FESE response to the ESMA Consultation on the MiFIR Review – RTS 2 transparency for bonds, SFP, and EUA

27th August 2024, Brussels

Q1: Do you agree with the definition of CLOB trading systems proposed above? If not, please explain why.

FESE welcomes the MiFIR objective to "enhance and improve pre- and post-trade transparency in non-equity markets" by improving, simplifying and further harmonizing transparency in capital markets.

Under Article 9(5)(f) MiFIR, ESMA is tasked to define the "characteristics of central limit order books and periodic auctions trading systems". Based on ESMA's definition of the central limit order book trading (CLOB) system and periodic auction system in Article 1 of RTS 2, a pre-trade transparency regime would apply to (i) a CLOB system, (ii) a periodic auction system, (iii) a trading system combining elements of both. However, the reality is that trading venues often use hybrid trading systems that combine elements not only of CLOB and periodic auction systems but also others, including RFQ, trade registration or block trading systems, which may be closely related to CLOB but are excluded from the definition and as a result from pre-trade transparency regime.

For what concerns the definition of a pure CLOB trading system, FESE agrees with the ESMA proposal but we would like to get clarity on one specific type of system. It would be helpful if ESMA could clarify if trading systems where matching is not automatic but requires confirmation by the Liquidity Provider, and could therefore require manual intervention, would fall under the definition of CLOB trading systems. We believe that these "last look" systems should also be subject to the same level of transparency as trading systems with firm prices, in particular those with a low rejection rate combined with quick response times.

Q2: Do you consider that the definition should include other trading systems? Please elaborate.

FESE finds it concerning that hybrid systems are not included in the definition, as the current pre-trade transparency regime risks being applied arbitrarily. It would be seen as a step back from the original MiFIR objective to enhance and improve the pre-trade transparency in non-equity markets. The current characteristics defined by ESMA are quite clear-cut focusing on CLOB and periodic auction systems and explicitly excluding any other trading systems, while in reality many of the trading systems are hybrid and combine elements of various systems, such as CLOB and block trading or trade registration systems.

Under the new proposed regime, there would be no need for trading venues operating hybrid systems to adhere to pre-trade transparency requirements for the parts of their hybrid systems that are neither CLOB nor periodic auction. While the pre-trade requirements would apply to the CLOB-like parts of the hybrid trading systems, we underline that pre-trade transparency requirements should also apply to the non-CLOB-like parts of the hybrid system if parts of the system fulfil the requirements of a CLOB system. We suggest that such an assessment is done on a holistic basis taking into account

how the different trading systems are described in the relevant trading rules and other supporting documents provided by the trading venue in combination with an assessment of the technical system. Here it should be noted that one technical system can be used to run more than one trading system and, consequently, it would be necessary to assess the technical specifications for the non-CLOB-like parts whether they form an integral system together with the CLOB-like parts. The transparency requirements applied to the not CLOB-like parts of the hybrid system (e.g. RFQ, block trading system, or trade registration system) should be the same as those applied to these systems before introducing the new MiFIR.

Without having a regulatory basis, any trading venue would have the flexibility of whether or not to adhere to the pre-trade transparency regime, creating a potential regulatory arbitrage, and a race to the bottom in terms of transparency standards. Low or no transparency standards will likely encourage further migrations from trading in a transparent venue to opaque systems with the consequent potential volume concentration on those. This would strongly contradict the ambition of the MiFID II/R legislation to increase transparency of financial markets.

FESE believes that ESMA should extend the definition of CLOB to other execution channels that are integral parts of the same system as the CLOB and thus, form a hybrid trading system of the exchange. As noted above, the assessment of whether such other execution channels are integral parts of the same system as the CLOB should be based on a holistic basis. For example, a block trading or trading registration system that falls in the category "other" trading systems in current RTS 2, Annex 1, would not qualify as a hybrid and not form part of the same system as the CLOB, as these could form a separate trading system aside from the CLOB and with no interaction with the CLOB.

Specifically, FESE believes that if a hybrid trading system contains parts that form a CLOB system, suitable transparency requirements should also apply to the non-CLOB-like part of the hybrid system, rather than just a CLOB part. This would ensure that the highest standards of transparency remain applicable in these situations and that there is a clear legal interpretation of the new rules across different member states.

Such an approach would ensure that any hybrid system with CLOB parts would keep high standards in terms of pre-trade transparency depending on the type of systems that form this hybrid system. Systems in which none of the components is covered by the CLOB (or periodic auction) definition would be the only hybrid systems excluded from pre-trade transparency requirements. Furthermore, despite the intention to be removed from the requirements, the definitions of voice trading systems and request-for-quote systems should be specified in RTS 2 to avoid a discretionary application of definitions by trading venues.

