and compliance risks.

### *Proposed solutions to the described challenges*

#### **Option 1: replacing the current methodology set out in RTS 2 with a product-specific approach**

ICE has extensive experience in operating a trade registration facility referred to as ICE Block and has developed sophisticated policies and carefully calibrated thresholds in this regard, long before MiFIR.

ICE proposes that the RTS 2 is amended in a way which builds upon these well-established practices. The current methodology for setting LIS thresholds should be replaced by a more appropriately tailored and market-based approach. Specific thresholds should be set by the relevant National Competent Authorities in cooperation with trading venues with regards to instruments these venues admit to trading.

The proposed approach to determining thresholds and rules for registered trades would depend mainly on:



- The current liquidity in the contract;
- The commercial activity that underpins trading in the central order book (including the average lot size or the most frequently traded lot size).

For example, in the case of a highly liquid instrument, such as the *ICE Futures Europe Brent Futures* contract, whilst approximately 600,000 to 900,000 lots are traded each day, the average trade size is only 2.4 lots and the number of lots at the best bid or offer is typically 30 or 40 lots. This means that an order of e.g. 1,000 lots is too large to be placed into the central order book since it would have a significant price effect, whether it is executed or not.

Brent, moreover, is a futures contract used to hedge entire cargoes of oil in sizes of 600 lots or more. There is substantial appetite for such large trades. The size of a block trade permitted in liquid contracts is thus driven by what size of order would disrupt the central order book and by whether the underlying physical trade would be likely to give rise to orders of such size.

In less liquid and illiquid contracts, it is probable that the market will even have difficulties in absorbing orders of a modest size. A more nuanced approach is therefore needed. Typically, ICE would consider which size of an underlying physical trade might require a futures hedge. For example, Fuel Oil contracts are not liquid in the central order book, but Fuel Oil itself is typically traded in tranches of 5,000 to 10,000 tonnes in the physical market. To enable a futures hedge to be executed on-exchange, the permitted block trade size should be equivalent, i.e. 5 lots. This adds to the open interest in the exchange contract, some of which is subsequently extinguished in the central order book which means that there is enough activity in the instrument for other market participants to offer or bid on-screen.

In addition, many contracts are traded as bundles – for example:

- i. A margin strategy will involve buying crude and selling gas oil, jet, and naphtha against it;
- ii. A seasonal hedge may involve buying all six months of the summer and selling all six months of the winter.

In these cases, ICE considers all the components to be a single reported trade as they share a common economic purpose and thus allow the size of each component to be added in order to meet the threshold.

### **Option 2: re-calibrating the LIS and IL parameters for energy commodity derivatives**

ICE believes that acknowledging the long-standing and well-established practice of setting minimum thresholds for registered trades and determining liquid markets through exchanges would be the most appropriate way of revising RTS 2. However, the Exchanges would also welcome a less comprehensive amendment, focusing on energy derivative markets, as a short-term measure in order to mitigate at least some of the negative effects the inappropriately calibrated MiFIR pre-trade transparency regime.



As mentioned above, the overly restrictive thresholds and improper classification of niche and nascent markets as liquid result inter alia from the inaccurately set parameters for LIS and IL waivers. ICE therefore proposes that these parameters are recalibrated as follows in order to better reflect the underlying characteristics of energy markets.

**Table 1: Proposal for revised thresholds for energy commodity derivatives and emission allowances derivatives**

	IL waiver (Table 7.1 Annex III, RTS 2)		LIS waiver (Table 7.2, Annex III, RTS 2)	
	Average daily number of trades	Average daily notional amount (ADNA)	LIS percentile	LIS, notional value of a trade
<b>Current value</b>	10	10,000,000	70	500,000
<b>Proposed value</b>	100	100,000,000	30	50,000

	IL waiver (Table 13.1 Annex III, RTS 2)		LIS waiver (Table 13.2, Annex III, RTS 2)	
	Average daily number of trades	Average daily notional amount (ADNA)	LIS percentile	LIS, notional value of a trade
<b>Current value</b>	5	150,000 tons of CO2 equivalent	70	EUA as underlying: 50,000 tons/other underlying: 25,000 tons
<b>Proposed value</b>	100	150,000 tons of CO2 equivalent	30	EUA as underlying: 50,000 tons/other underlying: 25,000 tons

