ICMA

MiFID II/R Post-trade transparency: trade reporting deferral regimes
An ICMA Position Paper
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Overview

This paper sets out the formal position of the International Capital Market Association (ICMA) with respect to the trade reporting deferral regime under MiFID II/R for fixed income securities. This position paper was prepared in close consultation with ICMA's MiFID II/R Working Group, which constitutes broad representation from ICMA's sell-side and buy-side members active in the international fixed income markets.

ICMA fully supports the principle of greater pre- and post-trade price transparency in Europe's fixed income markets, which can help to facilitate price discovery, and so greater market efficiency and liquidity. However, ICMA also recognizes that such transparency can create risks for both liquidity providers and liquidity takers, particularly with respect to less liquid securities or larger than standard-sized transactions. The effect of these additional risks is higher transaction costs for investors and increased borrowing costs for issuers.

ICMA has consistently maintained that for transactions that are large in size, or in less liquid securities, a suitably long deferral period should be allowed for post-trade reporting in order to protect both parties to the trade, and to help support market liquidity and efficiency.

ICMA understands that MiFIR grants a choice of options to national competent authorities regarding deferred reporting. This includes the publication of supplementary details when publishing information benefitting from a deferral and/or an extended deferral time period, up to four weeks. Examples of published supplementary details can include some of the following: aggregation of the information of several transactions, the omission of publication of the volume for individual transactions and in the case of sovereign debt instruments, the publication of several transactions in an aggregated form for an indefinite period of time.

However, ICMA understands that a range anywhere from minor to major differences could emerge between EU national competent authorities. In the event of the various competent authorities choosing individual deferral periods that either do not include a four-week supplementary deferral period for large in scale or illiquid trades or the four-week supplementary deferral period does not benefit from aggregated transactions, omission of volume or the full range of options available under MiFIR. It would seem likely that market liquidity will gravitate to those jurisdictions with the longest deferral periods and the most flexible publishing options, thus fragmenting market liquidity across the EU.

ICMA believes maximum flexibility is the key for a successful deferral regime. A four-week deferral period (allowing all available options under MiFIR) implies liquidity and size of trade will logically influence the level of information published, leading to a well-functioning market.

Discussion

While publicly available post-trade information can help both investors and liquidity providers with respect to price discovery, the detail of the information, and the timing of when it is published can also create risks for both parties to the transaction. This is particularly the case in fixed income markets, where securities tend to be relatively illiquid (particularly in the non-sovereign market),

where positions or orders are often large, and where pricing can be extremely sensitive to 'information leakage'.

Consider two scenarios related to an asset manager who is looking to sell a large block of an illiquid bond:

Example one:

An asset manager may approach a market-maker and ask them to bid for the entire size. The market-maker would then take this position onto their trading book and look to sell-out of the position over a period of time (potentially several days or even many weeks).

Essentially, the market maker is asked to bid for the illiquid corporate bond, on a one-to-one RFQ, the market-maker is able to price a bid based on a number of factors, including current market conditions, cost of balance sheet and expected return on capital, hedging costs, funding costs, market view, and risk appetite. But this is based on the understanding that the trade is not published 48 hours later (i.e. nobody else in the market knows that the trade has taken place in the timeframe that the market-maker holds, manages, and trades-out of the position. This allows the market-maker to manage, and trade out of the position judiciously without being compromised by the market knowing what the market-maker is trading.

Contrast this with a scenario where that trade gets published in 48hrs. The market is now alerted that somebody is trying to offload a portion of an illiquid bond. At best, dealers will mark their prices lower. At worst, dealers (or hedge funds) will try to trade ahead of the market-maker and short-sell, driving the market lower. In a 48 hour trade deferral regime, the only options open to the market-maker are to decline the RFQ, or show a bid so low that nobody would care to move the market even lower.

Example two:

Alternatively, the asset manager, rather than go to a market-maker for the full size, may choose to work the order themselves, breaking the trade into much smaller orders, and looking to sell the position gradually over several days or weeks. As the trade information becomes available to the market every 48 hours, market participants should be able to deduce that somebody is trying to sell what is likely to be a large block of the bond over a period of time (the fact that many investors publish holdings data will also work against the asset manager). Again, dealers will mark their prices lower, making it increasingly more expensive, and difficult, for the asset manager to complete his or her order, or may even trade ahead of the order and sell short the market.

In both these scenarios, the longer the time delay until the trade information is published, the less likely it will be that there is still an order in the market related to the underlying bond, and so the less impact the information will have on the market price. The question, however, is what should be the appropriate time delay until information related to large or illiquid trades should be made available without inadvertently putting investors or liquidity providers at risk? Ideally, this would be calibrated to the average time taken to execute orders based on size and liquidity. In compiling its response to the ESMA Level 2 MiFID II/R Consultation Paper in December 2014, members of the ICMA MiFID II/Working Group concluded that for large or illiquid transactions in fixed income the two-day deferral period outlined in the regulation is too short, and that in most cases even the four-week deferral period that can be provided at the discretion of competent authorities is not sufficient time to protect market participants. In its response, the Working Group suggested that 12 weeks

would be the acceptable minimum deferral period. However, ICMA accepts that ESMA rejected this 12-week suggestion.

In review, there is a risk that different competent authorities based on the experience and analysis of their own domestic bond markets, may reach different conclusions on what should be the appropriate deferral period for certain transactions. Also, what supplementary details should or should not be published (aggregated transactions, volume omission, etc.) within the deferral. Accordingly, there is a very real risk that the deferral period could detrimentally differ across various EU jurisdictions. In turn, this would impact pricing and liquidity depending on the relevant reporting jurisdiction. For example, market-makers would be more inclined to provide liquidity or competitive pricing to clients located in a jurisdiction with a longer four-week deferral period and where all options under article 11 (3) [see below] are open to them. Similarly, asset managers will want to work their orders with counterparties or venues based in less conservative jurisdictions. The likely impact will be a fragmentation of liquidity across the EU, with counterparties or venues based in more conservative jurisdictions being inadvertently disadvantaged.

