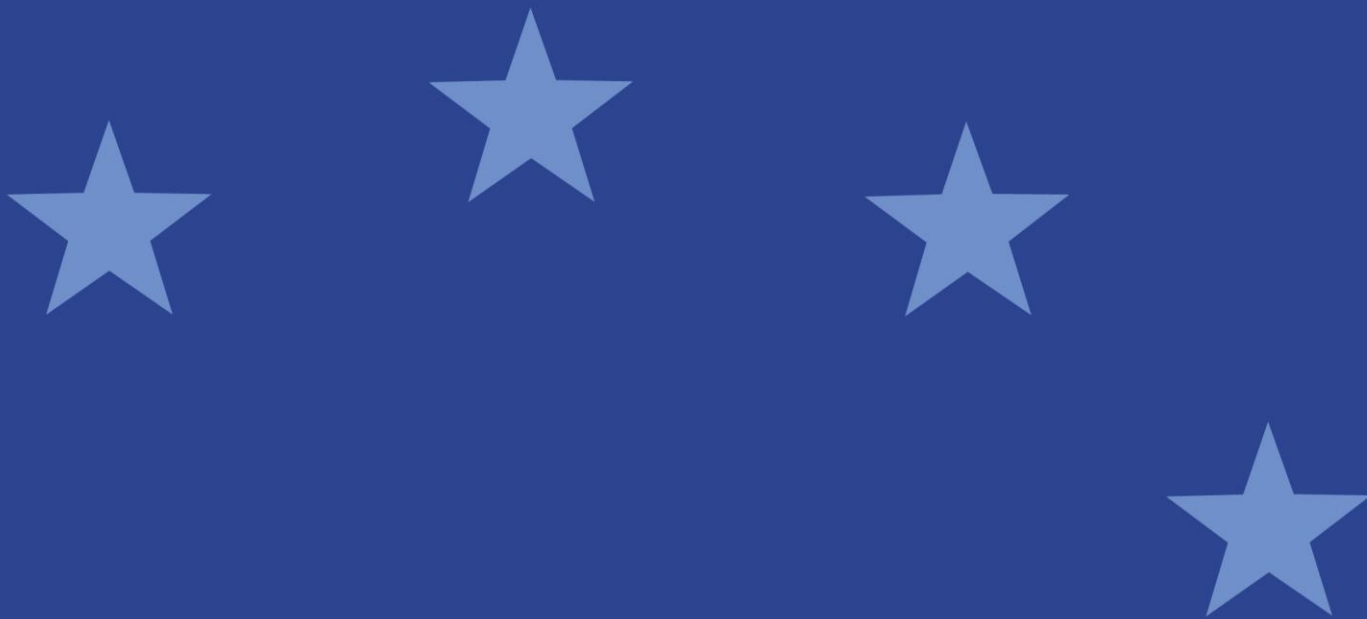




European Securities and  
Markets Authority

## Reply form for the Consultation Paper on the RTS 2 Annual Review



12 May 2021

## Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation Paper on the transparency regime for non-equity instruments and the trading obligations for derivatives MiFID II/ MiFIR review report published on the ESMA website.

### **Instructions**

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA\_QUESTION\_CP\_MIFID\_NQT\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

### **Naming protocol**

In order to facilitate the handling of stakeholders' responses please save your document using the following format:

ESMA\_CP\_MIFID\_NQT\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

e.g. if the respondent were ESMA, the name of the reply form would be:

ESMA\_CP\_MIFID\_NQT\_ESMA\_REPLYFORM or

ESMA\_CP\_MIFID\_NQT\_ANNEX1

### **Deadline**

Responses must reach us by 11 June 2021.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Your input - Consultations'.

### ***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### ***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings 'Legal notice' and 'Data protection'.