In addition, it is not clear if trading systems where matching is not automatic but requires confirmation by the Liquidity Provider and could therefore require manual intervention, are within the scope of the CLOB trading system definition. We believe that these "last look" systems should be subject to the same level of transparency as trading systems with firm prices, in particular those with a low rejection rate combined with quick response times.

On a separate topic, FESE is aware that the carve-out from pre-trade transparency requirement for non-financials entering into objectively risk-reducing trades in derivatives, e.g., through trade registrations, is removed from the former Article 8(1) of MiFIR (the so-called hedge exemption). This seems to be by mistake. The definition of CLOB should consider this. We welcome the opportunity to discuss this issue in the dedicated consultation package on RTS 2 on non-equity transparency which we expect to be published in Q4 2024.

Q3: Do you agree that the description of periodic auction trading systems set out in Annex I of RTS 2 is relevant for specifying the characteristics of those trading systems in the revised RTS? If not, please elaborate.

FESE agrees that a more restrictive definition of the periodic auction systems may facilitate the emergence of some auction types that fall outside of this definition and, therefore, would not be subject to the pre-trade transparency requirements. As the original MiFIR objective is to enhance and improve the pre-trade transparency for non-equity markets, this type of situation should be avoided unless a specific classification of periodic auctions is addressed.

Q4: Do you agree to use ESA 2010 to classify bond issuers. If not, please explain and provide alternatives on how clarify how to classify sovereign, other public and corporate issuers.

FESE Members acknowledge the difficulties in classifying different bond issuers and have considered the ESMA proposal to use the ESA 2010 methodology for FITRS reporting. While the ESA 2010 seems to be a widely used EU accounting framework, there are several aspects to keep in mind. The ESA 2010 states in section 20.310 that "each classification case needs to be judged on its own merits and some of these indicators may not be relevant to the individual case". Trading venues might not have the right capabilities and access to information to assess whether the issuer is a "sovereign", "corporate", or "other public" entity. Therefore, trading venues would still have to rely on the ESMA guidance as to which category issuers belong to, such as the Classification of bonds issued by certain entities (here) published as part of the Q&A on the Manual for Post-Trade Transparency (here). FESE Members would welcome having a similar register for information that would contain the necessary information for the purposes of the classification of bond issuers. Considering everything, we question whether this proposal would improve the process and we are concerned it could potentially give rise to further complications and may slow down the listing process. Therefore, we are of the view that it is unlikely to improve the current classification approach and suggest the current approach is retained.

Q5: Do you agree with the proposed LiS pre-trade thresholds for bonds? In your answer, please also consider the analysis provided in sections 4.2.1.

FESE observes that ESMA proposed some changes to the pre-trade LIS threshold compared to the levels that are currently applicable. For example, the proposed LIS pre-trade threshold for sovereign and other public bonds increased from 3,5 Mn EUR (according to the latest ESMA transparency calculations) to 5 Mn EUR. For covered bonds, it also increased from 1,5 Mn EUR to 5 Mn EUR. While corporate, convertible, and other types of bonds decreased to 1 Mn EUR. FESE generally welcomes ESMA's approach in increasing transparency overall throughout bond secondary markets. As such, we welcome the new proposed thresholds at 5 Mn EUR and, on the same logic, we would propose retaining the corporate, convertible and other bonds threshold at 1,5 Mn EUR or increasing it, instead of decreasing it. In general, static thresholds should be carefully calibrated, since there is always the risk that static thresholds are set using an incomplete or inadequate framework.

Q6: Do you agree with the proposed LiS pre-trade thresholds for SFPs and EUAs? In your answer, please also consider the analysis provided in section 4.2.2.

Q7: Do you agree with the approach taken for the illiquid waiver for bonds, SFPs and EUA? If you disagree with how the liquidity threshold is determined, please include your comments in Q11 for bonds, Q14 for SFPs and/or Q17 for EUAs.

As a first step, FESE would like to comment on the new definition of liquidity. As ESMA pointed out, the new definition places a particular emphasis on the issuance size of the bond. Based on our assessment, the issuance size might be a good indication of liquidity, albeit this is only one factor among many. As a general comment, we doubt whether static liquidity thresholds will reflect the reality of the market as securities do not have constant liquidity and it changes based on market tendencies in various Member States over the years. Nevertheless, FESE appreciates that the new system should not be overly complicated and that it needs to reflect the new wording from the Level 1 text. FESE also values the empirical approach taken by ESMA to better adapt the new systems and ensure that transparency requirements are applied to the vast majority of trades. We support that liquidity should be based on objective market observable metrics, the simplest one of them being volumes and outstanding notional. In particular, FESE would like to stress that it fully supports ESMA's approach in making sure that around 90% of total volumes and number of transactions would fall under the definition of liquid bonds. We believe that this is a significant improvement with respect to the previous regime.

