ICMA
International Capital Market Association

EU Sovereign bond transparency regime framework

An ICMA Position Paper

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Overview

ICMA proposes a post-trade transparency framework for sovereign bonds[1] traded in the EU. ICMA believes that improved transparency for the EU sovereign bond market is not only core to the ambitions of the Capital Market Union, but it will also address the current information asymmetry faced by existing and potential investors in EU sovereign debt,[2] whilst also acknowledging that there is an existing level of real-time transparency currently available.

The key principles that ICMA feels are required in any post-trade transparency framework for sovereign bonds are:

1) Harmonisation across national competent authorities for their respective sovereign bonds
2) Removal of the optionality for volume omission and indefinite aggregation

The proposed framework was developed over a six-month consultation period, analysing a dataset of publicly available MiFIR post-trade data, with a dedicated Transparency Taskforce, consisting of international buy-side heads of trading, sell-side senior trader representatives, and centralised market data specialists. In developing the framework, the Taskforce sought to achieve a balance between:

(i) optimising the amount of available transparency, particularly with respect to the number of transactions, while providing sufficient protection for market makers and other liquidity providers; and
(ii) creating a relatively uncomplicated and easily adoptable framework that also integrated the key determinants of underlying market liquidity.

The resulting framework is data-driven, while also complemented by the qualitative judgement of senior market practitioners, making this sovereign bond transparency framework a proposal that is uniquely market-based.

However, as there were some divergences in views between members of the Taskforce, the framework is a compromise proposal which is intended to provide a guide for further consideration.

Summary of framework features

- The proposal seeks to optimise real-time transparency, with scope for deferring the publication of the disaggregated details of certain transactions
- The thresholds for determining deferrals are based on three key variables:
  - Transaction size
  - Outstanding amount of underlying issue
  - Time to maturity of underlying issue
- There is no scope for indefinite aggregation of trades (with 12 weeks being the maximum time before full disaggregation)
- All deferrals apply to price and size: there is no "volume omission"

The ICMA Transparency Taskforce

The sovereign bond transparency taskforce 'the Taskforce' comprises multiple buy and sell-side investment firms from various countries across the EEA as well as Canada, UK and US (operating in EU countries). They also represent varied transparency preferences, some requiring more transparency and some requiring less, based largely on their business models and their relative sensitivity to information leakage. Also in the Taskforce were two market data aggregating specialist providers. ICMA's proposed sovereign bond transparency regime represents a compromise-based market-led transparency framework approach that we believe the industry can live with.

1 This includes all bonds issued by sovereign issuers, both in domestic and foreign currency, as well as by government agencies and supranationals (ie "SSA" issuance).
2 See also ICMA's Proposal for a new post-trade transparency regime for the EU corporate bond market (December 2021)

Why is sovereign bond transparency important?

Sovereign bonds are the most frequently traded bonds in the asset class. In the third quarter of 2022, sovereign bond trades (including supranationals and government agencies) represented 78.6% of overall bond trading volumes in the EU, compared with corporate bonds which represented 21.4%.[3]

As well as making up a large share of many investment portfolios, the influence of sovereign bonds cuts across fixed income markets more broadly.

Primary markets are critical for sovereign issuers, who rely on a deep and diverse pool of ready buyers to ensure both assurance of funding and favourable pricing. The appetite, and elasticity, of investors is heavily contingent on the ability to recycle risk in the secondary market. Their gauge of, and confidence in, secondary market liquidity[4] is premised on the amount of available and reliable information relating to current and historical price and volume data. The more liquid, and *transparently liquid*, the secondary market, the more resilient the primary market.

In this respect, it could be argued that smaller sovereign issuers are disadvantaged, both in terms of pricing and reliability of demand, as a result of information asymmetry with respect to their secondary market activity. Enhanced transparency could not only improve secondary market liquidity in their bonds, but also, indirectly, the cost of funding their national debt.

Improved data on sovereign bond secondary market transparency could not only be critical in attracting new, less sophisticated investors, but it also underpins confidence in larger, more sophisticated asset managers who are required to transact in high volumes and large sizes. This requires not only an understanding of liquidity conditions but also an informed sense of potential market impacts of their activity.