## General information about respondent

Name of the company / organisation	Association for Financial Markets in Europe (AFME)
Activity	Banking sector
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	Europe

## Introduction

*Please make your introductory comments below, if any:*

<ESMA\_COMMENT\_CP\_MIFID\_NQT\_1>

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **ESMA's RTS 2 Annual Review Consultation Paper, published on 12<sup>th</sup> May 2021**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

<ESMA\_COMMENT\_CP\_MIFID\_NQT\_1>

**Q1. Do you agree with ESMA's proposal to move to stage 3 for the determination of the liquidity assessment of bonds? Please explain.**

<ESMA\_QUESTION\_CP\_MIFID\_NQT\_1>

Although supportive of the transparency regime, AFME members unequivocally disagree with ESMA's proposal to move to stage 3 for the determination of the liquidity assessment of bonds, at this time. AFME members recognise that the move to stage 3 of the liquidity assessment for bonds is required, but this should be implemented based on a sufficient dataset. Furthermore, AFME members forewarn against looking at a move to stage 3 of the transparency regime for bonds in isolation, given the intricacies between the liquidity and SSTI thresholds and the broader MiFID II/MiFIR transparency regime which is mandated is currently under review.

AFME and its members do not consider that an imminent move to stage 3 captures the spirit of the regulation. As outlined in the level one text the transparency regime for non-equity instruments is subject to a four-stage phase-in approach, as set out further in Article 17 of RTS 2. Whilst we acknowledge that RTS 2 does not specify the amount of data required for assessing the move to the next stage of the regime, only that the assessment should be conducted by 30<sup>th</sup> July each year, the spirit of the text suggests that these assessments are based off yearly calculations/data. AFME notes the reference in paragraph 24 (pg. 13) of this consultation paper to ESMA's previous recommendation in 2015 to apply the stage 4 threshold for the liquidity assessment from the date of implementation of the MiFID II/MiFIR regime, however the European Commission ruled that a phased 4-stage process should be implemented. The premise of the 4-stage process is to move cautiously in order to fully assess the impact of each individual stage on the market.

AFME members stress that any assessment to move to the next stage of the transparency regime should be based on an adequate amount of trading data, and that the parameters of the assessment should be standardised for each stage. Given that stage 2 of the regime only came into effect on 15<sup>th</sup> April 2021 and the first full liquidity assessment of bonds, based on stage 2 calculations occurred less than a month ago (30<sup>th</sup> April 2021, this consultation was published 12 days later), AFME members do not consider one liquidity assessment, capturing one quarter of trading activity to be sufficient or valid to base future policy decisions on. This is all the more critical as Brexit did impact the bond market in the EU, if only by rebalancing volumes between the now-third-country UK and the EU, making a thorough assessment of the market indispensable before any quantitative threshold is modified.

AFME members are also concerned that if justification for a move is based on vastly limited data this would set a dangerous precedent. Any move based on partial, potentially inaccurate, and incomplete data significantly increases undue risk and may have significant negative implications on the functioning of the market. Additionally, if the implications of these factors negatively impact the market, but only become apparent after moving to stage 3 of the liquidity parameters, there is no provision contained within the relevant regulation to roll back any decision to the current existing (stage 2) thresholds.

AFME members reiterate that the current MiFID post-trade transparency reporting requirements have produced a significant amount of post-trade data. However, the fragmentation of the data between APAs and Trading Venues, alongside a lack of standardisation in terms of format and accessibility may be obscuring the amount of transparency that is theoretically available and usable to the public. This means that only consumers with extensive resources are able to utilise the data which is not always presented in an easy to use, machine readable or consumable way.

AFME strongly supports the development of a consolidated tape for fixed income instruments as this will assist with centralising the vast amount of post-trade transparency data that is already public through a cost-effective solution which enables all firms to access complete datasets.

Given previous concerns around data quality still remain, AFME also encourages ESMA to engage with market participants to verify any data they are intending to base calculations on. AFME notes that in ESMA's consultation paper on the transparency regime for non-equity instruments and the trading obligation for derivatives published on 10 March 2020, table 6 (pg. 109) calculated the total universe of bonds

(liquid and illiquid) at 320,696 in 2019 Q3 and cited a major reason for moving to stage 2 of the transparency regime was to ensure 2% of bond trading was made transparent. Nevertheless, 8 months later, in ESMA's EU Securities Markets Annual Statistical Report<sup>1</sup> published on 18<sup>th</sup> November 2020, ESMA calculated the total universe of bonds at 173,656 for 2019. Yet within this consultation, ESMA explains that the total universe of bonds constituted of only 38,076 instruments in 2020 Q4. Additionally, AFME members are also concerned as to whether the current data available provides an accurate and reliable picture of the EU bond market in the near future. As the move to stage 2 of the transparency regime coincided with the first post-Brexit calculations it is difficult to visualise the impact of Brexit.

