ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS

FINANCIAL MARKET PROFESSIONALS

AMAFI / 20-46
10 July 2020

ESMA Public consultation on the review of the MiFID II/MiFIR on the transparency regime for non-equity instruments and the trading obligation for derivatives

-

AMAFI and FBF Joint Contribution

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities.

Fédération bancaire française (FBF) has for mission to promote the banking and financial industry in France, Europe and around the world. It determines the profession's positions and makes proposals to public authorities and economic/financial authorities. FBF has 340 member banks including 115 foreign banks. Regardless of their size and status, credit institutions licensed as banks and the branch offices of credit institutions in the European Economic Area can, if they wish, become fully-fledged members of the FBF. The central bodies of cooperative or mutual banking groups are also fully-fledged members. The FBF is member of the **European Banking Federation (EBF)**.

QUESTIONS

Q1: What benefits or impacts would you see in increased pre-trade transparency in the different non-equity markets? How could the benefits/impacts of such pre-trade transparency be achieved/be mitigated via changes of the Level 1 text?

Regarding non-equity instruments, it appears in practice that the MiFIR SI pre-trade transparency regime has not created demand for such information. In fact, only the clients requesting a quote to a financial intermediary use the pre-trade transparency and are interested in executing a transaction with the latter. Conversely, no other investors show interest in accessing published quotes and entering a transaction at the quoted price with this financial intermediary.

Moreover, it should also be pointed out that each transaction involving a non-equity instrument has its own characteristics, linked to the nature of the instrument and to other factors (such as the volume of the transaction, the market conditions at the time of execution, etc.), which means that the price set for one transaction is not transposable to another.

Therefore, the bespoke nature of each quote/information request sent to an SI, including the characteristics of the instrument and the relationship between SI and client, make it challenging for pre-trade quotes to be generalised or relied on as a guide price, which explains the lack of clients' appetite for SI pre-trade transparency information.

AMAFI and FBF therefore consider that any increase in pre-trade transparency in the different non-equity markets appears useless as a bilateral price in a specific non-equity instrument given to a client is likely to be irrelevant to another one.

More generally, AMAFI and FBF consider that the MiFID II/MiFIR pre-trade transparency does not seem to be the priority in terms of interest for market participants and investors, and therefore not the priority in terms of action.

Q2: What proposals do you have for improving the level of pre-trade transparency available? Do you believe that the simplification of the regime for pre-trade transparency waivers would contribute to the improvement of the level of pre-trade transparency available?

Considering our answer to question 1, AMAFI and FBF are of the opinion that it is not necessary nor advisable to improve the level of pre-trade transparency available for non-equity instruments as the information already accessible to clients is of limited use.

Besides, we do not believe that the “simplification” of the regime for pre-trade transparency waivers would contribute to the improvement of the level of pre-trade transparency available. The term “simplification” would also need to be more precisely defined for further consideration.

Finally, we would also like to emphasize the fact that the current regime is based on a set of balanced waivers, which could be compromised in case of modification. MiFIR recognises the role and existence of RFQ and voice trading systems and defines the SSTI waiver to protect liquidity providers from undue risks. Similarly, for trading with SIs, MiFIR limits the quote transparency requirement by defining the concept of standard market size, also to protect liquidity providers from undue risks.

AMAFI and FBF therefore consider that these principles are sensible and guarantee the provision and access to liquidity, which is crucial. Indeed, it must be recalled that, instead of being a goal in itself, transparency is sought to increase liquidity available in the market.

Q3: Are you supportive of ESMA’s proposal to delete the pre-trade SSTI-waiver? Would you compensate for this by lowering the pre-trade LIS-thresholds across all asset classes or only for selected asset classes? What would be the appropriate level for such adjusted LIS-thresholds? If you do not support ESMA’s proposal to delete the pre-trade SSTI-waiver, what should be the way forward on the SSTI-waiver in your view?

