International
Capital
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Association

ICMA

MiFID II Trading suspensions

An ICMA Position Paper

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Overview

Articles 32 and 52 and MiFID II[1] establish obligations for National Competent Authorities (NCAs) and trading venues relating to the suspension and removal of certain financial instruments from trading. Where a multilateral trading facility (MTF), organised trading facility (OTF), or regulated market suspends or removes a financial instrument or a related derivative from trading, as a consequence of its rules, the respective venue is required to make this decision public and notify its NCA.

Depending on the reasons for the suspension or removal, the NCA has to make this decision public, and if so, suspend or remove that instrument, or related derivatives, from trading not only on other regulated markets, MTFs, and OTFs, but also systematic internalisers (SIs) under its jurisdiction. It is further required to communicate this to ESMA and other NCAs. Notified NCAs are then required also to suspend or remove from trading the instrument or derivative on regulated markets, MTFs, OTFs, and SIs under their respective jurisdictions.

The relevant NCAs, however, have the discretion not to apply the suspension or removal where this could cause significant damage to investors' interests or the orderly functioning of the market.

ICMA believes that there are many scenarios where a debt instrument or related derivatives may be suspended or removed from trading on an MTF or OTF, in keeping with the rules of the relevant venue, but where the continued ability to trade the instruments in the over the counter (OTC) market will be in the best interest of investors and the orderly functioning of the market. In these cases, the key source of liquidity is likely to come from specialist market-makers for the relevant instruments, who may also be SIs. It is therefore important that before NCA's require the suspension or removal of financial instruments or related derivatives, they first consider the implications for OTC trading in these instruments, the rights and interests of investors and other creditors of the issuer, and, as much as possible, consult with relevant investors and liquidity providers in their jurisdiction, who may be active in these instruments, prior to any decision to suspend or remove them from trading.

[1] Directive 2014/65/EU

Background

MiFID II establishes obligations for National Competent Authorities (NCAs) and trading venues relating to the suspension and removal of certain financial instruments from trading. Article 32 outlines the obligations related to the decision to suspend or remove a financial instrument from trading on an MTF or OTF, while Article 52 outlines the obligations related to the suspension or removal of financial instruments from trading on a regulated market. While NCAs have the right to suspend the trading of a financial instrument on a regulated market or under any other trading arrangement (outlined in Article 69(2)(n)), Articles 32 and 52 outline obligations in response to a regulated market, MTF, or OTF suspending trading in or removing a financial instrument in keeping with the rules of the regulated market or venue.

Where the decision is made to suspend or remove an instrument or any related derivative from trading, the operator of the MTF, OTF, or regulated market is required to make public its decision and communicate this to its NCA. Where the suspension or removal is due to suspected market abuse, a take-over bid, or the non-disclosure of inside information about the issuer or financial instrument,[2] the NCA in whose jurisdiction the suspension or removal originated is required to ensure that regulated markets, MTFs, OTFs, and systematic internalisers (SIs), that fall under its jurisdiction, also suspend or remove the same financial instrument or related derivative. The NCA is also required to make this public, as well as communicate the decision to ESMA and other NCAs. Notified NCAs are then required to ensure that regulated markets, MTFs, OTFs, and SIs, that fall under their jurisdiction, also suspend or remove the financial instrument or related derivative.

Importantly, Articles 32 and 52 also provide that the relevant NCAs have the discretion not to apply the suspension or removal *where this could cause significant damage to investors' interests or the orderly functioning of the market*.

Potential issues

The language used in Articles 32 and 52, and the references to market abuse, take-over bids, and non-disclosure of inside information about the issuer or financial instrument (with respect to MAR), seem to be primarily equity market focused, and give rise to the risk of a blanket suspension of trading in debt securities, or related derivatives, that would be unwarranted, and even damaging to investors' interests and orderly market functioning. It is therefore important to distinguish between suspensions driven by pending news (such as possible merger discussions or profit warnings), where a blanket suspension of trading in securities or related derivatives could be warranted, and suspensions triggered by a credit event, such as a downgrade or default, where the continuation of trading is justifiable to protect the best interests of investors as well as the orderly functioning of the market.