Furthermore, and as previously highlighted in response to ESMA's last annual review of the RTS 2 thresholds, ESMA does not account for newly issued bonds within their analysis of liquidity within the bond market. AFME notes that once new issuances are included the amount of liquid bonds and subsequent transparency also increases significantly, for example, in Q1 2021 (1<sup>st</sup> January – 31<sup>st</sup> March 2021) ESMA's FITRS calculated 1,720 liquid bonds (as the system takes into account new issuances) as demonstrated in annex 1. Discounting this area of the market significantly skews the results/forecasts and misleads stakeholders and policy makers. In order to ensure market stakeholders are "in possession of all the facts" AFME suggests that ESMA consider publishing a list of newly issued bonds alongside their quarterly liquid bond list/calculations.

Within this CP, ESMA also fails to directly acknowledge or consider the implications a move to stage 3 of the transparency regime will have on newly issued corporate and covered bonds, given a move to phase 3 of the regime significantly reduces the liquidity thresholds for these instruments from €1billion to €500million.

The analysis presented by ESMA in table 2 (pg. 10) of this consultation paper also lacks validity as it simply compares the percentage of liquid bonds to the total bond population. Such findings do not demonstrate any true degree of transparency within the market, making the calculation redundant for the purposes of this policy report. AFME members note, a far more accurate and robust evaluation would be to look at the direct relationship between the percentage of liquid bonds and their trading volumes to truly determine the level of transparency within the market.

AFME members also express concern with the statement made in paragraph 6 (pg. 7) of this consultation paper whereby ESMA states that "*In 2020, ESMA published the RTS 2 Annual Report where ESMA proposed to move to stage 2 of the liquidity assessment for bonds... Most stakeholders responding to the consultation were supportive of the move to Stage 2*". After undertaking our own analysis of the public responses to the 2020 Annual review of RTS 2 consultation, AFME members found that the basis of the opinion on which the previous decision to move to Stage 2 was founded, did not fully reflect the industries overall position, including the views of Trade Associations (such as AFME and ICMA) that represent committed liquidity providing bond market participants.

AFME requests both ESMA and the European Commission consider all market stakeholders' feedback in its entirety to ensure balanced, robust, and informed decisions are made in the future.

AFME notes the reference in this consultation paper in paragraph 22 (pg. 13) to TRACE (the Trade Reporting and Compliance Engine), the bond transparency regime in operation in the US. AFME members reiterate that both the design and implementation of the Trade Reporting Compliance Engine was gradual, the reason for this piecemeal approach was to promote transparency without impacting liquidity, hence FINRA adopted a measured approach and phased-in the reporting time and public dissemination requirements over several years. Nevertheless, since the introduction of the TRACE system in the US the industry (including AFME member firms trading in the US bond market) have observed a decline in block trading sizes and liquidity.

AFME members stress that great attention should be paid when considering to apply the TRACE case-study to the EU for two fundamental reasons: 1) there are significant differences in parameters across and

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<sup>1</sup> [https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355\\_mifid\\_asr.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf)

between the MiFID II transparency regime and the US TRACE system and 2) there are a number of differences in the market structure of bond trading in the EU and the US including but not limited to market size in terms of bonds issued, currency and links to benchmark bonds).

AFME and its members remain committed to assisting ESMA, where appropriate with all future assessments relating to the MiFID II/R review, including any assistance required to further develop the transparency regime for bonds.

<ESMA\_QUESTION\_CP\_MIFID\_NQT\_1>

**Q2. Do you agree with ESMA's proposal not to move to stage 2 for the determination of the pre-trade SSTI thresholds for all non-equity instruments except bonds? Please explain.**

<ESMA\_QUESTION\_CP\_MIFID\_NQT\_2>

While AFME does not cover OTC derivatives as an asset class, AFME members agree that any assessment to move to Stage 2 of the transparency regime for all non-equity instruments other than bonds should be based off accurate and complete data.

