



ESMA Final Report to the European Commission on the pre- and post-trade transparency regime for non-equity instruments International Bulletin, November 2020.

Article 52(1) of MiFIR requires ESMA to submit a report to the European Commission (EC) on waivers of the pre- and post-trade transparency (publication) obligation for orders and transactions in non-equity financial instruments as referred to in sections 2 to 5 of Article 9 of MiFIR, among other matters, to be presented to the co-legislators of the European Union (EU). Although ESMA was supposed to present this report before 30 March 2020, the extension of the period of public consultation on the proposals to improve transparency in this class of financial instruments, due to the impact of the COVID-19 pandemic, delayed its publication until 25 September 2020.

This same Article requires ESMA to submit a report to the EC with similar analysis on equity and equity like instruments, which was published on 16 July 2020. The content of this report was the subject of a review in the CNMV July International Bulletin.

The main recommendations sent to the EC for improving transparency in this segment of financial instruments while at the same time meeting the need *“to avoid the impairment of liquidity as an unintended consequence of obligations to disclose transactions”*, as referred to in recital number 2 of Commission Delegated Regulation (EU) 2017/583 (hereinafter RTS 2) are as follows:

- 1) Elimination of the SSTI (size specific to instrument) waiver;
- 2) Consideration as to whether the elimination of the SSTI waiver should be offset by lowering the threshold for determining LIS (large-in-scale) transactions;
- 3) In order to increase the percentage of bonds subject to the publication of orders and transactions in real time, three alternatives have been proposed:
 - a) removal of the liquidity determination test and the implementation of a simplified regime relying only on the LIS threshold;
 - b) amendment of RTS 2 and moving directly to Stage 4 (from Stage 1 or 2), thus increasing the number of liquid bonds (RTS 2 establishes a procedure in four stages to increase the number of bonds that are considered liquid and therefore subject to a higher level of transparency, which would be carried out successively from its entry into force. To be able to move from one stage to the next, ESMA must carry out an analysis of the impact on liquidity of the requirements of the stage implemented);
 - c) performance of the liquidity assessment by using a different liquidity measure different from the ones use at present, based on the number of transactions, volume and days traded, such as the size of the issue parametrised for each bond type (public debt, other public bonds, convertible bonds, covered bonds, corporate bonds etc.);

4) transfer to ESMA of the NCAs' power to suspend the pre- and post-trade transparency regime for orders where there is a significant reduction in the liquidity of financial instruments, as no NCA has made use of it until now.

5) Simplification of the system of deferrals for publication of transactions above the SSTI and LIS thresholds and of all transactions in illiquid instruments. The proposal is to go from the current 48-hour deferral model with a possible four-week extension or aggregate weekly publication (e.g. in sovereign bonds) to a 48-hour deferral, like the current one, but with only one two-week extension for the remaining details of the transaction.

Elimination of the SSTI waiver and lowering of the LIS threshold

Article 2 and Annex 1 of RTS2 state that trading venues for fixed income instruments (regulated markets, multilateral trading systems and organised trading systems) can manage their trading systems with different transparency regimes depending on the type of trading system. The trading systems and their transparency regime are as follows:

1) Continuous auction order book trading systems: for each financial instrument, the aggregate number of orders and the volume they represent at each price level, for at least the five best bid and offer prices.

2) Quote-driven trading systems: for each financial instrument, the best bid and offer by price of each market maker in that instrument, together with the volumes attaching to those prices. In exceptional market conditions, indicative or one-way prices may be allowed for a limited time.

3) Periodic auction trading systems: for each financial instrument, the price at which the auction trading system would best satisfy its trading algorithm and the volume that would potentially be executable at that price.

4) Request-for-quote trading systems: the quotes and the attaching volumes from any member or participant which, if accepted, would lead to a transaction under the system's rules.

5) Voice trading systems: the bids and offers and the attaching volumes from any member or participant which, if accepted, would lead to a transaction.

6) Trading systems not covered by the above models: adequate information as to the level of orders or quotes and of trading interest; in particular, the five best bid and offer price levels and/or two-way quotes for each market maker in the instrument, if the characteristics of the price discovery mechanism so permit.

The regulation allows request-for-quote and voice trading systems not to publish actionable indications of interest (AIOIs) that are greater than the size specific to the instrument (SSTI) and below the LIS (large in scale) threshold. ESMA advises the EC to eliminate this waiver, as according to its analysis and the responses to the public consultation carried out for the purpose, it is not often used. In addition, allowing it to only apply to two of the six trading systems described above creates a competitive disadvantage in the systems that do not have this waiver and leads to greater complexity which hampers the operation of these markets.