## II. Position Limits (MiFID II Article 57)

### *Background*

Article 57 of MiFID II has introduced position limits on the size of a net position that a person can hold at all times in commodity derivatives traded on trading venues and equivalent OTC contracts. Pursuant



to its implementing Regulation 2017/591 (“RTS 21”), these limits are set as a percentage of the deliverable supply available in the underlying physical market with regards to spot month contracts and a percentage of open interest with regards to contracts expiring in all other months.

Furthermore, Article 15 of RTS 21 has introduced a specific regime for new and illiquid contracts whereby a fixed limit of 2 500 lots is set for all months in contracts not exceeding 10 000 lots of open interest. In addition, contracts between 10 000 and 20 000 lots of open interest are eligible for a higher percentage limit of up to 40 % of deliverable supply in spot month and open interest in other months.

ICE has considerable experience in operating a position management system. Long before the application of MiFID II, it had developed a comprehensive, risk-based regime based on position, delivery and expiry limits with regards to commodity derivatives traded on its markets. This regime is calibrated so as to prevent market abuse and ensure orderly delivery while allowing new products to be developed. Since January 2018, it has been operated by ICE in parallel with position limits set by the relevant National Competent Authorities (“NCAs”) under MiFID II.

The Exchanges have long been of the view that a proportionate and efficient position limits regime should concentrate on a limited number of benchmark contracts. This would prevent market abuse and excessive speculation which may negatively impact global retail prices, while allowing new and nascent products to develop. Furthermore, in order to prevent market squeezes, it would be sufficient to set limits for the period right before expiry rather than covering the entire maturity curve.

### *ICE experiences with the MiFID II position limits regime so far*

In the opinion of ICE, the MiFID II position limits regime has so far been able to function for a number of well-developed benchmark contracts. These highly developed markets are characterised by a large number of different types of active trading firms and an overall substantial amount of open interest. However, for the development of new products and further growth of the existing illiquid commodity derivative markets, the position limits regime has proven to be a substantial barrier. Fast growing markets in particular have suffered from (1) an increasingly restrictive limit as open interest increases and (2) inflexible treatment in terms of their categorization under the position limits framework.

#### **(1) Increasingly restrictive standardized limit**

Contracts classed as ‘illiquid’ under the position limits framework receive a standardized limit of 2 500 lots and thereby effectively get a highly restrictive limit (resembling a baseline limit of 25 percent of open interest) when open interest increases close to 10 000 lots. In consequence, market participants are forced to decrease their positions and the open interest returns to a lower level thereby sealing the illiquid status of the product.

And whilst in theory, in line with ESMA Q&A on ‘commodity derivative topics’, National Competent Authorities (“NCAs”) can use different derogations for illiquid markets which have an open interest between 5.000 and 10.000 lots, these remain difficult to apply in practice and are often not sufficient to mitigate the negative impact of disproportionately low position limits.



Any increase of the limit under the available derogation will need to be substantial in order to provide sufficient relief to market participants close to the limits and prevent restricting trading activity in fast growing markets. An increase of a given position limit with for example 500 lots will only have a very limited impact, effectively allowing market participants close to the limit to trade an additional lots equivalent of four Calendar or eight Season contracts.

Once the limit is reached participants withdraw from the market, often switching to another trading venue outside of the MiFID II regime, thereby leaving the regulator no time to adjust the limit upwards. Furthermore, in relation to newly launched contracts, it is not unusual that only one participant sits on the buy or sell side of the market. In such cases, even a fifty percent limit is not sufficient to allow the market to take off.

