

## Briefing note

### ***“Pre- and post-trade transparency for non-equity markets” roundtable organised by the ECMI-CEPS in Brussels on 6 April 2017***

#### **Introduction:**

- Karel Lannoo, CEO, CEPS and General Manager, moderated the roundtable. He explained that this event was the first out of three. There will be a 2<sup>nd</sup> event on data consolidation/profiling, and a 3<sup>rd</sup> on investor protection rules (including best execution) under MiFID II.

#### **1) MiFID II and transparency – Impact on bond markets**

##### **Speakers:**

- **Jorge Yzaguirre Scharfhausen**, Director of Markets, Bolsas y Mercados Españoles (**BME**)
- **Bas Dommerholt**, Supervision Officer, Capital Markets, Netherlands Authority for the Financial Markets (**AFM**). Also involved in ESMA Working Group on the implementation of MiFID II.
- **Julian Allen-Ellis**, Director MiFID, Association for Financial Markets in Europe (**AFME**)
- **Per Loven**, Commercial Director, Boat Services, **TRADEcho**

##### **Bolsas y Mercados Españoles, BME:**

- Jorge Yzaguirre Scharfhausen presented BME’s approach on pre- and post-trade transparency for Spanish fixed income markets. BME comprises the following trading venues for fixed income: **AIAF**, a regulated market; **SEND**, a retail platform; **Exchanges**, which are due to cease operating; **SENAF**, a MTF; and **MARF**, a MTF for small, illiquid SME bonds and primary markets. BME will be extending their offering to include European sovereign and corporate bonds and target bonds of Spanish companies listed on other exchanges in particular. A new API will be live from July 2017.
- MiFID II and T2S will take effect within the same timeframe and impact BME’s trading members (TM) and clearing members (CM) respectively.
- **Transparency:** Jorge Yzaguirre Scharfhausen stated that approx. 98% of ISINs currently traded will be classified as illiquid while the remaining 2% meet liquidity thresholds and account for over 90% of traded volumes.
- **SI regime:** BME aims to avoid the inclusion of their trading members in the Systematic Internaliser (SI) regime. In practice, this will require their trading members to send all trades and volume to BME. Trades will then be classified as either liquid or illiquid, and routed automatically to the appropriate venue:
  - Electronic order book: for trades below size specific to the instrument (SSTI), exempt from pre-trade transparency, and above Large in Scale (LIS), with deferred post trade reporting according to the criteria established by the Spanish regulator.
  - RfQ: Trades above SSTI and below LIS thresholds.

- Julian Allan-Ellis from AFME noted that NCAs have discretion to determine the length of the deferral period and that these are likely to vary from one jurisdiction to the other (between 2 days and up to 4 weeks). This is a key concern for the industry.

#### **Netherlands Authority for Financial Markets, AFM:**

- **Liquidity:** Bas Dommerholt stated that the AFM was aware that market participants experience reduced liquidity, the link between higher capital requirements and reduced inventories, and, referring to the recent IOSCO report, that it can be difficult to source liquidity.
- **Transparency:** In his view, transparency will allow for “better connections” between clients and liquidity providers; economies of scale will become increasingly important. End-clients will benefit from post-trade transparency to assess best execution. Phasing-in of transparency requirements is a suitable approach that allows to review and amend calibrations if required.
- **SI regime:** This will gear fixed income markets towards equity markets, which are more standardized and perform better than bond markets. The requirement for SIs to price all bonds from an issuer will reinforce the link to issuers.
- Jorge Yzaguirre Scharfhausen from BME noted that due to the fragmentation of liquidity across venues it will be challenging to meet best execution requirements even for liquid instruments.

#### **Association for Financial Markets in Europe, AFME:**

- **Post-trade reporting deferrals:** Julian Allen-Ellis stated that the lack of harmonization of post-trade reporting deferrals is a significant concern for the industry. Diverging deferral regimes impose significant operational requirements to comply with best execution. He said that ESMA is not mandated to impose specific levels, which could lead to competition towards longer deferral periods in the institutional market for instance. The length of deferral periods also impacts a firm’s “footprint” in the market.
- **Transparency:** Increased transparency is generally desirable, but not at the cost of decreased liquidity. He noted that transparency will favour incumbents while it will have a detrimental effect on smaller firms. Moreover, he stressed that the phase-in approach was critical; it will allow the industry and regulators to interact and reflect on the impact during the phase-in period.
- **Brexit:** This is another key concern and raises the question how liquidity assessments will be conducted following Brexit.
- **SI regime:** Julian Allen-Ellis noted that the industry is concerned about the process to follow if a firm qualifies as SI or chooses to opt-in; and whether to be an SI for all instruments or just a few. The lack of a “golden source” to identify SIs at instrument-level is another concern. The AFM agreed it would be preferable for ESMA to provide a golden source if it had the resources.