A typical scenario would be in the case of bankruptcy and a subsequent debt restructuring. The equity may very well drop to zero, and so be suspended or removed from trading on the relevant regulated

[2] With respect to Articles 7 and 17 of Regulation (EU) No 596/2014 [Market Abuse Regulation]

market or trading venue. However, the debt, even in default, will continue to trade, often actively. Generally, in a bankruptcy or restructuring bondholders' rights take precedence over those of shareholders, and bonds will carry recovery rights and continue to have some value attributed to them pending the outcome of bankruptcy proceedings, where bondholders often share a court ordered distribution of any remaining assets of the debtor. At or near the time of a default, institutional investors will have a fiduciary duty to unwind any exposure to the relevant credit, or to hedge their exposure, and so will require access to liquidity in the markets for either the bond or related derivatives (such as credit default swaps). This liquidity will in most instances be provided bilaterally through specialist market-makers, rather than multilaterally via regulated markets or trading venues. These market-makers will, in most likelihood, also be SIs. Thus, the suspension of trading in these debt securities, or related derivatives, by SIs would be damaging for investors' interests and creditors' rights, depriving the market of the ability to reallocate efficiently and price discover the new distressed value of creditor claims (i.e. a suspension in a sense is creating a false market). It is also important to remember that in these scenarios, trading volumes in affected debt instruments can increase significantly, as risk is redistributed through the market. Again, suspending trading altogether under such a scenario would adversely impact the otherwise orderly functioning of the market.

The Novo Banco case

An example of how a blanket trading suspension could have been highly damaging for investors' interests and orderly market functioning is the case of Novo Banco bonds. In 2017, Novo Banco attempted to avoid a more disorderly default and restructuring, by means of a 'liability management exercise' (LME). The LME consisted of a bond buyback targeting over €8bn nominal of outstanding debt and was a condition for the sale of a significant stake in Banco Novo to a private equity firm.

Between 31 March 2017 and 20 October 2017, Novo Banco bonds were suspended from trading by the Luxembourg Stock Exchange.[3] Had this occurred post-MiFID II, the consequences could have been highly detrimental for Novo Banco creditors and depositors. While the volumes of Novo Banco bonds traded on the Luxembourg Stock Exchange would have been negligible, the volumes traded by investors through market-makers (which would be classified as SIs) going into the LME process increased significantly, running into multiples of billions. Had a blanket suspension of trading across EU trading venues, including SIs, been applied, the LME would not have been possible, and Novo Banco would have been forced to enter into resolution and liquidation and a much more detrimental outcome for investors.

ICMA foresees many similar circumstances where the automatic application of Article 32 or 52 in issuer default or bankruptcy scenarios with respect to debt instruments or related derivatives could have highly damaging impacts on investors' interests and/or the orderly functioning of the market.

[3] See: https://dl.bourse.lu/dl?v=ADyMFy5zxNFitbuuk6wDBiSP0HXQETdtWk9WuAdIBcDJSvIweKUPiJBeMcsdCWLOPgxx8hFIsNWHtt7556nOo7tjp0grFIX7L0K6LZZ0dDlm/e3pl1h4QhxRt2ds63gpW1PQZlF4HM+WFhMNLG2DlQ==

Conclusion

ICMA is concerned that the automatic application of MiFID II Articles 32 and 52 with respect to debt instruments or their related derivatives, under certain scenarios, could be significantly damaging to investors' interests and the orderly functioning of the market, particularly to the extent that this applies to SIs, who are the key source of bilateral liquidity in these instruments. ICMA therefore recommends that NCAs, in the event of a suspension or removal from trading by a regulated market or trading venue, consider carefully the potential impacts of a broader suspension or removal, including that affecting SIs. Furthermore, ICMA recommends that in such instances, the consideration to suspend or remove instruments and their derivatives from trading be informed by consultation with relevant market stakeholders, including affected investors, SIs and other liquidity providers, and trading venues.

Ends

About ICMA

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has 540 members located in over 60 countries.

ICMA brings together members from all segments of the wholesale and retail debt securities market, through regional and sectoral member committees, and focuses on a comprehensive range of regulatory and market practice issues which impact all aspects of international market functioning. ICMA prioritises four core areas – primary markets, secondary markets, repo and collateral markets, and the green and social bond markets.

The mission of ICMA is to promote resilient well-functioning international and globally coherent cross-border debt securities markets, which are essential to fund sustainable economic growth and development.

Asset Management and Investors Council (AMIC)

ICMA is one of the few trade associations with a European focus that has both buy-side and sell-side representation. To reflect the growing importance of the buy-side in the marketplace in general and add substance to ICMA output to public authorities, ICMA decided in 2008 to set up the Asset Management and Investors Council (AMIC). The Council was established to represent the views of and add value to the buy-side members of ICMA by discussing investment issues of common interest, reaching a consensus and recommending any action that ICMA should take. The AMIC is a fully structured Council encompassing 230 contacts. The AMIC now organises biannual conferences, quarterly Executive Committee meetings and manages subcommittees/working groups.

Secondary Market Practices Committee

The ICMA Secondary Market Practices Committee is an open forum for sell-side and buy-side member firms active in the international, cross-border secondary bond markets. Through open dialogue and engagement, as well as through its subsidiary working groups and work-streams, it seeks to be the representative body of the international, cross-border secondary bond markets: addressing practical issues directly relevant to market practitioners; standardising market best practice; disseminating relevant market information; and promoting the best interests of efficient and liquid markets.

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