As a way of mitigating the possible risk that market makers may incur due to the elimination of this SSTI waiver, ESMA suggests that consideration be given to whether the LIS threshold can be reduced. Although Table 2.3 of Annex III of the RTS 2 establishes the same threshold floor SSTI and LIS pre-trade, the percentiles to be applied to the volume of trades carried out in a period in SSTI (percentiles from 30 to 60 depending on the stage) are lower than for LIS (70 percentile regardless of the stage). Therefore, in practice, the SSTI is lower than the LIS and with the removal of the waiver for transactions over the SSTI, ESMA suggests that the EC study the possibility of reducing the LIS threshold. In post-trade transparency, the SSTI volumes are always lower than the LIS since the percentile in the former case is 80 and in the latter 90. Translating these

percentiles into numerical terms for the case of bonds, the difference is very significant. For example, for a sovereign bond the SSTI in pre-trade transparency is €0.7 million and the LIS is €6 million; in post-trade transparency the SSTI is €10 million and the LIS is €25 million.

As for systematic internalisers, the current regulations (Article 18.10 of MiFIR) establish that they are not obliged to publish quotes when they trade above the SSTI threshold. Therefore, ESMA proposes that the reference to this threshold be replaced by a reference to the LIS threshold which, as mentioned, should be recalibrated to a lower level.

Alternatives for increasing the percentage of bonds subject to real time transparency

The analysis carried out by ESMA and reflected both in the public consultation and in this final report shows that the level of transparency in the fixed income markets is not satisfactory for the majority of market participants. Given the complexity of this matter, ESMA proposes to the EC the study of three alternatives:

a) Remove the liquidity determination test with the sole aim of increasing real time transparency based on a simplified regime relying on the LIS threshold. In RTS 2, table 2.2 of Annex III establishes that illiquid bonds are those that do not comply with a series of characteristics, which will be reduced in successive reviews in four stages. In the first stage, a bond is considered illiquid if it has fewer than 15 daily trades, an ADNA (average daily notional amount) of less than €100,000 or has traded on fewer than 80% of the business days in the period considered. In the case of newly issued bonds, they will be considered illiquid if the volume issued is less than €500 million or €1 billion depending on the type of bond (public, corporate, convertible etc.) In stage four, for bond already issued the number of daily trades would be reduced to 2 from 15, whereas for bonds that have been newly issued and therefore have no trading history the volume the volume would be reduced to €500 million for covered bonds and corporate bonds (for other types of bonds, the issue size to be considered a liquid market instrument continues at €1 billion for sovereign bonds and €500 million for other public bonds and convertible bonds). As can be seen, the system described for determining whether a bond has a liquid market is very complex. ESMA suggests that the determination of real time transparency be based not on this classification of bonds but on whether the order or transaction is above the LIS threshold.

b) The second alternative is to amend the RTS2 and move directly to stage 4 (from stage 1 or 2) and thus increase the number of liquid bonds. As explained in letter a) above, in stage 4, only two daily trades are required, together with the minimum ADNA of €100,000 and trades on 80% of trading days.

c) The third proposal in this area is to assess whether an instrument has a liquid market using a different liquidity measure (currently based on the number of transactions, a minimum trading volume and days traded), such as, for example, the size of the issue discriminating among different types of bond (public debt, covered bonds, etc.). In other words, ESMA proposes that consideration be given to using a static liquidity measure without considering the trading history of each instrument.

Transfer to ESMA of the power to temporarily suspend transparency obligations for liquid financial instruments

In the public consultation, ESMA requested comments on a possible elimination of the NCAs' power to suspend the pre- and post-trade transparency obligations for orders and transactions due to a significant reduction in the liquidity of instruments, or replacement of this power with coordination at a European level of the implementation of a suspension of the transparency requirements for a particular bond.

ESMA suggested modifying this power of the NCAs due to (1) its lack of use by NCAs, as they can suspend a financial instrument to safeguard the integrity of the market at any time, while it is very difficult to determine when the transparency obligation should be suspended without suspending the instrument from trading and (2) there may be situations in which an NCA suspends the transparency obligations for a liquid bond which, being

liquid, is likely to be traded on other platforms supervised by other NCAs which do not take such action or are not notified of it in advance. In these situations, the lack of coordination in the European Union could distort the level playing field.

In the responses received to the public consultation, ESMA detected a significant interest in maintaining this power, not at the level of each NCA but at the European level, with ESMA being in charge of carrying it out. In this way, ESMA would ensure coordination among the Member States, avoiding possible arbitrage between markets and investors.

Simplification of the deferral regime for publication of transactions

ESMA has calculated that 95.6% of the trading volume are benefiting from deferred publication, i.e. those trades are not subject to the requirement to be published as close as possible to real time and in any case within 15 minutes. Therefore, transactions above LIS, SSTI and/or on illiquid financial instrument are reported to the public on T+2 and in only 4.1% of the cases the volumes of these transactions are published over four weeks. In 2018 the other exceptions were applied in just 0.3% of cases. The rationale for these exceptions is explained in Section 3 of Article 11 of MiFIR and in Article 11 of RTS2. Regarding bond types, ESMA has noted that the main beneficiaries of the exceptions are sovereign bonds and that in the majority of bonds with illiquid markets, the details of their transactions are published in 48 hours. Given that ESMA suggests the elimination of all exceptions in orders and transactions above the SSTI, this proposal to extend the deferral by two weeks, in addition to the 48-hour deferral for some details of the transactions, would apply to transactions above the LIS threshold and transactions on illiquid instruments.

Links of interest:

[Final report](#)

[Public consultation](#)