AMAFI and FBF are not supportive of deleting the pre-trade SSTI waiver for trading venues.

As previously said in our answer to question 2, we believe that MiFIR principle to protect liquidity providers from undue risk is sensible and guarantees the provision and access to liquidity. Besides, the current regime is based on a set of balanced waivers, which could be compromised in case of modification.

Q4: What are your views on the use of the SSTI for the SI-quoting obligations. Should it remain (Option 1) or be replaced by linking the quoting obligation to another threshold (e.g. a certain percentage of the LIS-threshold) (Option 2)? Please explain.

AMAFI and FBF favour keeping the current SSTI waiver for trading venues and the SSTI thresholds for the SIs quoting obligations. Indeed, and as recalled here above, the current MiFIR regime ensures the protection of liquidity providers from undue risk and guarantees the provision and access to liquidity, which is crucial for investors.

Consequently, we believe that the pre-trade transparency obligations applicable to SIs should not be modified, unless they are simplified as proposed by ESMA in its consultation on SIs for non-equity instruments.

Q5: Would you support turning the hedging exemption into a limited negotiated trade waiver? If so, would you support Option 1 or Option 2? If not, please explain why.

AMAFI and FBF support ESMA's proposal to turn the hedging exemption into a limited negotiated trade waiver as it would bring more clarity and legal certainty than the current clarification provided by ESMA through Q&A.

For AMAFI and FBF, option 1 would be preferable.

Q6: Do you agree with ESMA's observations on the emergence of new trading systems and the proposed way forward requiring a Level 1 change and ESMA to issue an Opinion for each new trading system defining its characteristics and the transparency requirements? Would you have suggestions for the timeline and process of such Opinions? Please explain.

AMAFI and FBF disagree with ESMA's proposal to issue an opinion for each new trading system. We believe that such a process would be a hurdle to new initiatives of trading systems willing to operate in the EU.

We also consider that the MiFID II/MiFIR framework already provides a sufficiently clear definition of trading systems, and that the analyses made by ESMA in this matter could result in non-pertinent assessments of the trading systems.

Q7: Do you agree with the proposal for the definition of hybrid system? Are there in your view trading systems currently not or not appropriately covered in RTS 2 on which ESMA should provide further guidance? Please explain.

AMAFI and FBF are not responding to this question.

Q8: Do you agree with ESMA's proposal to require SIs to make available data free of charge 15 minutes after publication? Please explain.

As previously mentioned in our answer to question 1, our experience shows that pre-trade transparency rules appear rather useless in practice, for the following reasons : (a) only the clients requesting a quote to a financial intermediary use the pre-trade transparency and are interested in executing a transaction with the latter, (b) no other investors show interest in accessing published quotes and entering a transaction at the quoted price with this financial intermediary, (c) we have not been informed of any difficulties that would have been experienced by clients (such as the impossibility to trade on a specific firm quote) which may justify to impose on SIs to trade with clients other than the one requesting a quote.

AMAFI and FBF therefore support ESMA's proposal to simplify the current applicable pre-trade transparency regime applicable to SIs as stated in its consultation on SIs for non-equity instruments.

For the same reasons, AMAFI and FBF are now questioning the usefulness of ESMA's proposal to require SIs to make available data free of charge 15 minutes after publication. In fact, we consider that, in absence of a full cost-benefit analysis, including establishing demand for such a change, this proposal does not create any added value and could even have a detrimental impact on the market.

More generally, AMAFI and FBF consider that the modification of the pre-trade transparency regime is not a priority issue. Indeed (a) it has been costly to implement while no market participant is seeing any benefit in it, and (b) any change of requirement, such as the one contemplated by ESMA, would lead to even more implementation costs.

Q9: Would you see value in further standardising the pre-trade transparency information to increase the usability and comparability of the information? Please explain.