## **(2) Inflexible categorization of markets and recalibration of position limits**

In order to provide for a workable regime for growth markets, NCAs need to be able to process near instant updates to the categorisation of markets and readjust the applicable limits as open interests in a market increases. This is especially true for markets that experience strong increases in open interest in a small period of time. Markets with initially relatively low levels of open interest can develop into liquid markets in a matter of weeks or months. In order for a limit not to impede the development of fast growing markets:

- the growth of open interest requires a timely reclassification of a market under the position limits regime (for example from 'illiquid' to 'less liquid') in order to allow the position limit to be adjusted to a workable level, before it becomes unnecessarily restrictive.
- the calculation of open interest in a market for the purpose of setting a position limit needs to adequately capture the period of growth of open interest. It is therefore essential that an appropriate methodology for calculating open interest is used. The usage of a randomly selected period with an inappropriate duration could furthermore result in relatively frequent requests to amend the established limits, as the newly set limit could be reached with only a limited amount of transactions in a fast growing market.

In practice it has proven to be impossible for NCA's to reclassify markets and recalibrate the applicable limits and in a manner that would prevent a negative impact on the development of fast growing markets. Figure 1 illustrates this negative impact on one of ICE's previously fast growing markets when subjected to the MiFID II position limits regime. The material growth in open interest (above the dotted 5.000 lots of open interest line) started in the last month of Q4 2017, but this momentum has been severely impaired in the first period of 2018 following the introduction of the MiFID II position limits regime. Before any reclassification of this market and subsequent recalibration of the limit could occur, the damage to the development of this market has proven to be irrevocable. This negative effect on the development of commodity derivative markers described above is stereotypical for fast growing markets subjected to the MiFID II position limits regime.

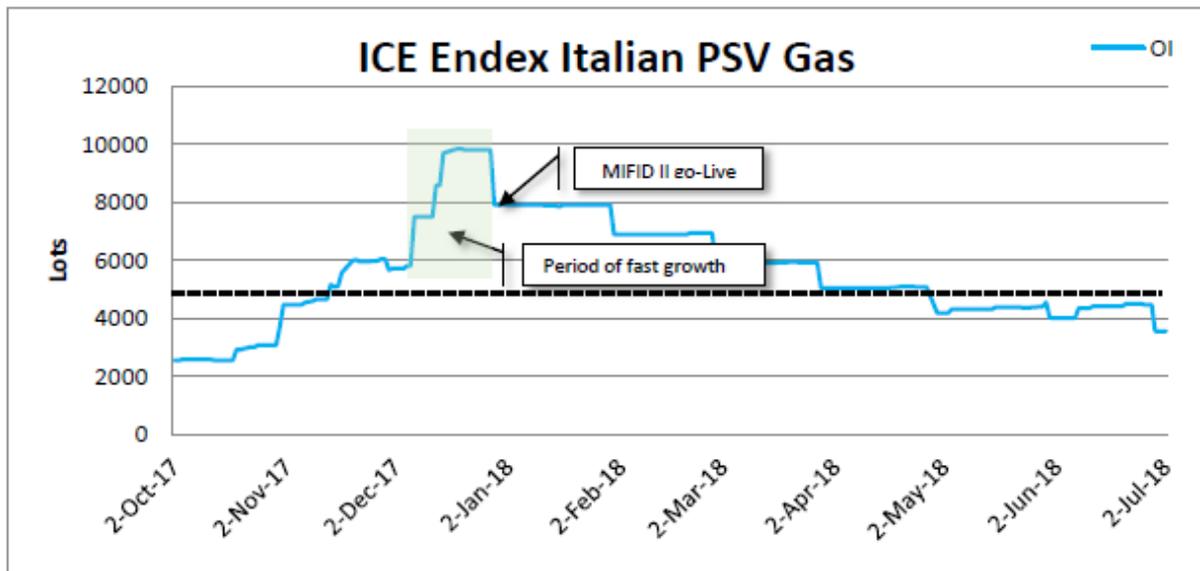


Figure 1. Development of open interest on the Italian PSV Gas market.

### 3) Inaccurate reflection of the underlying physical markets

Moreover, for some commodity derivatives, the characteristic of the underlying physical market is such that an effective hedge can only be achieved by trading a specific number of lots. Such a number cannot be traded without exceeding the limit. Yet, under the current MiFID II provisions, the limit cannot be raised without sufficient increase of the open interest.

