Questions

Definition

Q01 S.23	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?

No, Deutsche Börse Group (DBG) generally does not agree with this definition of pre-hedging.

Firstly, we would like to note that the definition starts with the use of the term "dealer" which is not clearly defined in this consultative report. From our perspective, the description of the dealer should include "any person/persons authorized to trade in the relevant product".

Secondly, with regards to the three qualifying points of the definition, we would like to provide the following comments:

(i) Based on our remark above and to enhance clarity, we believe that this first point should refer to "the authorized person" instead of "dealer" and we suggest rephrasing it as follows: "*the authorized person is dealing on own account or on behalf of a client account".* OR, indeed, *"in ANY authorized capacity"*.

(ii) We believe that ANY trading undertaken as a result of information gained but before a deal is agreed is the same as "front running". Front running can occur in an instrument that is not necessarily the same as the traded instrument, in which the price will/may be affected by the deal completed with any market counterparty. Indeed, this is known as 'leakage' and can be a significant issue for current market participants.

(iii) We would agree with this statement as long as the "anticipated" transaction has been agreed in principle (deal agreed) or the client explicitly agreed on pre-hedging before. In the case of exchange listed derivatives, even if ultimately the deal does not conclude, it would have been agreed on a transparent exchange platform under exchange rules qualifying that the intention for the deal to conclude was valid. We believe the "intention" is the key element.

Genuine Risk Management Purpose

Q02 S. 27	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?

DBG agrees that pre-hedging can be a tool for dealers to manage risk. Nevertheless, as indicated in Q1, we believe that the anticipation of a transaction must be validated by way of an agreed deal or the client explicitly agreed on pre-hedging before.

We also agree that pre-hedging allows more time for dealers to hedge, but we would like to point out that for exchange listed derivatives, time limits are imposed anyway between agreeing a deal and concluding the deal. These time limits are there to protect other market participants by maintaining a regular transparent marketplace.

Available Liquidity

Q03 S. 28	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.

No, DBG does not agree. We believe pre-hedging should only be justified to allow dealers to find liquidity and secure a better hedging price in order to benefit their client. A better hedging price allows the dealer to agree a better price in the associated product/structure to their client. In sufficiently liquid instruments this is not required.

Q04 S. 28	Can there be a genuine need to pre-hedge small trade sizes in liquid markets for risk management purposes?

No. Any hedging that can be absorbed by at least two layers of the bid ask size in a liquid product has no justification to be pre-hedged. This is a basic measure, but exchanges already have complex measuring techniques in place and these sizes are expressed as minimum block trading sizes (MBTS). For hedging in exchange listed instruments, pre-hedging should only be allowed if the size is above or equal to the MBTS.

Proportionality of Pre-hedging

Q05 S. 29	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?

DBG believes that this is at the discretion of the dealer.

Q06 S. 29	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.

In line with the key principles of FX Global Code, the Precious Metals Code and the FMSB Standard on Large Trades the maximum value of the pre-hedging should be limited to the value of the anticipated client transaction. Besides this, price, size and market liquidity at the time have to be considered.

For bilateral OTC transactions under ESMA rules, the regulated RFQ Platform (e.g. an MTF) should be able to validate "deal agreed".

Client Benefit

Q07 S. 30	Do you agree with the concept of client benefit described above?

Yes, DBG agrees with the concept of client benefit.

Q08 S. 30	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.

In relation to competitive RfQ systems, we expect the dealer to offer better prices using pre-hedging. Thus, his offer would win the competitive RfQ. We consider the client to be sufficiently benefitted by the best price as this is what the clients ultimately seek.

Q09 S. 30	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

Q10 S. 31	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?

Yes. In case the deal does ultimately not conclude with the client and the dealer is left with the hedge, then DBG believes it is in the dealer's best interest to unwind the unwanted hedge in a way that has minimal market impact in order to be able to unwind it in a way that will cost the least amount of

money, if indeed it even makes a loss. This risk of loss is all part of the cost of being a dealer, and also why it is in the best interests of dealers to only pre-hedge once a deal has been agreed on a regulated platform. However, if the dealer (who has agreed a deal with the client) retracts from the deal after pre-hedging, then the unwinding of the hedge nets a trading profit, this profit must be disclosed to the client for market integrity and transparency reasons.

Policies and procedures

Q11 S. 34	Do you agree with this recommendation on appropriate policies and procedures for pre-hedging? If not, please elaborate.

Yes, DBG agrees and considers the process of documenting and implementing appropriate policies and procedures for pre-hedging as a bare minimum.

Disclosure

Q12 S. 35	What type of disclosure would be most effective for clients? Why?

DBG considers that the most effective type of disclosure for clients is to provide both upfront disclosure in a general manner (like in terms and conditions) plus a trade-by-trade disclosure for each anticipated client transaction except electronic trading platforms.

