Joint association statement on MIFIR RTS 2 post-trade deferrals for bonds

3rd October 2024

Overview

This statement is supported by the following financial markets Trades Associations ("the Associations") on behalf of their members active in the EU bond markets, including sell side, buy side, and financial market infrastructures: the Association for Financial Markets in Europe (AFME), BVI (German Investment Funds Association), Bundesverband der Wertpapierfirmen (BWF), the European Banking Federation (EBF), the European Fund and Asset Management Association (EFAMA) and the International Capital Markets Association (ICMA).

It follows the respective associations' responses to the May 2024 ESMA *Consultation Paper on the amendment to RTS 2* and is intended to guide ESMA in fulfilling its mandate of drafting regulatory technical standards to support an effective post-trade deferral regime as required by Article 11(4) of MiFIR.

Central to the recommendations offered by the Associations is the importance of ESMA following a credible, balanced and data-driven approach in determining the appropriate calibrations for applying deferrals. The proposal put forward by ESMA in its May 2024 Consultation Paper is not consistent with this approach and, as currently designed, could fail in its objective of creating an effective transparency framework for EU bond markets.

The importance of an effective deferral regime

The Associations fully support ESMA's aim of providing for an adequate level of transparency. This will be beneficial to investors, liquidity providers, other intermediaries, as well as issuers, across the entire range of different and diverse bond classes. Furthermore, this will play an important role in underpinning the development, unification and internationalisation of the EU's capital market, enhancing its profile as a globally competitive and attractive centre for both issuance and investment. Critical to the attainment of this goal is the successful delivery of ESMA's parallel aim of ensuring that liquidity providers are not exposed to undue risk.

The bond market encompasses a vast array of acutely heterogenous classes and sub-classes, with very different liquidity and risk profiles, and varying sensitivities to information leakage. Unlike other markets, such as equities or exchange traded derivatives, the ability to access liquidity is very much dependent on market makers, or other principal trading firms, who are willing to assume market risk by taking the other side of an investor's buy or sell order, hedging as best they can, before looking to trade out of the position over time. In the case of many bonds, particularly when the trade is of a very large size, information leakage can lead to an immediate repricing of the market to the detriment of the liquidity provider. Disseminating details of such trades too quickly will not serve investors or the wider market well and would likely degrade liquidity in some bond classes and market segments. This becomes even more material in times of stress, where the ability and willingness of market makers to provide liquidity and immediacy becomes the basis for market stability and resilience.

Accurately determining which bonds and transactions will benefit from increased transparency (the large majority), and those for which a level of information deferral is necessary, is therefore critical to the success of the EU's transparency regime.

The importance of a data-led approach

Given the extensive diversity of liquidity profiles of different bonds, even within similar classes and groupings, and the relative infrequency with which many bonds trade, the effective functioning of the market is highly reliant on the ability and willingness of market makers and other principal trading firms to take risk to facilitate investor liquidity requirements. Understanding and quantifying this risk is the starting point for determining appropriate deferral calibrations.

This appreciation has resulted in four organisations, independently, taking very similar approaches in using historical trading data to estimate the time required by liquidity providers to trade out of risk positions, for a given size, whether in terms of classes or subclasses of bonds, or at the individual security level. These are the Autorité des Marchés Financiers (AMF), the Association for Financial Markets in Europe (AFME), the International Capital Market Association (ICMA) and EFAMA/BVI.

While the methodologies differ slightly, the four approaches use the historical average daily traded volumes of different bonds and bond types as the basis for their analysis. All reach similar conclusions in estimating the average, and longest, times required to trade out of certain bonds or bond types, for a given size.

The insights derived from these analyses also help to identify more suitable groupings of bonds, rather than solely the classifications used by FITRS, more meaningful liquidity determinants and related metrics, as well as to better target deferrals and calibrate more appropriate trade size thresholds for those corresponding deferral categories.

Recommendation to ESMA

The Associations strongly recommend that ESMA use a similar approach in assessing the appropriate groupings, liquidity determinants, deferrals, and related thresholds, to shape its design and calibration of the revised transparency regime. We would further advise that ESMA engages with data management companies experienced in fixed income markets, DG FISMA's data expert group, as well as relevant trade associations, to consult on the technical details of the methodology used for the calculation of Average Daily Volume per ISIN traded (ADV), as well as other datacentric considerations related to this process.

In particular, the Associations would ask ESMA, based on such analysis to consider:

- More appropriate groupings of bond types based on similar liquidity profiles, and not be constrained solely by FITRS classifications.
- Additional liquidity determinants to outstanding issuance size, which help to capture the associated risk and liquidity of certain bond types, where appropriate[1]. These, in an ideal world, could include time to maturity, credit rating, and currency denomination.
- An assessment of the time required to trade out of positions of a given size as the basis for selecting the appropriate size thresholds for the various deferral categories.

The Associations believe that this will result in a far more effective transparency regime that maximises the number of transactions and associated trade volumes where real-time visibility will enrich the market, while better protecting the liquidity of those trades where information leakage would be detrimental to investors and the wider market.

Conclusion

Improving bond market transparency is an underpinning objective of developing and deepening a more cohesive and globally competitive EU capital market and the introduction of a consolidated tape presents an opportunity to enhance market quality and resilience. Key to the success of the tape and the realisation of these goals will be the design and calibration of the related deferral framework. It is imperative that this reflects the nature, structure, and liquidity of Europe's bond markets.

The Associations therefore urge ESMA to reassess the proposal put forward in its May 2024 Consultation Paper and to take on board the recommendations outlined in this statement, using a more scientific, data-driven and balanced approach as its basis.

We believe that this will better support the successful attainment of ESMA's dual aims of providing for an adequate level of transparency and ensuring that liquidity providers are not exposed to undue risk. It will also result in a deferral regime that is more appropriately calibrated to the market it is intended to serve.

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[1] For covered bonds, issuance size as a proxy for liquidity assessment should be considered, according to Recital 10 of the MiFIR Review, and be set appropriately for each jurisdiction.

AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. 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. AFME participates in 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) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu

The **Bundesverband der Wertpapierfirmen e.V. (bwf)** protects and promotes the common professional interests of Germany's investment firms on a national, European and global level. The association assists and informs its members in all matters that concern them in connection with their activity as licensed and regulated investment firms. The bwf furthermore works closely together with national and international industry associations of the banking and capital markets sector.

BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from 45 countries. The EBF is committed to a thriving European economy that is underpinned by a stable, secure and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere. Website: www.ebf.eu Twitter: @EBFeu.

EFAMA is the voice of the European investment management industry, which manages around EUR 30 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors. Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book. More information is available at www.efama.org

International Capital Market Association (ICMA) promotes well-functioning cross-border capital markets, which are essential to fund sustainable economic growth. It is a not-for-profit membership association with offices in Zurich, London, Paris, Brussels, and Hong Kong, serving around 620 members in almost 70 jurisdictions globally. Its members include private and public sector issuers, banks and securities dealers, asset and fund managers, insurance companies, law firms, capital market infrastructure providers and central banks. ICMA provides industry-driven standards and recommendations, prioritising three core fixed income market areas: primary, secondary and repo and collateral, with cross-cutting themes of sustainable finance and FinTech and digitalisation. ICMA works with regulatory and governmental authorities, helping to ensure that financial regulation supports stable and efficient capital markets.