#### **TRADEcho:**

- **Equity v bond markets:** Per Loven said that the changes in fixed income markets will be unprecedented. He pointed out the differences between equity and bond markets, and concluded that bond markets are by nature less liquid and less concentrated. He noted that the bond market shrank significantly in terms of size in the last years.
- **Transparency:** His view was that transparency will not be beneficial for its own sake. It will be beneficial where end-clients have the largest exposure ie through pension funds in the wholesale market and not as retail clients. Transparency requirements will lead to further electronification, but it remains to be seen whether it will allow new entrants to enter the market and increase liquidity.

- **Post-trade reporting deferrals:** Per Loven noted that deferrals are critical for intermediary services and risk management.

#### Discussion:

- **Transparency and liquidity:** One of the participants noted that MiFID II demonstrated regulators' lack of understanding of fixed income markets. He suggested taking into consideration what hasn't traded, and the differences between sovereign and corporate bonds. His view was that liquidity of sovereign bond markets owes to the trading obligation of primary dealers. However, the lack of profitability has prompted an increasing number of investment banks to exit government bond markets. He stressed that in the absence of a quoting obligation for corporate bonds, liquidity was adversely affected on a much wider scale. He also highlighted the importance of functioning repo and CDS markets.
- **Quality of reported data:** One participant questioned the quality of data considering the risk of duplicate reporting, or misreporting. TRADEcho noted that MiFID II establishes a clear reporting hierarchy. The reported data should therefore be fairly accurate, albeit not 100% accurate. With regard to pre-trade transparency, it was noted that dealers in equity instruments generally disseminate their quotes across the market as quickly as possible. In return, in fixed income markets there is a preference not to disseminate price information.
- **Other points:** Participants discussed the suitability of fixed income markets for retail investors, and the potential benefits of transparency. Another participant noted that ESMA was providing guidance, albeit non legally binding, on fundamental issues, and questioned the institutional set-up at EU level.

## 2) MiFID II and transparency – Impact on derivatives markets

#### Speakers:

- **James Roberts**, Director, European Public Policy, International Swaps and Derivatives Association (ISDA)
- **Alex McDonald**, CEO, Wholesale Markets Brokers' Association (WMBA)
- **Tom Springbett**, Manager, Trading and Post-Trade Policy, Financial Conduct Authority (FCA)
- **Uwe Hillnhütter**, Director, MiFID II Implementation, Tradeweb

#### Key points:

- Panelists discussed **key issues** such as equivalence, the “traded on trading venue” (TOTV) concept, the potential (infinite) creation of ISINs for swaps curves, liquidity assessments, package orders, and contradictory requirements under RTS 2 and RTS 23.
- Participants noted that the **operational requirements to comply with transparency rules** and overall regulation favoured incumbents whilst disadvantaging smaller firms and increasing barriers to entry.
- Even though regulatory initiatives such as EMIR or the Dodd-Frank Act are based on the same global agreements, diverging rules and implementation carry a **risk a fragmentation of liquidity pools** along regional boundaries. This is reinforced by the lack of a global policy, and the lack of clarification on a European level.
- To determine which rules apply, participants noted the **difficulty in establishing where a trade executed across borders** occurred ie either where (i) the core terms of a trade were agreed, or (ii) the economic terms were established or (iii) the trade cannot be reversed.
- There was consensus that the gradual approach in the **calibration of liquidity assessments** was positive and allowed regulators and the industry to review the results and engage. Participants

also noted that ESMA was facing a daunting task in calculating the respective thresholds and providing guidance in view of the lack of clarity of level 1 text.

- The **impact of transparency requirements on non-MiFID firms and non-EU firms** is another source of concern. In terms of transaction reporting, for instance, platforms will have to report on behalf of non-MiFID firms. Considering the level of granularity of the data, it was noted that it may prove to be impossible to collect the required data. In addition, the reporting requirements create a disincentive for non-EU firms to operate in Europe.

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