Sovereign bonds are also a crucial reference point in trading bonds more generally, either as a pricing benchmark or as the default hedging instrument. Corporate bonds, and other credit classes, for example, are widely valued, quoted, and traded, as a spread in yield to sovereign bonds. Whether pricing or trading investment grade corporate debt, high yield, emerging markets, covered bonds, mortgage-backed bonds, or other forms of securitised debt in secondary markets, the relevant sovereign bond yield curve will often be the point of reference.

Greater price transparency in certain sovereign bonds can help to enhance liquidity and price efficiency for various derivatives, in particular exchange traded bond futures.

Away from markets themselves, sovereign bond data acts as an economic barometer, providing valuable analysis of the impact of exogenous factors (for example Covid and the war in Ukraine) upon a nations' fiscal health. This can also assist with future event impact planning.

Besides other market uses for sovereign bond data, there are prudential dependencies on data, such as the High-Quality Liquid Assets (HQLA) standard, whereby qualifying HQLA stock can be readily sold, or immediately converted to cash under Liquidity Coverage Ratio obligations. Additional dependencies are price data points in IMA risk models that calculate market risk capital requirements under the FRTB (Fundamental Review of the Trading Book).

For all these reasons, ICMA believes that a well-designed, harmonised, and appropriately calibrated transparency framework contributing to a single source bond consolidated tape (CT) will facilitate useable and valuable sovereign bond post-trade data, on a trade-by-trade basis. This centralised golden source of data would be in the best interests of all market participants and associated parties, from sovereign issuers themselves to more empowered retail investors.

3 According to Ediphy Analytics (see annex 1, Q3 2022 data set), Ediphy Analytics | Access High Touch Trading Data Analytics
4 ICMA defines liquidity in bond markets as the ability to buy or sell any bond, at any size, with minimal impact on market price.

Addressing the structural challenges of the current regime

ICMA believes that structural challenges exist under MiFIR RTS 2 that complicate the pathway to a single authorised bond consolidated tape. Addressing these is an important element of the ICMA proposal.

In its objective of protecting sovereign bond liquidity providers from undue risk, the current regulation allows for a supplementary deferral regime, providing for both (i) the omission of trade volumes for a 4-week period, and (ii) indefinite deferrals and aggregation of price and volume trade data.

This is further complicated by the ability of individual competent authorities of member states effectively to choose one of four options:

1) not to adopt a supplementary deferral regime; or
2) to apply volume omission for a 4-week period; or
3 to apply indefinite price and volume aggregation; or
4) to choose a combination of 4-week volume omission and indefinite price and volume aggregation.

In practice, these deferred trades are mostly aggregated indefinitely or, confusingly, in combination with volume-only 4-week deferrals.

This has resulted in a high volume of indefinitely aggregated transactions, which effectively hides a significant amount of valuable post-trade data from the market, thereby undermining the benefits, and objectives, of the EU transparency regime.[5]

Such a compromised transparency regime will not facilitate a clear roadmap to a meaningful sovereign bond populated consolidated tape in the EU. Consequently, the necessity to eliminate the possibility for indefinite aggregation of sovereign bond market data is a key, and consensus, conclusion of the ICMA Taskforce and a fundamental element of the proposed framework.

5 Some 68% of sovereign bond market activity in the EU is currently subject to indefinite deferral (see ICMA, Secondary Bond Market Data: H1 2022, p.18)

Basis of the ICMA proposal

The proposal was developed following six months of intensive, collegiate interaction between senior sovereign bond market traders, market structure heads, market data providers, and market professionals, representing a broad and diverse range of EU and global firms active in sovereign bond markets, analysing a representative subset of publicly available MiFIR sovereign bond post-trade data (see Annex 2 for additional details).

ICMA representative dataset – analysis notes

The analysis was run by Propellant, based on aggregated publicly available post-trade data under MiFIR. The data set:

- Covers the period 1st January to 1st September 2022.
- Only includes the debt of selected sovereign issuers in their own domestic currency (see annex 2).
- Only includes D2C trades and only where the trade count is available in the publications.
- Excludes supranational and agency debt (which is largely classified as corporate debt in FIRDS), but includes EU issuance as an illustration of the potential impact on supras/agencies.