In example, the recently launched *ICE Futures Europe TD20 West Africa to UK-Continent (Baltic) Future* has grown significantly over the past few months, reaching over six thousand lots of open interest. The contract is a Suezmax crude route, West Africa to UK Continent for tankers sized on average 130,000 MT (DWT). The biggest positions exceeding 1.9k lots are held by commodity traders, some of which are located outside of the EU and do not hold hedging exemptions. Companies with Suezmax types of tankers fleets tend to hedge calendar years forward, fleet sizes up to 20 tankers and above.

To hedge a fleet of ten tankers on a year forward basis - the trade size will be (either as a single trade or done in a sequence of multiple smaller trades for the same Calendar Year tenor, keeping positions open throughout expiry):

**130 lots \* 12months \* 10 tankers = 15,600 lots** to hedge freight rates exposure for a single Calendar year (i.e Cal 2019 trade)

With fast growing trading volumes in wet freight, companies are now seen extending hedges down the curve, trading to cover Cal19 / Cal20 and even Cal21 tenors that we are now seeing in a VLCC TD3C route (Arab Gulf to China crude route). [International Maritime Organization's regulation going live in 2020](#) has been a significant factor behind the longer-dated hedges as companies are seeking certainty and stability of "locked in" freight levels that are expected to become volatile as the new sulphur caps for bunker fuel will start affecting the cost of shipping from January 2020.



Since the traders active in TD20 have indicated the business need to hedge multiple calendar years forward in TD20 route that would result in tripling trading volumes in the traded volume calculation scenario above, with potential volumes amounting to 46,800 lots.

However, the growth of the contract is restricted by the current *de minimis* position limit. Further development of this contract requires dynamic changes of the current limit from a fixed 2 500 lots level to a much higher limit based on the open interest.

### *Proposed solutions to the described challenges*

Considering the above illustrated negative impacts that the MiFID II position limits regime has had on the proper functioning and further development of nascent commodity derivatives markets as well as the competitive position of European trading venues, ICE is of the view that changes thereto are urgently required.

#### **Option 1: temporarily suspending position limits for nascent commodity derivative markets**

The Exchanges recommend that position limits on new and less liquid contracts are suspended for an interim period to allow them to develop. Within the context of MiFID II, this would mean that the limits for a commodity derivatives contracts are suspended until their open interest exceeds 20 000 lots.

Such an approach would ensure that sufficient flexibility is allowed for fast-growing markets to thrive and thus the development of new products is not restricted by disproportionately low position limits. Furthermore, it would be in line with the policy objective of the Directive as expressed in its implementing RTS 21 which provides that

*“Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately”.*

At the same time, ICE believes that such an amendment would better fulfil the overall policy objective of MiFID II to *“improve the functioning and transparency of commodity markets and address excessive commodity price volatility”*. New and nascent products normally constitute a minor share of commodity markets. Such contracts are unlikely to influence such price movements in the underlying physical commodity markets that could negatively impact consumers. Furthermore, even in case of a limit suspension, these contracts would remain subject to internal position monitoring and management by the trading venue, market surveillance procedures aimed at preventing abuse as well as position reporting under MiFID II Article 58.

Thus, the suspension of position limits for such contracts would not pose any risk to the transparency and functioning thereof. Rather, attracting more volume to regulated venues would contribute to a more transparent trading environment.



## **Option 2: increasing the *de minimis* limit for new and nascent commodity derivative markets**

ICE believes that position limits for new and less liquid contracts should be temporarily suspended in order for these contracts to be able to develop. However, should such a change not be immediately possible, the Exchanges recommend that the current provisions are nonetheless adjusted in order to mitigate their adverse negative impact on the development of markets in commodity derivatives.

ICE proposes that the current *de minimis* limit is increased to 5 000 lots to better accommodate the nature of fast growing contracts. Such an approach would ensure that (1) the development of contracts is not curbed by an overly restrictive limit once open interest grows closer to the 10.0000 lots upper range of the illiquid markets category and (2) the overall framework becomes less dependent on unreasonably high levels of flexibility required from NCA's in terms of re-classifying markets and re-calibrating applicable limits on a near real-time basis.