AFME members note that in 2020 ESMA concluded that for non-equity instruments other than bonds, the move to stage 2 was premature based on two main factors 1) data quality issues and 2) because the first partial publication of the annual calculations for derivatives were only conducted in 2020. The factors relevant to this conclusion are reflective of the current situation within the bond market, firstly there are still data quality issues, some of which are a result of Brexit and secondly, the annual transparency calculations for stage 2 of the transparency regime for bonds has only applied since 15<sup>th</sup> April this year. We therefore question why ESMA is still determined to move to stage 3 of the transparency regime for bonds when they delayed the move to stage 2 for derivatives based on similar concerns.

<ESMA\_QUESTION\_CP\_MIFID\_NQT\_2>

**Q3. Do you agree with ESMA's proposal to move to stage 3 for the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs)? Please explain.**

<ESMA\_QUESTION\_CP\_MIFID\_NQT\_3>

As stated in our response to question 1, AFME members unequivocally disagree with ESMA's proposal to move to stage 3 for the determination of the pre-trade SSTI thresholds for bonds at this current time. Such a move should be implemented at an appropriate time based off an adequate, accurate and complete dataset.

Firstly, AFME and its members do not consider that a move to stage 3 at this point in time captures the spirit of the regulation, as stated in paragraph 1 of this consultation paper "Article 9 (5)(d) of MiFIR required ESMA to develop draft regulatory technical standards to specify the pre-trade SSTI thresholds for all non-equity instruments. The system developed was based on annual recalibrations" as outlined further in article 17 of RTS 2, a four-stage phase-in approach was established, whilst RTS 2 does not specify an amount of data the assessment for moving to the next stage of the regime should be based on, only those yearly assessments should be undertaken before 30<sup>th</sup> July each year. The premise of the 4-stage process is to move cautiously in order to assess the impact of the individual stages.

Secondly, we also consider that ESMA's premise for not moving to stage 2 of the SSTI thresholds for non-equity instruments other than bonds in 2020 referred to in paragraph 7 of this consultation paper (pg.7) is reflective of the current situation within fixed income and that the move to stage 3 of the pre-trade SSTI thresholds for bonds would also be premature as 1) there are still data quality issues, some of which are a result of Brexit and 2) the annual transparency calculations for stage 2 of the transparency regime for

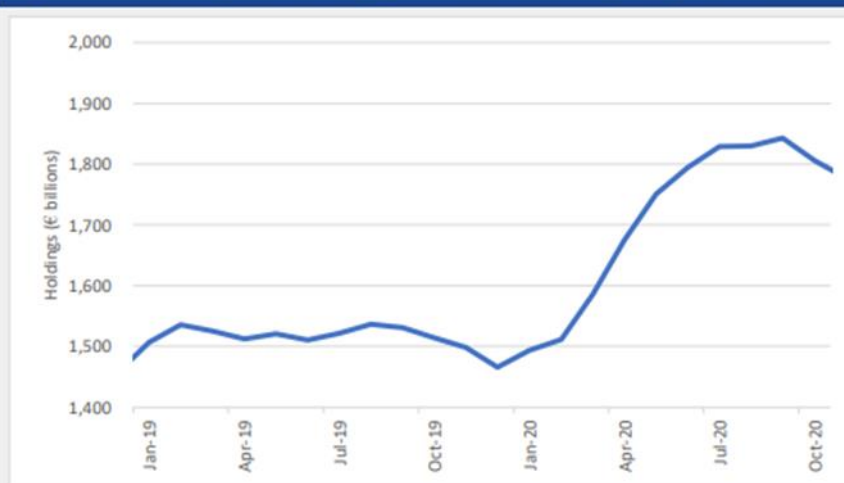
bonds has only applied since 30th April this year, As a result the move to stage 3 should be delayed as those factors that prevented a move to the next phase of the transparency regime for derivatives are current concerns within the bond market.

