

## IOSCO Consultation Report on pre-hedging EDMA response

Comments as submitted via [online survey to IOSCO](#) are outlined below.

### Definition

- 1. Do you agree that this is the correct definition of pre-hedging? If not, how would you define pre-hedging? Does the definition of pre-hedging clearly differentiate it from inventory management and hedging?**

### Genuine Risk Management Purpose

- 2. Do you agree with the proposed types of genuine risk management? Are there other factors not mentioned in this report that should be considered for determining genuine risk management?**

### Available Liquidity

- 3. Do you agree that pre-hedging of wholesale transactions should be acceptable where there is sufficient liquidity in the underlying instrument/s to hedge after the trade is agreed to? Please elaborate.**
- 4. Can there be a genuine need to pre-hedge small trade sizes in liquid markets for risk management purposes?**

### Proportionality of Pre-hedging

- 5. Where a dealer holds inventory should they first consider using such inventory to offset any risk connected with an anticipated client transaction or should they be allowed to pre-hedge?**
- 6. What factors should dealers consider in determining the size of prehedging an anticipated client transaction (e.g., size, instrument type, quotation environment)? Should there be an upper limit for the prehedging amount? If so, what type of limits (e.g., percentage based, Greek based) are appropriate for consideration? Please elaborate your response in relation to bilateral OTC transactions and for competitive RFQ systems including those in electronic platforms.**

Electronic Debt Markets Association (EDMA) represents the common interests of companies whose primary business is the operation of regulated electronic fixed income trading venues (multilateral trading facilities and regulated markets) in Europe and appreciate the opportunity to respond to this consultation.

We understand authorities are keen to address “conduct and market integrity issues associated with the practice of pre-hedging” across all types of trading in order to preserve market integrity, protect investors and address the issue of conflicts of interest between counterparties. If there are concerns surrounding pre-hedging best practice, those concerns apply equally to bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions.

Given the long-established principle of technology neutrality in regulatory action<sup>1</sup>, whereby different media and channels for trading are treated equivalently irrespective of media, any new requirements for pre-hedging should be applied equally to bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions<sup>2</sup>.

If different approaches to pre-hedging are adopted for bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions, trading activity will be encouraged to migrate to the lesser regulated environment (bilateral OTC) to the detriment of market integrity and investor protection<sup>3</sup>.

In addition, EDMA notes that electronic trading platforms foster the development of technology innovation for markets. By applying additional new regulations only to competitive RFQs and pre-hedging in the context of electronic transactions - and not to bilateral OTC transactions - this will constrain and slow the pace of technology innovation generally.

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**Client Benefit**

- 7. Do you agree with the concept of client benefit described above?**
- 8. Do you believe that financial benefits derived from pre-hedging by the dealer should be shared with the client? What proportion of the benefit to be shared with the client would be fair? Please elaborate.**
- 9. Should pre-hedging always be intended to achieve a positive benefit for the client or is it enough that a dealer pre-hedges for its own risk management and does not detrimentally affect the client?**

**Market Impact and market integrity**

- 10. Should dealers be able to demonstrate the actions they took to minimise the market impact of their pre-hedging trading? In the event of not entering the anticipated client transaction, are there any considerations for dealers to minimise market impact and maintain market integrity prior to unwinding any pre-hedging position?**

**Policies and procedures**

- 11. Do you agree with this recommendation on appropriate policies and procedures for pre-hedging? If not, please elaborate.**

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**Disclosure****12. What type of disclosure would be most effective for clients? Why?****Upfront disclosure**

**13. Should upfront disclosure be applicable irrespective of factors such as the size and complexity of the transaction and/or other factors such as level of client sophistication? Are there any key challenges for dealers to providing ~~pre-trade~~ upfront disclosures?**

**14. What should be the minimum content of any upfront disclosure? Please differentiate between bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions**

EDMA understands authorities are keen to address "conduct and market integrity issues associated with the practice of pre-hedging" across all types of trading in order to preserve market integrity, protect investors and address the issue of conflicts of interest between counterparties. If there are concerns surrounding pre-hedging best practice, those concerns apply equally to bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions.

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EDMA recommends that, if any new disclosures for pre-hedging are mandated, they should be identical in terms of content and timing for all trading activity including bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions.

EDMA would like to understand better why it is necessary or justified to propose different recommendations for bilateral OTC transactions versus competitive RFQs and pre-hedging in the context of electronic transactions.

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### Trade-by-trade disclosure

**15. *Should trade-by-trade disclosure be proportional to factors such as the size and complexity of the transaction and/or other factors such as level of client sophistication? What should be the minimum content of trade-by-trade disclosure? Please differentiate between bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions, in particular in electronic trading platforms.***

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**16. *Are there any challenges or barriers to trade-by-trade disclosure in the context of competitive RFQs and in the context of electronic trading? If yes, please elaborate.***

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surrounding pre-hedging best practice, those concerns apply equally to bilateral OTC transactions, competitive RFQs and pre-hedging in the context of electronic transactions.

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#### **Post-trade disclosure**

**17. *Would clients benefit from post-trade disclosures about the dealer's pre-hedging practices in a transaction?***

**18. *Should the nature and form of post-trade disclosure be agreed between the client and dealer at the start of their engagement on an anticipated transaction and be proportional to factors such as the size and complexity of the transaction and/or other factors such as level of client sophistication?***

**19. *Are there any barriers to post-trade disclosure? Please differentiate between bilateral OTC transactions, competitive RFQs and prehedging in the context of electronic transactions, in particular in electronic trading platforms.***

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#### Consent

**20. Do you agree that clients should have the ability to explicitly inform the dealer that they do not want pre-hedging to take place in relation to a specific transaction (or revoke explicit or implicit consent to prehedging)? Are there any circumstances under which the dealer would not be obliged to follow the new client instructions? If not, what are the potential issues or risks to clients of this approach? Please elaborate your response to the question for bilateral OTC transactions, for competitive RFQ systems and for those in electronic trading platforms.**

**21. Should dealers be required to obtain explicit prior consent to prehedge for certain types of transactions? Please elaborate your response to the question for bilateral OTC transactions, for competitive RFQ systems and for those in electronic trading platforms.**

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#### Post-trade reviews

**22. Should stand-alone post-trade reviews be conducted for prehedging? How would this improve supervision of pre-hedging activities? Could this review be also used to respond to client requests for post trade review of execution practices?**

#### Controls

**23. Do you think it is reasonable (in terms of costs and benefits) to require dealers to have internal controls to ensure differentiation between prehedging and inventory management?**

#### Record-keeping

**24. What level of detail would be sufficient to have adequate records of pre-hedging activity to facilitate supervisory oversight, monitoring and surveillance?**

#### Industry codes

**25. Do you believe that the industry codes already meet some or all of the recommendations? If so, please explain in detail how.**

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#### About EDMA

Electronic Debt Markets Association represents the common interests of companies whose primary business is the operation of regulated electronic fixed income trading venues (multilateral trading facilities and regulated markets) in Europe. EDMA seeks to foster and promote liquid, transparent, safe and fair markets and act as the voice and a source of consultation between the members in their roles as operators of such venues. EDMA projects collective views on regulatory matters and market structure topics to governments, policy makers and regulators for the benefit of the electronic fixed income markets. Our 6 members are: BGC Fenics, Bloomberg, BrokerTec, MarketAxess, MTS and Tradeweb. More information at [www.edmae.org](http://www.edmae.org)

