# FESE response to the ESMA Consultation Paper on the RTS 2 Annual Review

11th June 2021, Brussels

## Introduction

Please make your introductory comments below, if any:

FESE welcomes the opportunity to respond to the ESMA Consultation on the Annual Review of RTS 2.

We fully agree with ESMA that 'transparency is a key attribute of well-functioning markets, and, if appropriately calibrated, more transparent markets attract more liquidity thereby triggering a reinforcing feedback cycle, ultimately translating into lower trade execution costs.'

With regards to bonds markets, this would provide investors with increased visibility on the most liquid bonds – the ones that actively trade. We should be aiming to increase this number so that the trading activity is visible in the market and the advantages of a transparent price formation process can be achieved. Transparency will benefit investors, both professional and retail, and entities such as pension funds and insurance companies which are very beneficial to the real economy. To facilitate this, we believe that the criteria for assessing the liquidity of bonds need to be revised to take into account market reality, as highlighted in our response to Q1.

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

The number of bonds currently classified as liquid shows that the liquidity determination process is not delivering. This is clearly shown by the results of ESMA's insightful analysis included in the consultation paper.

As indicated in our responses to the CP on transparency for non-equity and to the Call for Evidence on the review of RTS 2, we believe that the limited number of liquid bonds can be attributable to (i) criteria that have been incorrectly defined, (ii) numerical parameters that are not appropriate or (iii) an inaccurate or incomplete reporting from market stakeholders.

To solve the issues with the liquidity determination process, we would suggest proceeding as it follows:

**Measures needed in the short-term**
In the immediate, we suggest that ESMA should move directly to stage 4 in RTS 2 instead of stage 3. This, however, would only be a small step into the direction of increasing transparency for bonds markets. Further actions are needed in the medium-longer run.

**Measures needed in the medium-term**
We have identified a series of proposals that could help amend the current methodology. We believe that our suggestions are still valid and would help ESMA defining the new

calculations. We would suggest, however, that the approach taken by ESMA will have to be reviewed in light of UK data no longer being included. This would ensure that the calibrations are appropriate for EU-27 bond markets.

Our suggestions include:

- We would like to reiterate the need to look at market reality which shows that not all bonds trade. These bonds should therefore be excluded from the transparency calculations.
- Currently, a bond is considered as liquid when it is traded on a percentage of days greater or equal to 80%. However, evidence published by the AMF ('Measuring liquidity on the corporate bond market', March 2019) on the distribution of the number of different bonds traded in the course of a day points out to an average number of days traded substantially lower than the current 80% threshold. The current parameter is therefore distant from market reality.
- A bond is currently classified as liquid when it has an average daily notional amount (ADNA) greater or equal to 100,000 EUR. Based on the results of the FESE internal survey, we identified that approximately 30% of EOB trades in 2019 had a notional amount equal or above 100,000 EUR. The wide gap between this figure and the 0.2% of liquid bonds found in the Q3 2019 quarterly assessment casts doubt into this threshold.
- In order to better understand the impact of the thresholds included in MiFID II, simulations with different transparency thresholds should be conducted.
- In addition, a full assessment of the underlying data should be performed, and the data adjusted when required (before running new transparency calculations).

**Measures needed in the long-term**

In the long-term, after having performed an impact assessment and considered the impact of Brexit, we would suggest performing the liquidity assessment by using a different liquidity measure, such as the issuance size parametrised for each bond type.

**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.

N/A

**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.

Yes, we support the move to stage 3 for the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs). This is, however, only a small step into the direction of increasing transparency for bonds markets. We agree with ESMA that the removal of the pre-trade SSTI waiver and a lowering of the LIS threshold would lead to a more appropriate level of transparency, simplify the pre-trade transparency regime and make it coherent for the market.