AFME members also question the validity of ESMA's observations as set out in paragraph 40 and 41 of this consultation paper (pg. 16) which infers that the SSTI waiver "has become somewhat less important" as ESMA has observed a reduction in market-making activity over the last year and an increase in electronic trading protocols such as all-to-all trading. This position seems to contradict that of ESMA's 2020 annual report on non-equity waivers and deferrals which recognised 'the significant role that waivers and deferrals still have in the bond market.'<sup>2</sup> AFME members therefore question ESMA's shift in perspective and request further information is provided to better understand the reasoning behind this.

AFME members consider that all-to-all trading may have increased in absolute terms, however in relative terms due to market growth all-to-all trading remained constant. Given AFME members understanding of the market, AFME requests that ESMA provide evidence to support their statement in paragraph 40 and 41 to further assist market stakeholders understanding of the changes observed by ESMA in the market.

AFME members refute ESMA's claim that there has been a reduction in market making activities over the last years. A report published by ISDA on the role of financial markets and institutions in supporting the Global Economy During the Covid-19 Pandemic<sup>3</sup> provides evidence that market making in derivatives and securities (including corporate and government bonds) within the secondary markets strengthened. As demonstrated below many banks increased their inventory holdings across an array of sectors and instruments (including government and corporate bonds) during the pandemic to support their clients' trades.

**Figure 4.9: Holdings of euro area government debt during the pandemic**



**Holdings of debt securities issued by euro area General Government reported by MFI excluding ESCB in the euro area, in billions of euros: January 2019–October 2020**

**Source:** ECB Statistical Data Warehouse.

AFME members also request further evidence to demonstrate a direct relationship between the increase in all-to-all trading and a reduction in market making activity.

<sup>2</sup> [https://www.esma.europa.eu/sites/default/files/library/esma70-156-3926\\_annual\\_report\\_2020\\_non-equity\\_waivers\\_and\\_deferrals.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-156-3926_annual_report_2020_non-equity_waivers_and_deferrals.pdf)

<sup>3</sup> The role of financial markets and institutions in supporting the global economy during the Covid-19 pandemic, ISDA, May 2021: <https://www.isda.org/a/zZzTE/The-Role-of-Financial-Markets-and-Institutions-in-Supporting-the-Global-Economy-During-the-COVID-19-Pandemic.pdf> (pg. 41 – 53)



AFME members stress the importance for the industry to continue supporting diverse trading mechanisms in order to allow the market to naturally grow, adapt, and attract new market participants. AFME and its members recognise that all-to-all trading is an established protocol that should sit alongside a range of other trading modalities, such as RFQ, which better suits the requirements of the wholesale market. AFME members note that the wholesale European bond market is predominately a dealer to client market, bond products generally do not lend themselves well to being traded in an all-to-all capacity. This is mainly due to the low probability of equal and opposite simultaneous trading interests emerging in these products which do not have continuous liquidity. Market makers therefore play a vital role in taking on risk to facilitate trading. Furthermore, in times of stress (such as the recent global pandemic) where markets are less liquid, institutional investors are likely to be one directional in their trading, resulting in amplification of negative effects if all-to-all trading was the default trading mechanism. As the buy-side are not generally mandated to take on risk they are also unlikely to have a technical infrastructure which would enable them to support the market in periods of uncertainty. Whereas market makers are committed liquidity providers and will utilise their balance sheet to regularly provide two-way quotes.

AFME members disagree with ESMA's position to remove the SSTI waiver as this would not reinforce the level playing field in the way that is suggested by ESMA's under paragraph 42 (pg.16) AFME reminds ESMA that unlike equity markets, bond markets are not order book driven. Thus under MiFID II/R the SSTI waiver was calibrated for voice and RFQ trading systems to guarantee the continued provision and access to liquidity within the bond market. Whereas the LIS threshold which is set higher is applicable to all trading systems. If the concern ESMA is addressing within this paragraph outlined above is in relation to trading protocols, AFME members stress that there are significant differences between trading systems and trading protocols and request that ESMA engage with industry stakeholders on this issue before completion of the final report.

In addition to the above, feedback AFME members have received from their buy-side clients suggest that they also consider the move to stage 3 at this time to be a rushed decision. There are also concerns that moving to stage 3 will have a negative impact downstream on prices quoted to clients.

<ESMA\_QUESTION\_CP\_MIFID\_NQT\_3>