Furthermore, for contracts between 10.000 lots and 20.000 lots or "less liquid contracts", ICE proposes that the current derogation for the position limit should go up to 50% and be transformed into a default approach from which derogations could be envisaged if needed.

### **III. Scope of the hedging exemption**

Indeed, both the pre-trade transparency as well as the position limits regimes include exemptions for market participants pursuing hedging activity. However, the MiFID II definition of *hedging* as set out in RTS 20 is clear that only non-financial entities can engage in such activity, thereby rendering the exemption unviable to investment banks or commodity trading houses which both play a vital role in providing smaller commercial players with access to commodity derivatives markets.

Therefore, the hedging exemption cannot be considered a universal solution to inappropriately designed pre-trade transparency regime or disproportionate position limits.

An example of such situation is the so called *Refining Margin Hedge* often used in oil markets, whereby an investment bank agrees with its client, a refiner, on a single price of a basket comprising various refined products. Once the refiner agrees the single price for the basket, the bank executes the offsetting trades in the futures market on its own account.



**1. Banks' Client-Facing Trade (either directly/bilaterally or on an ICE Cleared basis)**

ICE Contract Code	ICE Contract Name	No of Lots
I	Brent 1st Line	1000
DBF	Dated Brent vs Brent 1st Line Future	1000
UCF	Urals Med vs Dated Brent CFD Future	1000
BAR	Fuel Oil 3.5% FOB Rotterdam Barges Future	31
ULA	Low Sulphur Gasoil 1st Line Future	540
JCN	Jet CIF NWE Cargoes (Platts) Future	13
AEO	Argus Eurobob Oxy FOB Rotterdam Barges Future	24
NEC	Naphtha CIF NWE Cargoes Future	11

**2. Bank's Offsetting Hedge in the Market for taking on the Refining Margin trade from the client:**

ICE Contract Code	ICE Contract Name	No of Lots
B	Brent Future	1000
DBF	Dated Brent vs Brent 1st Line Future	1000
UCF	Urals Med vs Dated Brent CFD Future	1000
BOB	Fuel Oil 3.5% FOB Rotterdam Barges vs Brent 1st Line Future	31
G	LS Gasoil Future	670
ULJ	Jet CIF NWE Cargoes (Platts) vs LS Gasoil 1st line Future	13
EOB	Argus Eurobob Oxy FOB Rotterdam Barges vs Brent 1st Line Future	24
NOB	Naphtha CIF NWE Cargoes vs Brent 1st Line Future	11

Even though within the context of such transaction the bank clearly performs a hedging activity, it would not be able to make use of the exemption envisaged under MiFIR Article 8 or MiFID Article 57.

*Proposed solution to the described challenges*

ICE has extensive experience with operating a position management system based on hedging exemptions. Under its regime, it can grant such exemptions to any market participant, regardless of their legal status, provided that the hedging intention is adequately documented and demonstrated. This ensures that the genuine hedging activity is not restricted and allows commodity market participants to manage their risks efficiently.

The Exchanges propose that an analogous regime is introduced within the context of MiFID II/MiFIR package.

**IV. Open Access**

*Background*

MiFIR has introduced a non-discriminatory access requirement for trading venues and central counterparties ("CCPs"). In particular, trading venues are obliged to provide access including data feeds on a non-discriminatory and transparent basis to CCPs that wish to clear transactions executed on those trading venues.



All major European derivatives exchanges, including ICE, had successfully applied for deferrals from complying with the regime which will however expire in 2020, at which point the open access requirements will start applying to them.

ICE believes that applying non-discriminatory access in MiFIR to transferable securities and money market instruments is non-contentious. However, with regards to markets in exchange-traded derivatives (“ETDs”) it undermines the stability and liquidity thereof, for which there is no effective solution. Post-Brexit, both the UK and EU will need to re-consider the construction and fundamental architecture of the capital markets. ICE suggests that for efficient and liquid hedging and risk transfer markets, non-discriminatory access has no place in that architecture - at least for ETDs. Non-discriminatory access is already in place for OTC derivatives through EMIR. This causes no policy concerns and, in the view of ICE, no changes to the OTC derivative market structure are thus required in that regard.