Position

ICMA fully supports the principle of post-trade transparency in the European fixed income markets to help facilitate price discovery and market efficiency, while also recognizing that the timing and detail of the information being published can have a counterproductive impact in the case of transactions that are large in size, or in less liquid securities. Within the limitations of the regulation, ICMA therefore feels that for fixed income trades that qualify for post-trade reporting deferrals, the maximum deferral period allowable of four weeks, should be the discretionary choice for EU competent authorities. Furthermore, all supplementary information options available under MiFIR, within the four-week deferral, should also apply across EU national competent authorities. The adoption by all 28 EU competent authorities of a supplementary four-week deferral period, taking into account maximum flexibility of available options, will lead to the avoidance of fragmented market liquidity and the insurance of a level playing field for all EU market participants and venues.

Supporting Regulatory context

MiFIR trade reporting and deferrals:

Article 10 of Regulation (EU) No 600/2014 **(MiFIR)** requires market operators and investment firms operating a trading venue to make public the price, volume and time of the transactions executed in respect of bonds, structured finance products, emission allowances, and derivatives traded on a trading venue. Furthermore, market operators and investment firms operating a trading venue shall make details of all such transactions public as close to real-time as is technically possible.

Article 11 of the same regulation enables competent authorities to authorise market operators and investment firms operating a trading venue to provide for deferred publication of the details of transactions based on the size or type of the transaction.

In particular, the competent authorities may authorize the deferred publication in respect of transactions that:

(a) ***are large in scale*** *compared with the normal market size for that bond, structured finance product, emission allowance or derivative traded on a trading venue, or for that class of bond, structured finance product, emission allowance or derivative traded on a trading venue;*

(b) *are related to a bond, structured finance product, emission allowance or derivative traded on a trading venue, or a class of bond, structured finance product, emission allowance or derivative traded on a trading venue for which* ***there is not a liquid market****;*

(c) ***are above a size specific to that bond****, structured finance product, emission allowance or derivative traded on a trading venue, or that class of bond, structured finance product, emission allowance or derivative traded on a trading venue,* ***which would expose liquidity providers to undue risk*** *and takes into account whether the relevant market participants are retail or wholesale investors.*

The regulation further specifies that market operators and investment firms operating a trading venue shall obtain the competent authority's **prior approval of proposed arrangements for deferred trade-publication**, and shall clearly disclose those arrangements to market participants and the public. ESMA shall monitor the application of those arrangements for deferred trade-publication and shall submit an annual report to the Commission on how they are used in practice.

Article 11, paragraph 3, outlines the possible application of such a deferral:

*Competent authorities may****, in conjunction with an authorisation*** *of deferred publication:*

(a) request the publication of limited ***details of a transaction or details of several transactions in an aggregated form****, or a combination thereof, during the time period of deferral;*

(b) allow the ***omission of the publication of the volume of an individual transaction*** *during an extended time period of deferral;*

(c) regarding non-equity instruments that are not sovereign debt, allow the ***publication of several transactions in an aggregated form during an extended time period of deferral****;*

(d) regarding ***sovereign debt instruments****, allow the* ***publication of several transactions in an aggregated form for an indefinite period of time.***

In relation to sovereign debt instruments, points (b) and (d) may be used either separately or consecutively whereby once the volume omission extended period lapses, the volumes could then be published in aggregated form.

In relation to all other financial instruments, when the deferral time period lapses, the outstanding details of the transaction and all the details of the transactions on an individual basis shall be published.

The regulation requires ESMA to draft regulatory technical standards (RTS) to specify how post-trade information is to published, including the conditions for authorising deferred publication.

This is outlined in RTS 2. In particular**, Article 8** provides the technical standards with relation to the deferred publication of transactions. Essentially, it provides that where a competent authority authorises deferred publication (pursuant to Article 11 of MiFIR) *investment firms trading outside a trading venue and market operators and investment firms operating a trading venue shall* ***make public each transaction no later than 19:00 local time on the second working day after the date of the transaction****, provided one of the following conditions is satisfied:*

(a) the transaction is ***large in scale*** *compared with the normal market size*

(b) the transaction is in a financial instrument or a class of financial instruments for which there is ***not a liquid market***

(c) the transaction is executed between an investment firm dealing on own account other than on a matched principal basis…and another counterparty and is ***above a size specific to the instrument***

(d) the transaction is a package transaction

Article 11 outlines the **transparency requirements in conjunction with deferred publication at the discretion of the competent authorities**. This provides competent authorities with the discretion to authorize:

(a) trade details, excluding size, to be published during the deferral period, or trade details in aggregated form by the next day;

(b) the omission of the publication of trade size for an extended period of four weeks;

(c) for non-sovereign bonds, the publication of trade details in aggregated form for an extended period of four weeks; and

(d) for sovereign bonds, an unlimited extended period for the publication of trades in aggregated form.

In other words, the regulation allows for competent authorities to provide a 48-hour reporting deferral for trades that meet the specified thresholds for being large in size (LIS), or above the size specific to that instrument (SSTI), or where the underlying security is classified as illiquid. However, competent authorities also have further discretion to authorize deferrals for up to 4 weeks (and possibly longer in the case of sovereign bonds). Lastly, all deferrals allow a choice of options relating to supplementary publication of information (aggregated transactions, volume omission etc) within both the 48hr deferral and the supplementary four-week deferral periods

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