If a dealer generally uses pre-hedging to manage the risks this should be explicitly stated to all stakeholders e.g. in the terms and conditions. Thus, clients/intermediates can consider this before asking that dealer for a quote (depending on the client`s favor in this regard).

Additionally, the case-by-case disclosure is necessary to avoid any misunderstanding and to clarify/discuss intended pre-hedging measures and their possible impacts on the final quote price.

Upfront disclosure

Q13 S. 36	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?

In our view Upfront Disclosure should be mandatory for all dealers applying pre-hedging. We see no challenges to provide this information in the business terms.

Q14 S. 36	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.

Upfront disclosure in the Terms of Business could simply lay out the above information (the dealer's definition of pre-hedging, its general rationale for pre-hedging, the types of transactions or circumstances where it may pre-hedge (these include differentiations between RfQ, OTC and electronic transactions) and a note that pre-hedging can impact prices).

Trade-by-trade disclosure

Q15 S. 37	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.

No, DBG strongly believes that trade by trade disclosure should be applied for each anticipated transaction. Particularly, trade by trade disclosure has to take place for OTC transactions and (competitive) RfQs, otherwise we would classify pre-hedging rather as front-running. For both, it is possible to shortly inform the intermediate/client about the intention to pre-trade.

In terms of trade by trade, DBG believes the same information should be disclosed for bilateral OTC, competitive RFQs, etc. Namely, the information regarding the price being offered based on a disclosed average weighted value of the hedge and the price variation range in case that hedge varies. The client then can pre-agree how much they want the price to vary. Best Execution can be used to allay any fears that the dealer does not correctly disclose the average weighted price of the hedge.

Q16 S. 37	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.

Although we generally see no challenges, DBG believes that electronic trading would reduce any challenges, especially if the platform is regulated and run by an exchange. Eurex (for example) already has an RFQ Platform that incorporates this workflow and associated disclosure.

Post-trade disclosure

Q17 S. 38	Would clients benefit from post-trade disclosures about the dealer's pre-hedging practices in a transaction?

Yes, DBG believes that clients would benefit from post-trade disclosures about the dealer's pre-hedging practices in a transaction since they would be able to understand the direct correlation between the price they are being quoted for their product/structure and the price of the dealer's hedge. It also means that they could ask the dealer not to use pre-hedging and see (over time) whether this affects the price of their transactions with the dealer. This would be hugely beneficial to Trade Cost Analysis (TCA).

Q18 S. 38	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?

Yes, we agree.

Q19 S. 38	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.

DBG believes that the barriers are minimal if these transactions are electronic, particularly if these systems are already integrated into dealer operations.

Consent

Q20 S. 38	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.

Yes, DBG agrees 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. It is not clear to us why a dealer would ever need to not disclose the use of pre-hedging. The risk of non-disclosure is minimized as long as pre-hedging only takes place once a deal is agreed on a regulated platform. Without disclosure or deal agreed on a regulated platform, unscrupulous dealers may be tempted to use the asymmetric distribution of client information to front run client orders under the guise of pre-hedging. Except for electronic trading platforms, the dealer should be obliged to follow these clients' instructions. If the dealer isn`t able to do so, he has to inform the client accordingly which might stop the anticipated deal if no agreement can be found.

Q21 S. 38	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.

Yes, DBG believes that dealers should be required to obtain explicit consent prior to pre-hedge, so the client better understands the risk of leakage. This is applicable across all market types.

Post-trade reviews

Q22 S. 39	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?

Yes, DBG believes that these reviews should be conducted on a voluntary basis. If client and dealer agree to do so when engaging this should be provided on client`s request to demonstrate all taken measures by the dealer and their outcome. We see no need to implement an obligation for post-trade reviews.

Controls

Q23 S. 40	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

Q24 S. 41	What level of detail would be sufficient to have adequate records of pre-hedging activity to facilitate supervisory oversight, monitoring and surveillance?

From a DBG perspective, a distinct link between the anticipated transactions and all related pre-trading activities is necessary. Besides this, the following data would be required:

- anticipated transaction: instruments (incl. ISINs), sizes, sides, times, accounts (trading capacities), intended prices to offer, intended trading venues
- pre-hedging: instruments (incl. ISINs), sizes, sides, times, prices, accounts (trading capacities), investment/execution decision maker, trading venues
- final deal: instruments (incl. ISINs), sizes, sides, times, prices, accounts (trading capacities), investment/execution decision maker, trading venues.

Industry codes

Q25 S. 41	Do you believe that the industry codes already meet some or all of the recommendations? If so, please explain in detail how.

DBG believes that the Market Abuse Directive/Regulation (MAD/MAR) and Best Execution rules already cover a great deal of the potential oversight.