However, enforcing non-discriminatory access would fragment the structure of currently unitary exchange-traded derivatives markets, thereby causing problems for price formation, oversight and systemic risk that cannot be efficiently addressed. These consequences are discussed in more detail below.

**1) The extension of mandatory access arrangements to ETDs made available for trading by regulated markets would magnify operational risks through a complex market structure, while fragmenting execution risking volatility and inefficient price formation**

An ETD is made available for trading by a regulated market (RM) on the basis of a contract specification drawn-up and controlled by that RM and is cleared through the CCP of that RM’s choice.

In addition, most business in ETDs is anonymous. This reflects the fact that those trades are accepted by the CCP such that the CCP becomes the buyer to every selling clearing member and the seller to every buying clearing member. The CCP actively manages the financial risk of outstanding exposures and values and collateralises them on an ongoing and independent basis. The CCP also nets trades into an overall position and guards against the trade failing to complete. These various measures on RMs remove several concerns and thus promote liquidity.

Taking an example in which a RM operating a market in ETDs had access arrangements with three CCPs, any order placed into the anonymous order book could only match with other orders which were intended to be cleared by the same CCP. This is because the CCP needs to offset the buy and sell positions in order to maintain its own flat position. Given that fact, the RM would be forced to create separate order books for any given product (i.e. there would need to be one order book for each CCP connected to the RM through MiFIR access arrangements). So, for example, the current ICE Futures Europe Euribor Futures Contract would fragment into:

- (i) Euribor Contract I, clearing through ICE Clear Europe;
- (ii) Euribor Contract II, clearing through CCP A; and



(iii) Euribor Contract III, clearing through CCP B.

It should be noted that in each of these now separate products, there are likely to be unfilled orders which would have been matched with one another in the original consolidated market cleared by a single CCP. This would be problematic enough in markets in which trading is relatively simple, i.e. where participants trade outright delivery months only. However, that is not the case for many ETDs, such as the market in this particular Euribor Futures Contract. In such markets, most transactions are combinations of different delivery months, reflecting the fact that market participants mainly engage in spread or strategy trading. In order to maximise liquidity and trading opportunities in such products, ICE Futures Europe has created links between the order books for the outright delivery months and those for the strategies. The maximisation of liquidity in this way would be undermined if a separate set of outright and strategy order books were required for each CCP destination. The practical reality, therefore, is that what is today a coherent market composed of product and variations would be fragmented into multiple products, reflecting the different destination CCPs.

The alternative to creating separate order books per CCP – i.e. retaining a single order book to which all orders would be submitted irrespective of CCP – would be unviable from the perspectives both of market participants and the trading venue itself, and would not resolve the issues described above. In practice, the trading venue would not be able to match orders which will be cleared on different CCPs. A "single order book" in which multiple CCPs may be used for clearing would almost certainly create a misleading impression of liquidity, market depth and activity. For one, the best bid and offer as well as the volume presented in the order book would be inaccurate as only a portion of the order book, dependent on CCP destination, would be capable of interacting with an incoming order. As a result, orders in that order book would appear to be "traded through" without being executed (e.g. a participant who had an order in the order book to buy 1 lot at a price of 5 would see transactions occurring at prices of 6, 5 and 4, without his order being filled); and "at market" orders would be filled at prices which were worse than the apparent best bid and offer.

**2) Mandatory access arrangements to ETDs made available for trading by regulated markets, if applied, would make it impossible for those markets to comply with other MiFID II requirements**

Pursuant to MiFID II Article 47(1)(d), regulated markets are obliged to have rules which provide for fair and orderly trading. If contractual netting of ETDs is imposed, the regulated market would no longer be able to ensure the fair and orderly trading of the ETDs that it admits to trading. This is because the cumulative trading of ETDs forms a pool of open interest belonging to each market participant that will mature and expire under the terms of the contract. The RM must have oversight of the evolution of this open interest in order to ensure proper market conduct over the course of time - as the contracts for which it is responsible expire. Under a contractual netting arrangement, ETDs from all trading platforms subject to the arrangement would mix and none of the trading platforms would be able to disaggregate their trading from that originating on other platforms or the original RM.



