We thank you for your time spent taking this survey.
Your response has been recorded.

Please indentify yourself

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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 pre-hedging an anticipated client transaction (e.g., size, instrument type, quotation environment)? Should there be an upper limit for the pre-hedging 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.

Client Benefit

7. Do you agree with the concept of client benefit described above?

We share IOSCO's intention to identify criteria and conditions for determining when pre-hedging practices are acceptable, in order to provide a sort of safe harbour for market participants, allowing them to comply and thereby automatically exclude potential unlawful conduct, especially in terms of market abuse. However, we believe that some of the proposed criteria, in particular the exclusive benefit of the client, are currently difficult to assess and even more difficult to demonstrate. It would be advisable to provide further guidance as to which criteria should be used to measure client benefit, bearing in mind, on the one hand, that the likelihood of order execution (especially in the case of illiquid markets and large orders) should already be considered a benefit to the client, and, on the other hand, that the assessment of the existence of a client benefit should be carried out ex-ante, regardless of the subsequent actual execution of the transaction: client benefit may not always be the expected outcome. It is necessary to refine the definition of this concept. In this regard, we deem more appropriate to focus on the intention and purpose of not harming or disadvantaging the client from the outset of the transaction, while recognising that client benefit may not be guaranteed. Consider, for instance, a responsible trader who receives a large order in an illiquid security that he should pre-hedge. However, if the realisation of an exclusive client benefit (which would also have to be measured in unclear terms) were mandatory, there could be a risk that the trader would refrain from pre-hedging and thus be unable to ensure the execution of the transaction due to insufficient inventory, with negative consequences for both the market and the clients. An intermediary could reasonably verify the intention to benefit the client, but not the actual and exclusive benefit to the client.

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.

While we recognized that IOSCO is an international organization and, in carrying out its activities, cannot delve into the specifics of individual jurisdictions; however, we note that EU intermediaries currently face significant difficulties in drafting a policy that fully and concretely implements some of the high-level principles provided by IOSCO, such as, for example, the concept of client benefit. These principles do not represent objective elements that are easily verifiable, and their verification would require excessive procedural/organizational burdens that would have a negative impact on the successful outcome of the transaction itself. It must also be noted that current sector regulations, including the EU market abuse framework, provide more objective criteria for identifying prohibited market practices and more effective safeguards (such as the regulation on the handling on inside information). Furthermore, European intermediaries are already required – in accordance with the same sector regulations – to implement procedures and safeguards to manage risks arising from pre-hedging, such as: (i) managing conflicts of interest in proprietary trading; (ii) handling inside information (including through information barriers); (iii) using client complaints to assess intermediary conduct; and (iv) staff training.

Disclosure

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

As part of the recommendations for managing conduct risk from pre-hedging, IOSCO suggests that dealers provide clear disclosure to clients regarding their pre-hedging practices, offering various alternatives (upfront disclosure, trade-by-trade disclosure, and post-trade disclosure). In this regard, we believe it is useful to note that pre-hedging practices are most frequently applied in dealings with institutional clients. In view of this (and by analogy with other disclosure obligations prescribed by European legislation on investment services provided to eligible counterparties), it is generally considered that client disclosure on pre-hedging practices should only be provided in the contract, rather than on a trade-by-trade basis. We consider this approach to be more appropriate even in (more limited) cases of dealings with professional clients. In practice, case-by-case disclosure has often proved to be counterproductive: some clients do not fully understand pre-hedging practices and misinterpret disclosure as an attempt by the intermediary to disclaim liability. We believe that if the Regulator provides clear rules on the pre-hedging disclosure method (which we reiterate is ineffective in terms of timeliness when applied on a case-by-case basis and when the counterparty is one with which the trader does not usually deal), what is set out in the contracts and terms of business previously exchanged between the parties will be sufficient without the need for further disclosure.In any case the disclosure obligation should apply uniformly to all market participants, as practical experience has shown that European operators who have opted for trade-by-trade disclosure for particularly complex transactions are at a disadvantage compared to others: in particular, when dealing with professional clients, prior disclosure is often misinterpreted as a greater conflict of interest on the part of the disclosing intermediary. We also note that the need to harmonize disclosure requirements across different jurisdictions is particularly relevant in competitive RFQs, which are a typical example of the use of pre-hedging practices: in such cases, different disclosure requirements could have a negative impact on competition between participants, as practical experience has shown that the intermediary that does not provide specific disclosure generally wins the trade. There shouldn't be any distinction between the different methods of negotiation (e.g. bilateral via BBG chat, voice or competitive RFQ) since this distinction could favour one trading method over another and not allow customers to find better quotes by asking multiple traders instead of exclusive one-on-one negotiation. Therefore we believe it is essential for the manteinance of fair competition that the disclosure obligation should apply uniformly and clearly (with no grey areas) to all market participants, regardless of the trading channel used and without implementation gaps across jurisdictions.

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

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.

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.

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 pre-hedging in the context of electronic transactions, in particular in electronic trading platforms

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 pre-hedging)? 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.

With reference to prior client consent, given the nature of the client base (as noted above, pre-hedging practices are most commonly used with professional clients) and the nature of the transactions, we believe that it is sufficient for the dealer to obtain consent at the time of the initial contract, rather than on a trade-by-trade basis.

21. Should dealers be required to obtain explicit prior consent to pre-hedge 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.

Post-trade reviews

22. Should stand-alone post-trade reviews be conducted for pre-hedging? 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 pre-hedging 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?

European intermediaries believe that, in order to promote supervisory oversight, monitoring, and surveillance of communications related to pre-hedging, it is extremely important that the recommendation leaves no doubt about the scope of the required records (e.g., it would be useful to clarify whether recording and monitoring of all communications during pre-trade, trade, and post-trade phases are required). The current wording of the recommendation does not clarify these aspects and does not ensure a level playing field across jurisdictions, leaving open the risk of different surveillance and monitoring obligations across countries based on applicable data protection and employment laws in each jurisdiction. This is particularly relevant in several EU countries (including Italy), where both privacy and labour laws (e.g., the Workers Statute) impose various restrictions on the monitoring of employees' communications in the absence of mandatory legal obligations. Furthermore, it would be more useful for the recommendation to clearly identify the purpose of the records; rather than indicating a generic "to facilitate," it would be clearer to state "to fulfill" or similar wording. Therefore, we suggest that the recommendation be revised as follows: "The dealer should maintain adequate records of pre-hedging communications and trade records to fulfill 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