Q8: Do you agree with the changes to post-trade fields summarised in Table 5? Please identify the proposal ID in your response.

Regarding proposal No 1, we do not support this approach as it is not practical for market data disseminated via technical protocols. Regarding proposal No 4, we disagree with this as the type of venue of publication (RM, MTF, OTF, APA) is already available via ESMA's registers; it does not need to be also included in the post-trade transparency publication. Regarding proposal No 5, it is proposed to introduce transaction flags but the format and logic are not aligned with that of the MMT (Market Model Typology) which venues already implement. This consists of several levels of subsequent nested dolls codes to identify transactions with granularity. We suggest ESMA reviews this to ensure consistency with MMT. Regarding proposal No 6, it is not clear what should be used for off-order book trading. It is important that the post-trade transparency rules should apply equally to all trades regardless of how they are executed to ensure there is a level playing field.

Q9: Do you agree not to change the concept of "as close to real-time as technically possible"? If not, what would be in your view the maximum permissible delay?

FESE believes that the current definition of the concept of "as close to real-time as technically possible" works well and as intended. We do not see a need or reason to change it.

Q10: Do you agree with the changes proposed for the purpose of the reporting of OTC transactions?

Q11: Do you agree with the liquidity thresholds set out in Table 7 above? If not, please provide an alternative approach.

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pointed out, the new definition places a particular emphasis on the issuance size of the bond. Based on our assessment, the issuance size might be a good indication of liquidity, albeit this is only one factor among many. As a general comment, we doubt whether static liquidity thresholds will reflect the reality of the market as securities do not have constant liquidity and it changes based on market tendencies in various Member States over the years. Nevertheless, FESE appreciates that the new system should not be overly complicated and that it needs to reflect the new wording from the Level 1 text. FESE also values the empirical approach taken by ESMA to better adapt the new systems and ensure that transparency requirements are applied to the vast majority of trades.

While we agree with ESMA's approach to consider the amount outstanding rather than the initial issuance size, so that it takes into account any additional issuance or buy-backs during the life of the bond, we would suggest it should be clarified that there will be one source for the data on the outstanding issuance size and that it is maintained by ESMA. Trading venues would not have this information and if it is not centralised within ESMA, there is a risk that different trading venues may use different figures resulting in divergent application of the transparency requirements. The general process for this is not clear to us given the current approach under paragraph 18 (p.172 of the ESMA consultation paper) is removed. We suggest that this paragraph needs to be updated in line with the new approach so that it is clearly set out that the liquidity determination is published by ESMA on a regular basis (perhaps daily) to ensure convergence amongst trading venues.

In addition, it would be helpful for ESMA to clarify whether the current rules set out in its Post-trade Transparency Manual will be updated or remain valid regarding the default value of liquidity and threshold assignment in the case of the first listing, or when the value is not present.

In particular, FESE would like to stress that it fully supports ESMA's approach in making sure that around 90% of total volumes and number of transactions would fall under the definition of liquid bonds. We believe that this is a significant improvement with respect to the previous regime.

Q12: Do you agree with the proposed thresholds specified in the above Tables? If not, please justify by providing qualitative data to your analysis and differentiating per asset class.

FESE strongly supports ESMA's objective to make around 90% of transactions real-time post-trade transparent. FESE supports the proposed thresholds for the 6 categories of trades, in particular, the 5 Mn and the 15 Mn proposed for small and medium trades for sovereign and covered bonds, and 1 Mn and 5 Mn for corporate bonds.

In this regard, we welcome the clarification that small trades will fall under real-time post-trade transparency and that they fall in an ad hoc category, beyond the categories defined in the Level 1 MiFIR. This reflects the reality that EU markets have the majority of transactions either of small or medium sizes. It is also our understanding that post-trade requirements would apply to all trading venues, including the hybrid ones.

Q13: Do you agree with the maximum deferral period set out in the tables above?

FESE generally welcomes the price and volume deferrals for categories 1 and 2, including for the new ad hoc category for small trades. In our view, the proposed deferrals for these categories sufficiently reflect the market functioning and will bring more transparency. While we note the deferral periods ESMA has proposed relate to the figures set out in the Level 1 text, we support the approach that these figures were agreed as the maximum deferral and therefore could be lower if deemed appropriate.