In such circumstances, a RM would lose the ability to exercise any regulatory control over open positions (e.g. in relation to the prevention of market squeezes and other forms of position-based manipulation) - because positions created in its market could be reduced or increased by activity in other trading venues over which it had no oversight or control. This inability to exercise oversight over contracts opened on its systems would be exacerbated for physically-delivered contracts e.g. soft commodities, the delivery of which is monitored by regulated markets to ensure orderly pricing, expiry and settlement. The regulated market in question would be completely unable to do this under a non-discriminatory access arrangement as their contracts would be indivisible from those of other trading venues.

**3) The extension of mandatory access arrangements to ETDs made available for trading by regulated markets would expose the CCP to a risk that the merged ETDs behave in a dissimilar way in response to market events**

In the following example, Clearing Member A buys an ETD from Clearing Member B on trading venue 1, and Clearing Member A sells an equivalent ETD to Clearing Member C on trading venue 2, where both transactions are cleared by a single CCP which applies contractual netting. This will result in Clearing Member C holding a long position, Clearing Member B holding a short position and Clearing Member A having no position.

However, the transaction of Clearing Member C was executed on trading venue 2 and the transaction of Clearing Member B was executed on trading venue 1, under the contractual terms, rules and arrangements of the respective trading venues to ensure settlement of buyer and seller's rights and obligations. Notwithstanding the economic equivalence of these two transactions, the two markets each retain regulatory responsibilities in relation to the outstanding contracts traded through their facilities.

In the event that conventional settlement of the contracts is complicated or frustrated by unexpected circumstances, a trading venue will seek to facilitate - and, ultimately dictate - alternative arrangements. With individual equity derivatives, this is a relatively straightforward procedure and there are generally common industry standards as to how contracts should be adjusted to reflect e.g. rights or bonus issues, special cash dividends etc. However, during particular periods of stress in the financial system, more complex issues may emerge with respect to derivatives which would pose significant risks if there is a mismatch in the potential treatment of the net long and short positions that result from a CCP having applied contractual netting to contracts which were only economically equivalent in a business as usual environment.

The collapse and nationalisation of Northern Rock in 2008 is an example in which such a risk crystallised. As a result of nationalisation, there was no means of settling the exercise of outstanding (put) options contracts by physical delivery. The relevant trading venue, LIFFE, needed to react to that situation and suspended exercise and settlement, pending alternative cash settlement arrangements. The opinion of the Independent Valuer appointed by HM Treasury was that Northern Rock shares were worth zero at the point of nationalisation; this opinion was used by the OTC market in settling outstanding OTC contracts on Northern Rock shares. However, this action ignored the appeal process



which continued for five years. LIFFE ruled that the settlement of LIFFE Northern Rock options would remain suspended during that period in order to reflect the uncertainty as to their value, during which time they continued to be margined using a share value of £0.10. That difference in treatment is an example of how it is dangerous to treat economically equivalent positions traded through different venues as being fungible. If open interest in the LIFFE options contracts was co-mingled with open interest in equivalent contracts traded on another venue, it would not be possible to resolve this complex issue of settlement in such a relatively straightforward way.

If such positions were treated as fungible, the CCP would be exposed to a significant financial risk. As the decomposition of open interest could not be accomplished, those risks would need to be dealt with by the financial counterparty i.e. the CCP.

*Proposed solution to the described challenges*

In the light of the above, ICE recommends that the provisions on non-discriminatory access are removed from the MiFIR regime. They are not fit for purpose and indeed the EU is the only jurisdiction in the world to have introduced such requirements.

In the view of the Exchanges, there is no other adequate solution to the complex issues generated by these requirements and they should not be applied in the interest of preserving integrity and safety of the European ETDs markets.