The starting point for the Taskforce's analysis was to identify the key components that impact sovereign bond market liquidity and to assess the extent to which these could affect sensitivity to information leakage (ie non deferred price and size transparency).

Secondary bond market liquidity is primarily supported by market makers, and other liquidity providers, who are willing to make prices (bids and offers) even when they do not hold an underlying position in the bond. This requires them taking positions onto their trading books, hedging their risk, and running the position until they are able to unwind it.[6] While liquidity providers are able to hedge certain elements of their market risk, they are not able to hedge against information leakage, which can impact the market valuation of the bonds relative to any hedge. The liquidity of the bond, and the size of the position, directly impact the sensitivity of the market reaction to trade information, and therefore the risk of the liquidity provider. In turn, this affects the willingness, and price, of the liquidity provider, which can be to detriment of the liquidity taker and the market more generally.

After long assessment, and much debate, it was felt that most transactions, particularly those that were relatively small or "usual" in size, did not require a deferral and should be published as close to real-time as logistically feasible. For trades where the underlying bond is not particularly liquid, or where the transaction size is relatively larger than usual, and where information leakage could put a liquidity provider at risk, deferrals were appropriate for the integrity and health of the market.

While it is difficult to draw definitive conclusions on the time it takes market makers, and other risk takers, to trade out of a position, it does seem reasonable to take an informed view on when trade information no longer becomes valuable enough to act upon. Accordingly, despite a range of opinions in some cases, the Taskforce fell on the consensus proposal for three deferral categories to cover the most sensitive trades:

(i) **Category 1:** for trades that are considered relatively small, but where the underlying issue size is also relatively small;

(ii) **Category 2:** for trades that are relatively large; and

(iii) **Category 3:** for trades that are extra-large.

In these cases, transactions will still be reported weekly, in aggregate form, but subsequently disaggregated in line with the time for each relevant deferral period.

While ultimately it will be for ESMA to decide on the actual deferral categories, and the appropriate period for each category, many in the Taskforce felt that for the eventual CT data to be meaningful, while also protecting large and illiquid trades, there should be a maximum deferral period of 12 weeks.

6 In the case of sovereign bond positions, the primary risk is interest rate risk, which is usually hedged by taking a (delta-weighted) opposing position in a core sovereign bond (such as Germany) or exchange traded government bond futures contracts.

Volume omission is ineffective

An important part of this consideration was the recognition that in bond markets separating price and size in any public transparency is ineffective, as it is possible to infer significant information from price alone, including whether or not it is a risk trade (ie is a liquidity provider going long or short), the direction of the trade, and the relative size of the transaction (see Annex 3). Any deferral would, by necessity, have to apply to both price and size.

In assessing the factors that affect liquidity and price sensitivity to information, the Taskforce looked at a number of bond and bond market characteristics, including: outstanding issue size; the overall outstanding debt and number of issues of the underlying issuer; time to maturity; time since maturity; benchmark ("on-the-run") status; futures deliverability; trading activity; and, importantly, relative transaction size.

Benchmarking any impact on transparency against current MiFIR transparency outcomes was a key consideration, ensuring that the proposed framework would increase transparency.

It soon became clear that the underlying market structure and liquidity conditions for sovereign bond issuers are fairly diverse and complex, and that prescribing a "one-size-fits-all" deferral framework would be challenging. However, when changing thresholds on different inputs to assess the relative impact on non-deferred transparency it soon became clear that two consistent determinants of underling liquidity were **time to maturity** of the underling bond and **outstanding issue size**. These, along with relative trade size, would establish themselves as the fundamental determinants of the framework's deferral criteria.

What also become clear was that *time to maturity* and *outstanding issue size* have far more impact on the sensitivity of smaller sovereign issuers when it came to potential (and requirement) for deferrals, which the Taskforce felt was key in developing a balanced transparency framework that did not disadvantage smaller EU economies.