As mentioned in our answers to questions 1 and 8, each transaction involving a non-equity instrument has its own characteristics, linked to the nature of the instrument and to other factors (i.e. volume of the transaction, market conditions at the time of execution, etc.), which means that the price set for one transaction is not transposable to another. This situation covers all non-equity financial instruments, whether liquid or non-liquid, and is applicable whatever the type of financial intermediary (SIs or others).

For this reason, AMAFI and FBF consider that a standardisation of the pre-trade transparency information would be useless to ensure a comparability of the information provided to clients and investors.

Q10: Do you agree with ESMA's assessment of the level of post-trade transparency and with the need of a more streamlined and uniform post-trade regime which does not include options at the discretion of the different jurisdictions? If not, please explain why and, where available, support your assessment with data.

AMAFI and FBF do not agree with ESMA's assessment of the level of post-trade transparency. As a matter of fact, we believe that the current regime includes a sufficiently large number of types of products and financial classes.

We do not take issue with the level of transparency or the scope of the regime as much as we take issue with the availability and quality of data. The reporting delegation process and the fragmented publication of data by APAs in divergent formats lead to a more difficult access to data by market participants.

As for the deferrals, we believe that a limitation of their use would lead to unbalance the delicate arbitrage between the level of transparency and the adequate conditions for the provision of liquidity into the non-equity markets. An increase in transparency for illiquid and large in scale instruments would lead to higher risks for liquidity providers and hence reduce their ability and willingness to facilitate transactions.

Rather than altering the post-trade transparency regime, AMAFI and FBF recommend harmonizing the deferral systems by converging towards the better calibrated system, currently enforced by numerous NCAs (including France, Germany and Italy). We believe this system is best suited to preserve liquidity provision, as it allows for the 4-week volume omission and the 48 hours deferral period for price information, while retaining the other deferral provisions under article 11(3), points (b), (c) and (d) of MiFIR...

Q11: Do you agree with this proposal? What would be the appropriate level of such a revised LIS-threshold in your view?

Although simplification of the post-trade transparency regime is desirable, AMAFI and FBF consider that this can only be done on the basis of a full analysis of the regime and its consequences on the ability of market participants to provide liquidity. This analysis should be conducted by the competent authorities in liaison with the industry and should take into account all factors. This analysis should also consider the possible creation of a consolidated tape.

In our view, ESMA's method based on asking successive questions on detailed parts of the MiFIR II/MiFIR framework (Q11 to Q15) is not the right way to achieve a meaningful post-trade transparency regime in Europe.

Furthermore, it should be stressed that the quality of data is not optimal even though progress has been made over the last two years.

Therefore, AMAFI and FBF believe that it is premature to modify important rules of the current mechanism.

It is only based on reliable data commonly shared between regulators and the industry that a change to the current regime can be considered.

Q12: In your view, should the real time publication of volume masking transactions apply to transactions in illiquid instruments and above LIS waiver (Option 1) or to transactions above LIS only (Option 2 and Option 3). Please elaborate. If you support another alternative, please explain which one and why.

AMAFI and FBF do not support moving to real time publication for any of the proposed options. As stated in our answer to Q10, the deferral regimes are very useful for the protection of liquidity provision in the non-equity markets. We believe that the priority should be set on i) improving data quality and ii) a quantitative assessment of the impact of the many envisaged changes suggested by ESMA. Notably, the suppression of the SSTI, the eventual decrease of the LIS, moving from the two days deferral to real time and decreasing the 4-week deferral.

In the present situation, we do not believe ESMA has backed its suggestions for significant change to the transparency regime, notably putting an end to the deferral systems with any solid quantitative evidence pointing to the possible benefits of such actions.

Q13: Do you agree with the publication of the price and volume of all transactions after a certain period of time, such as two calendar weeks (Option 1 and 2) or do you support the two-steps approach for LIS transactions (Option 3)? Please explain why and provide any alternative you would support. Which is the optimal option in case a consolidated tape would emerge in the future?