Given the overall objective of improving transparency, we suggest that the first category of medium-size trades should be subject to real-time transparency. In our view, a delay

of 15 minutes is not necessary and only adds an additional layer of complexity that is of no real benefit to the market. Indeed, the 15-minute deferral for Category 1 would result in some trades that are currently published in real-time today being instead published with a 15-minute deferral, e.g. liquid sovereign bond trades with a trade size of EUR 5m – 5.5m based on the Post-Trade SSTI threshold. Therefore, we would suggest Category 1 being subject to real-time transparency.

As for categories 3-5, we believe that deferrals longer than 1 week would not make much sense from the market-functioning perspective. For example, a 4-week deferral for very large transactions might have an impact on the price of bonds and, once the information is public, would not have any value for market participants but only for statistical and historical research purposes. We believe that maximum deferrals should be based on the time necessary for market participants to hedge or process large positions which in most cases, even for larger trades, do not take more than a few days.

Q14: Do you agree with a static determination of liquidity and determine that all SFPs are illiquid? If not, can you suggest any alternative methodology on how to define liquidity for SFPs?

Q15: Do you agree not to introduce changes to the threshold size currently applicable to SFPs as provided in RTS 2?

Q16: Do you agree with the maximum duration proposed?

Q17: Do you agree with a static determination of liquidity and determine that all EUA are liquid? If not, can you suggest any alternative methodology on how to define liquidity for EUAs?

Q18: Do you agree with the proposed framework for the deferral regime for EUAs? If not, please suggest an alternative methodology.

Q19: Do you agree with the classification of ETCs and ETNs as types of bonds?

FESE understands that, from a legal construct, ETCs and ETNs are classified as bonds. However, we would underline that those instruments are traded in a similar way to ETFs in the EU. ETCs and ETNs can track different markets, including equity and commodity, exhibiting the same properties in the cash market in terms of liquidity and trading participants as regular ETFs, which would render it reasonable to re-classify ETCs and ETNs as equity instruments. Hence, we would be in favour of an alignment of the transparency requirements between ETCs, ETNs and ETFs. Consequently, ETCs and ETNs should not be part of the consolidated tape on bonds but part of the consolidated tape on ETFs. In that sense, we believe ESMA should consider that despite their classification as bonds, ETCs and ETNs should be considered ETFs for transparency requirements and reporting matters.

Q20: Do you agree with the liquidity determination for ETCs and ETNs. If not, please suggest an alternative approach to the liquidity determination.

Yes, FESE agrees with the liquidity determination.

Q21: Do you agree with the pre- and post-trade thresholds? If not, please suggest an alternative methodology.

No, we do not agree with the proposed thresholds. Consistent with our response to Q19, FESE believes that the maximum price and volume deferral for ETCs and ETNs shall be fixed at the end of the trading day and not end of T+2, to be aligned with the requirements for ETFs, despite the liquidity qualification. This comes from the fact that ETCs, ETNs, and ETFs are generally considered similar products and traded the same way on lit trading venues.

Q22: What is your view in relation to the implementation of the supplementary deferral regime for sovereign bonds?

FESE agrees with ESMA's suggestion for only the volume omission supplementary deferral to be used concerning sovereign bonds. The aggregation supplementary deferral would be very difficult for data users to consume and for data providers to implement and manage.

Q23: Do you agree not to make any changes to the temporary suspension of transparency obligations framework as it currently in RTS 2?

Yes, FESE agrees that no changes are necessary.

Q24: Do you have any further comment or suggestion on the draft RTS? Please elaborate on your answer.

Please see the response to Q25 regarding the implementation of these changes.

Q25: What level of resources (financial and other) would be required to implement and comply with the draft amended RTS and for which related cost (please distinguish between one off and ongoing costs)? When responding to this question, please provide information on the size, internal set-up and the nature, scale and complexity of the activities of your organisation, where relevant.

These changes will require various system updates and will be a significant project from an IT/Market Services perspective. It would include the management of new reference data, market data fields and formats, as well as the inclusion of new transparency indicators on trade messages. It would also bring an extensive change to the deferral management system. Given the MiFIR Review covers many other aspects relevant to trading venues, it is critical from a project implementation point of view that timelines are aligned wherever possible. For instance, we note that it is proposed that the changes to RTS 23 are likely to be applicable 18 months after publication of the Technical Standards and we strongly urge ESMA to take the same approach for changes to RTS 2. Given the interlinkages between RTS 2 and RTS 23 and the fact that fields are moving from RTS 2 and RTS 23, we believe the timelines need to be the same. Otherwise, it will result in missing data for a certain period of time as fields will have been removed from RTS 2 but not yet included in RTS 23. In addition, this could lead to potential rejections in files if they are not all fully aligned. Therefore, a harmonised approach would be the most practical and appropriate

approach. It will also give the market participants sufficient time to implement the changes so it is less likely to create any issues and additional risks.