Accordingly, ICMA proposes a deferral framework that is based on **amount outstanding** and **trade sizes**, conditional on **time to maturity**.

While a more complicated, multi-variable deferral framework would have been possible, and even justified, the Taskforce felt that from an implementation perspective there is a requirement to ensure that the eventual framework is both relatively simple and robust. This still leaves scope for applying tiered calibrations of the thresholds for the proposed criteria in the Level 2; but this degree of granularity is beyond the remit of the Level 1, which should seek only to outline the deferral categories.

The ICMA framework

A considerable amount of analysis on a representative subset of publicly available MiFIR sovereign bond post-trade data was carried out by Taskforce market experts to the best of the Taskforce's ability, given the limitation of the sovereign bond data available. The transparency framework described below is a useful assessment and example of what is possible regarding appropriate transparency in EU sovereign bond markets.

- In its analysis, the Taskforce settled on respective deferrals (both price and size) for each category being:
  - Category 1: 1 week
  - Category 2: 4 weeks
  - Category 3: 12 weeks

- The Taskforce also settled on the following thresholds:
  - Outstanding issue size: €3bn equivalent
  - Time to maturity: 7 years
  - Trade size: €2.5mm illiquid / €10mm liquid

- It is important to note that the eventual deferral periods and thresholds would be verified by ESMA and established based on its own analysis in level 2.

All sovereign bond transactions would be made publicly available as close to real-time as possible, with the exception of trades that qualify for deferrals, as outlined in the following table.

Category	ICMA Deferral Category	Price - Deferral	Size - Deferral	Amount Outstanding	Trade Size Range (conditional on time to maturity)
1	Small Trades & Illiquid Issues	1 week	1 week	≤ €3.0bn	≤ €10mm for ≤ 7yrs to maturity OR ≤ €2.5mm for > 7yrs to maturity
2	Large Trades & Any Issue Size	4 weeks	4 weeks	N/A	> €10mm for ≤ 7yrs to maturity OR > €2.5mm for > 7yrs to maturity
3	Extra-Large Trades & Any Issue Size	12 weeks	12 weeks	N/A	> €30mm

Level 1 Level 2

It should be noted that transactions that were previously indefinitely aggregated now become transparent after the deferral period expires with ICMA's framework. This leads to a net improvement in overall transparency, even for large trades.

Summary of rationale for deferral periods used in the analysis and subsequent framework

The Taskforce's analysis looked at various threshold ranges for trade sizes and the data led to the threshold parameters and deferral timeframes used for illustration in this paper. If not real-time, then trades are deferred as below:

- **Small trades & Illiquid issues – 1-week Deferral category**

  The analysis suggested that €3bn (equivalent) amount outstanding is the optimal threshold for smaller, less liquid sovereign issues. Time to maturity of the underlying bond also appears to have greater sensitivity with respect to liquidity. Here it is felt that trade size (which is generally small) is less relevant, and that a minimum one-week deferral will help to protect liquidity providers. Many of these issuers have few sovereign bonds, which trade sporadically.

- **Large trades, regardless of issue size – 4-week Deferral category**

  Sensitivity to time to maturity is also a consideration, but in this case the trade sizes are larger. Therefore, it will usually take market-makers longer to trade out of their positions. As such, the deferral length in this category is 4-weeks. However, as the sizes are larger, illiquidity is already assumed, and amount outstanding is less relevant.

- **Extra-large trades, regardless of issue size – 12-week Deferral category**

  Any trade that is greater than €30mn, will automatically fall into this 12-week deferral category. Here time to maturity or underlying issue size are superseded as considerations by the fact that this is a larger than median transaction with above normal risk for any market maker or liquidity provider assuming a risk position. While it may take more than 12 weeks to trade out of the position, it is assumed that after this period it is unlikely that any information would be acted upon.

While the appropriate calibrations for the three criteria for determining deferrals (*trade size, amount outstanding,* and *time to maturity*) should be determined as part of the Level 2 process, along with the relevant categories and deferral periods themselves, with subsequent scope for recalibration, ICMA has provided the results of its own analysis, which are included in the above framework. The impact of which on current transparency is also illustrated in Annex 2. These are purely for illuminating purposes and to underline the case for the proposed deferral criteria. ICMA maintains that the appropriate calibrations should be determined as part of the Level 2 process and based on similar, detailed analysis of market data.