As stated above, AMAFI and FBF do not support a modification of the current deferral regimes. Moreover, the suggestion made by ESMA to decrease the 4-week omission to two weeks does not seem to rely on a solid assessment or to serve any specific purpose. As much as the initial 4-week omission had a clear objective of balancing transparency and liquidity purposes, there seems to be no strong justification as to why a decrease to a 2-week omission would better serve the transparency or liquidity of the non-equity markets in the Union.

ESMA states that it aims to align MiFIR more closely with the U.S regime. However, it is unclear as to which regime is referred to in this statement, considering that different regimes are enforced depending on asset class and product type. Nevertheless, even when taking into consideration all of the U.S regimes available, shortening the 4 week omission to two weeks does not seem to align with the U.S regime where the traded volumes of corporate bonds are actually masked for a 6 months period.

Q14: Do you agree with ESMA's proposed way forward to issue further guidance and put a stronger focus on enforcement to improve the quality of post-trade data? Are there any other measures necessary at the legislative level to improve the quality of posttrade data? What changes to the transparency regime in Level 1 could lead to a substantial improvement of data quality?

AMAFI and FBF agree with the issuance of further guidance and putting a stronger focus on enforcement to improve the quality of post-trade data. However, we believe that such steps should be taken within the broader objective of establishing a consolidated tape. A regulators' led governance system with a close cooperation with market participants would fit best to the upcoming challenges, notably the implementation of a phased standard approach to non-equity data. Such an approach has already been taking place since the implementation of MiFID II/MiFIR and showed important results in improving data quality through working with NCAs to improve the transaction reporting system.

Finally, a simplification of the transparency regime would allow market participants and regulators alike to shift their focus further into the improvement of data quality and would make it easier to implement standards and best practices through the different non-equity asset classes and types of products. For example:

We believe that ESMA needs to clarify the application of the SI regime. The SI regime should only apply to TOTV instruments, and not to uTOTV instruments. This confusion leads to the unnecessary burden of instrument reference data reporting for uTOTV instruments for SI under RTS 23. Such a clarification would strip the reporting regime from an unnecessary complexity while allowing all the other reporting obligations to be met, notably the transactions reporting under RTS 22 for TOTV and uTOTV instruments. We therefore call for ESMA to issue a clarification through a Q&A or to support changes in level 1 texts (MiFID II, Article 4(1)(20) and MiFIR Article 27).

Other examples of simplification can be put forward and would allow for an easier implementation of standards and best practices aiming at improving data quality. Such provisions, combined with the bigger project of implementing a consolidated tape, would be very helpful in improving post-trade data quality.

Q15: What would be the optimal transparency regime to help with the potential creation of a CTP?

We believe that the current transparency regime should serve as a basis for the creation of a CTP, with an objective to improve data quality in the process, notably by determining standards and best practices, and intensifying cooperation between NCAs and market participants. However, we do not believe that a specific transparency regime is best fit to help with the potential creation of a CTP. We believe that the best way to establish a CTP would be through a phased approach by taking the necessary measures to adapt the transparency regime once the CTP is set up. The improved vision of the market brought by the establishment of a CTP will be helpful to take more informed steps into transforming the transparency regime.

Q16: Do you agree with ESMA's above assessment? If not, please explain.

AMAFI and FBF do not agree with ESMA's assessment. While the current situation exempts many OTC derivatives from the MiFIR transparency and reporting requirements as stated by ESMA, we believe that this is the case for non-TOTV instruments, designed as custom solutions for specific clients by the investment firms. With this consideration in mind, we do not believe that non-TOTV instruments should be subject to transparency requirements for the simple reason that it would not serve any valid purpose. Investment firms offer custom products to their clients with unique characteristics. Requiring transparency measures to apply to those instruments would not help price discovery or set a benchmark for clients trading those non-TOTV products. Furthermore, these instruments are not traded on-venue, and therefore, cannot be required to be made transparent for the sake of levelling the playing field between on-venue and off-venue trading.