ICMA continues to advocate for the creation of a stakeholder-based Market Expert Advisory Group ("MEAG") that would play an instrumental role in advising EMSA and the European Commission in calibrating, and periodically reviewing and recalibrating, the relevant deferral thresholds (see Annex 2).

Conclusion

Public transparency is a cornerstone of bond market integrity and liquidity. This could not be more true for sovereign bond markets, which are not only the safest and most investible debt instruments for retail investors, but are the benchmark reference point for valuing and trading all debt issuance, not least corporate bonds. In many respects, deep, liquid, and resilient sovereign bond markets underpin the ambitions of the EU Capital Markets Unions project.

The ICMA proposal for an EU sovereign bond market transparency regime, as discussed by market experts representing an array of interests across the EU and global fixed income markets, is intended to inform the current discussions by EU policy makers and regulators in their review of the current MiFIR bond market transparency framework. ICMA, and its members, representing both sell and buy side firms, as well as other key stakeholders such as market data providers, believe that this is an opportunity to create a credible and impactful bond market transparency regime that could put Europe at the forefront of the international debt markets.

ICMA MiFIR level one key recommendations

The following represents ICMA's proposed key level one legislation recommendations:

2a. With respect to sovereign debt instruments, competent authorities of a sovereign debt instrument may allow, with regard to transactions in that sovereign debt instrument in the Union:

(a) deferred publication based on some or all of the following: issuance size, time to maturity and trade size; and

(b) the price and volume details of several transactions to be published in an aggregated form for three months.

Annex 1

ICMA Volume Analysis - Split of bond trading activity per issuer type.

	Q3 2022 Volume €bn
Sovereign bonds	11,061
Corporate bonds	3,008
Total	14,069
Sovereign %	**78.6%**
Corporate %	**21.4%**

Source: Ediphy

Disclaimer: All effort has been made to clean the data and interpret it in a reasonable manner, with results checked for reasonableness. However, Ediphy Analytics will not be held liable for any errors, whether its own or those of third parties.

Annex 2

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Illustration of potential impact on trade transparency of the ICMA framework

	Today				ICMA Proposal									
	Real-Time		Deferred		Real-Time		Deferral 1 (small trades / illiquid issues)		Deferral 2 (large trades)		Deferral 3 (extra-large trades)		Deferred Total	
	% Trades	% Volume	% Trades	% Volume	% Trades	% Volume	% Trades	% Volume	% Trades	% Volume	% Trades	% Volume	% Trades	% Volume
AUSTRIA	48%	17%	52%	83%	85%	26%	2%	0%	12%	46%	1%	28%	15%	74%
BELGIUM	52%	8%	48%	92%	82%	14%	1%	1%	15%	43%	3%	42%	18%	86%
BULGARIA	18%	4%	83%	96%	0%	0%	93%	46%	8%	54%	0%	0%	100%	100%
CROATIA	22%	12%	78%	88%	0%	0%	97%	80%	3%	20%	0%	0%	100%	100%
CZECH REPUBLIC	30%	21%	70%	79%	77%	44%	12%	5%	11%	43%	0%	8%	23%	56%
DENMARK	46%	17%	54%	83%	72%	19%	15%	3%	11%	30%	2%	48%	28%	81%
FINLAND	20%	8%	80%	92%	83%	28%	0%	0%	15%	43%	2%	30%	17%	72%
FRANCE	59%	6%	41%	94%	70%	7%	0%	0%	19%	27%	11%	66%	30%	93%
GERMANY	73%	18%	27%	82%	75%	13%	0%	0%	18%	30%	7%	57%	25%	87%
HUNGARY	24%	21%	76%	79%	33%	27%	60%	42%	7%	27%	0%	3%	67%	73%
ICELAND	0%	0%	100%	100%	0%	0%	100%	100%	0%	0%	0%	0%	100%	100%
IRELAND	34%	15%	66%	85%	87%	29%	0%	0%	12%	47%	1%	24%	13%	71%
ITALY	82%	27%	18%	73%	89%	14%	0%	0%	7%	29%	3%	58%	11%	86%
LATVIA	0%	0%	100%	100%	0%	0%	100%	100%	0%	0%	0%	0%	100%	100%
LITHUANIA	4%	5%	96%	95%	0%	0%	91%	67%	9%	33%	0%	0%	100%	100%
LUXEMBOURG	14%	13%	86%	87%	0%	0%	88%	39%	12%	43%	1%	18%	100%	100%
NETHERLANDS	57%	12%	43%	88%	79%	20%	0%	0%	18%	43%	3%	37%	21%	80%
NORWAY	54%	10%	46%	90%	93%	40%	0%	0%	6%	40%	1%	21%	7%	60%
POLAND	25%	21%	75%	79%	85%	55%	1%	0%	13%	37%	1%	8%	15%	45%
PORTUGAL	65%	12%	35%	88%	83%	24%	3%	1%	13%	48%	1%	27%	17%	76%
ROMANIA	38%	13%	62%	87%	0%	0%	97%	63%	3%	24%	0%	12%	100%	100%
SLOVAKIA	5%	15%	95%	85%	9%	2%	65%	33%	25%	55%	0%	10%	91%	98%
SLOVENIA	14%	44%	86%	56%	8%	2%	79%	27%	12%	29%	1%	42%	92%	98%
SPAIN	73%	17%	27%	83%	78%	12%	1%	0%	16%	40%	5%	48%	22%	88%
SWEDEN	20%	4%	80%	96%	57%	13%	21%	4%	19%	39%	3%	44%	43%	87%
UNITED KINGDOM	14%	14%	86%	86%	78%	14%	0%	0%	18%	33%	5%	52%	22%	86%
UNITED STATES	65%	29%	35%	71%	87%	35%	0%	0%	11%	34%	2%	30%	13%	65%
EU (EURATOM)	0%	0%	100%	100%	0%	0%	0%	0%	0%	0%	100%	100%	100%	100%
EU (ESFS)	14%	2%	93%	98%	59%	11%	18%	4%	18%	37%	5%	49%	41%	89%
EU (ESM)	65%	2%	95%	98%	62%	11%	20%	4%	14%	33%	4%	52%	38%	89%
EU	25%	8%	75%	92%	45%	8%	5%	1%	46%	54%	5%	37%	55%	92%
Total	65%	21%	35%	79%	83%	21%	2%	0%	12%	32%	4%	47%	17%	79%

The above table is an illustration of how sovereign bond transparency could change under the proposed ICMA framework.

Annex 2 – Continued

The first four left-hand columns (next to issuer country) represent the current status quo for real-time and deferred trade reporting, as a percentage of the number of transactions and underlying trade volumes (in terms of notional value). For example, 73% of transactions in German government bonds (based on the underlying data set) were subject to real-time reporting, which is 18% of the notional value of traded volume on German sovereign bonds. Meanwhile, for Ireland's debt, 66% of transactions and 85% of notional traded value is subject to reporting deferrals.

The subsequent columns (again based on the underlying data set) provide the resulting transparency outcomes with respect to real-time and the three proposed deferral categories, applying the following threshold calibrations (which were instrumental in informing the Taskforce's final framework):

ICMA Deferral Category	Price - Deferral	Size - Deferral	Amount Outstanding	Trade Size Range (conditional on time to maturity)
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Large Trades & Any Issue Size	4 weeks	4 weeks	N/A	> €10mm for ≤ 7yrs to maturity OR > €2.5mm for > 7yrs to maturity
Extra-Large Trades & Any Issue Size	12 weeks	12 weeks	N/A	> €30mm

The results provide an overall increase in real-time transparency for sovereign bond markets, particularly with respect to the number of transactions, while ensuring that the smaller subset of transactions in less liquid sovereign bonds, and larger outright trades in all bonds, are protected by calibrated deferrals.