More importantly, we believe that the focus should be directed to narrowing the interpretation of the scope of TOTV, as suggested by ESMA's opinion of May 2017, that suggested there should be a clear distinction between OTC derivatives that are standardised and traded on trading venues, from those that result from bilateral contracts and should be considered non-TOTV.

Q17: Are you of the view that the interpretation of TOTV should remained aligned for both transparency and transaction reporting? If not, please explain why.

AMAFI and FBF believe that an extension of the scope of OTC transactions covered by the reporting regime should not be done following the adjustment of the interpretation of TOTV but rather by using the EMIR reporting for OTC derivatives. We believe that an approach looking into merging the transaction reporting for derivatives with EMIR reporting would extend the scope of transactions covered while simplifying the reporting framework. Such a provision would also reduce an unnecessary burden of identification required in order to define if an instrument is TOTV.

Q18: Which of the three options proposed, would you recommend (Option 1, Option 2 or Option 3)? In case you recommend an alternative way forward, please explain.

AMAFI and FBF are in favour of option 1 (status quo) on this matter. As we stated earlier in our response, requiring transparency for non-TOTV custom instruments would not achieve any of the goals initially set by the MiFID II/MiFIR transparency framework. Furthermore, the other options suggested by ESMA do not seem to be backed with any serious assessment.

Q19: What is your view on the proposal to delete the possibility for temporarily suspending the transparency provisions? Please explain.

AMAFI and FBF consider that the possibility for temporarily suspending transparency rules should be maintained on condition, as suggested by ESMA, that where the thresholds are met, the temporary suspension is applied across the Union.

Q20: Do you have any remarks on the assessment of Article 28 of MiFIR? Please explain.

AMAFI and FBF agree with the assessment of the legal framework of the DTO made by ESMA. However, we also believe that the provisions of article 28(2) of MiFIR are problematic in the current context and would ultimately need to be amended.

The uncertainty surrounding the possibility of granting an equivalence to UK trading venues poses a great risk for UK branches of EU firms. In the event that an equivalence is not granted to UK trading venues, these branches would be subject to conflicting EU and UK trading obligations, therefore limiting their trading activity to the US Swap Execution Facilities (SEF) and chasing away significant volumes of trades from EU and UK trading venues.

To avoid this situation, we recommend amending the provisions of article 28(2) of MiFIR in order to remove third countries branches of EU firms from the scope of application of the EU DTO.

Q21: Do you have any views on the above-mentioned criteria and whether the criteria are sufficient and appropriate for assessing the liquidity of derivatives? Do you consider it necessary to include further criteria (e.g. currency)? Do you consider that ESMA should make use of the provision in Article 32(4) for asset classes currently not subject to the trading obligations? Please explain.

AMAFI and FBF agree with the above-mentioned criteria and believe that they are sufficient and appropriate for assessing the liquidity of derivatives. We do not think it is necessary to include any further criteria.

However, we believe that the changes that will be brought to the EU derivatives markets by Brexit should be considered and welcome a reassessment of the liquidity of instruments subject to the DTO and the scope of the DTO itself.

As for the use of the provision in article 32(4) for asset classes currently not subject to the trading obligations, we do not agree with this measure and believe that the clearing obligation is necessary for the application of the trading obligation.

Q22: Do you agree that a procedure for the swift suspension of the trading obligation for derivatives is needed? Do you agree with the proposed procedure? Please explain.

AMAFI and FBF agree with the need for a more rapid process allowing the suspension of the DTO by ESMA and approve the proposed procedure.

In fact, the current procedure does not address urgent situations where the suspension of the trade obligation is necessary for the orderly functioning of the markets and was challenged during the uncertain period surrounding Brexit in early 2019.

Q23: Do you have a view on this or any other issues related to the application of the DTO?