Annex 3

How ‘corporate and sovereign’ bond dealers can infer market sensitive information from a price

In bond markets it is relatively easy for a dealer to infer useful information from the reported print of a trade, even where the volume of the transaction is deferred or masked. Visibility of the price alone can be extremely informative, providing useful insights both about the direction of the trade (with respect to the liquidity provider) and a sense of the relative size of the transaction. The sooner a dealer gets to see these price prints, the quicker they can take advantage of this information.

From a market participant perspective, if they see the price of the reported trade, they can begin to build a picture of the underlying trade. The fact that the size is deferred already tells them that this is probably a larger than median trade for the security. If they now compare the price to where the market was quoted at the time of the trade (bids and offers) they can determine whether the trade created a new risk position. If the price is within the bid-offer spread, it is most likely that the trade was against a dealer ‘axe’: ie it is a trader that is selling out of an existing long position or buying back a short position. This means that the trade is probably closing out an existing risk position. It could also be a transaction between two buy sides. However, if the price is skewed, either to the ‘left’ or ‘right’ of the bid-offer spread, it is reasonable to assume that this is the creation of a new risk position. If the price is lower than the quoted bids, then it is likely that this is a dealer going long (client selling). And if the price is higher than the quoted offers, this probably means that a dealer is going short (client buying). What is more, the further the price is from the quoted bids or offers, the larger the size of the transaction is likely to be.

Based on this very useful information, market participants will now adjust their pricing for the security. If they can infer that a dealer has gone long a relatively large position, they will move their price lower as they anticipate that the position will need to be sold back into the market at some point. Similarly, if they can assess that there is a new large short in the market, they will move their price higher. This, of course, will be to the detriment of the liquidity provider who is now trying to exit their position at a worse price than would otherwise have been achieved. And this is based purely on the publication of a transacted price.

When a market maker takes a position onto their trading books (long or short), they will immediately look to hedge the various risk components, and maintain and manage these hedges until they are able to trade out of the position. For example, in the case of corporate bonds, the market maker will hedge the interest rate risk and potentially also the credit risk. Hedging could be at the individual trade level, or it could be at the book (portfolio) level. A simple example would be where a dealer buys a corporate bond onto their book from a client. They will hedge the interest rate risk, say by selling a duration weighted amount of a similar maturity sovereign bond, and they may choose to hedge their credit risk by buying a delta weighted amount of a credit default swap. However, they cannot hedge the ‘idiosyncratic risk’ that is specific to the underlying security, and which will impact its value relative to any hedges.

Information leakage with regard to market positioning is a key source of idiosyncratic risk, which is why deferrals for publicizing both price and volume for certain transactions are necessary to protect liquidity providers.

Annex 4

Market Expert Advisory Group "MEAG"

The bond consolidated tape will require a Market Expert Advisory Group (MEAG) to be part of the operating model of the chosen bond consolidated tape provider or its overarching governance entity, with regulator participation. The MEAG will consist of buy-side, sell-side, trading venue and APA market participant experts and meet on a semi-annual basis to review and assess the transparency situation in sovereign bond markets, as well as for corporate bonds, over the previous six months. This expert group will recommend to ESMA in a semi-annual report to either increase/decrease/hold sovereign bond related thresholds (as mentioned) based on real market participant experiences. The semi-annual MEAG report will report on the health and state of both sovereign and corporate bond markets over the previous six months.

- If there are found to be negative market liquidity impacts, perhaps from reduced sell-side balance sheet risk provision, then sovereign bond thresholds could be modified to provide less transparency for certain transactions. Whereas if the sovereign bond market is found to be working well with current thresholds, and the MEAG agrees that there would not be any undue risk to increasing transparency, then recommendations could include changing thresholds to increase transparency.
- This MEAG would also convene in times of crisis (e.g., Covid, war in Ukraine) to recommend necessary changes to thresholds/deferrals to protect market stability.
- All MEAG proposed threshold modifications will be data-driven and evidence based. As such, recommendations from the MEAG should be considered 'actionable'.
- The MEAG buy-side and sell-side market participant representation should include a balance of natural transparency preferences. APAs and trading venues will advise on data quality and market operator experiences from the last six months.

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