As stated in our answer to question 20, we believe that in the event an equivalence is not granted by the European union to UK trading venues, the trading obligation should not apply anymore to transactions carried out by third countries branches of EU firms in order to avoid applying two conflicting trading obligations to these branches so they can remain competitive.

This would require an amendment to the provisions of article 28(2).

Q24: Do you have any views on the functioning of the register? Please explain.

AMAFI and FBF agree with ESMA's view that the register is useful and should continue to be published and maintained.

Q25: Do you agree that the current quarterly liquidity calculation for bonds is appropriate or would you be of the view that the liquidity determination of bonds should be simplified and provide for more stable results? Please explain.

AMAFI and FBF are of the view that the current methodology fails to capture the actual changes to the liquidity of bonds, considering that many bonds are only liquid for a short period of time. A more appropriate methodology would seek to determine the correct status of liquidity for bonds, and to counter the cyclical trading pattern observed on bonds. An adapted assessment of liquidity based on a more dynamic approach, for example intensifying renewed assessments over the last running month or weeks of the maturity of bonds. Such an approach would require an improved data quality on bonds, capable of representing accurately the liquidity status of bonds over a short period of time. Such an improvement can only be achieved through the establishment of a post-trade consolidated tape, with a strong governance framework setting the appropriate data standards.

Q26: Do you agree with ESMA proposal to move to stage 2 for the determination of the liquidity assessment of bonds? Please explain.

We do not believe that the determination of the liquidity assessment of bonds should move to stage 2, considering the high level of uncertainty pertaining past and future changes brought to the trading of bonds.

As mentioned in previous answers, the recent changes brought to the SSTI and LIS are yet to be understood by market participants. We would also like to stress the uncertainty surrounding the next changes that are going to occur in these indicators following the trading peek that was observed during the Covid-19 crisis. The consequences of the calculations made based on those trading levels are yet to be witnessed and assessed.

Furthermore, the unfolding of Brexit and its impact on the instruments previously traded in the UK reinforces the level of uncertainty and calls for caution towards the idea of moving to stage 2 for the determination of the liquidity.

We believe that these elements, combined with the bad quality of data, should be taken into consideration when deciding to implement stage 2 for the determination of the liquidity assessment for bonds, and that a better implementation would only be possible with improved data quality. Moving to stage 2 in the current circumstances would impose transparency requirements on illiquid bonds categorised as liquid following the calculations made on an exceptional period, which is contrary to the initial objectives of the non-equity transparency regime and ultimately detrimental to liquidity provision.

Q27: Do you agree with ESMA proposal not to move to stage 2 for the determination of the pre-trade SSTI thresholds for all non-equity instruments except bonds? Please explain.

Based on the same arguments raised in the answer to Q26, we believe that the determination of the pre-trade SSTI thresholds for all non-equity instruments should not move to stage 2.

Q28: Do you agree with ESMA proposal to move to stage 2 for the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs)? Please explain.

Based on the same arguments raised in the answer to Q26, we believe that the determination of the pre-trade SSTI thresholds for bonds should not move to stage 2.

Q29: What is your view on the current calibration of the ADNA and ADNT for commodity derivatives? Are there specific sub-asset classes for which the current calibration is problematic? Please justify your views and proposals with quantitative elements where available.

AMAFI and FBF are not responding to this question.

Q30: In relation to the segmentation criteria used for commodity derivatives: what is your view on the segmentation criteria currently used? Do you have suggestions to amend them? What is your view on ESMA's proposals SC1 to SC3? In your view, for which sub-asset classes the "delivery/cash settlement location" parameter is relevant?

AMAFI and FBF are not responding to this question.

Q31: What is your view on the analysis and proposals related to the pre-trade LIS thresholds for commodity derivatives? Which proposal to mitigate the counterintuitive effect of the current percentile approach do you prefer (i.e. keep the current methodology but modify its parameters, or change the methodology e.g. using a different metric for the liquidity criteria)? Please justify your views and proposals with quantitative elements where available.

AMAFI and FBF are not responding to this question.