Final FESE response to the ESMA consultation paper on the transparency regime for non-equity and the DTO

12th June 2020, Brussels

Introduction

Please make your introductory comments below, if any:

FESE welcomes the opportunity to respond to the ESMA Consultation on transparency for non-equity. We fully agree with the objectives of MiFID II /R to increase pre- and post-trade transparency for non-equity, but we fear that these have not materialised. To solve this, we suggest the following changes to the current regulatory framework:

On pre-trade transparency:

- The regime needs to be simplified and made more coherent for the market. Therefore, we support the proposal to remove the SSTI waiver and to recalibrate the methodology to determine LIS thresholds where appropriate, including the lowering of the LIS threshold e.g. for commodity derivatives and bonds.
- For bonds, we suggest allowing the execution of trades which are at and below a threshold of 100,000 EUR on transparent RMs, MTFs and OTFs only. This would significantly reduce market fragmentation, aggregate liquidity and increase pre- and post-trade transparency, in particular for retail investors.
- With respect to ETDs markets, we support ESMA's current approach and methodology which aims to increase the proportion of lit trading while preserving the needs of market participants for pre-arranged transactions based on an analysis of the instruments' liquidity. In this context, we believe a tailored approach finetuning - possibly lowering - the current LIS threshold could be investigated for some ETDs.
- These measures should be accompanied by removing the SSTI-concept also for the SI-quoting obligation and replacing it by a reference to (a high percentage of) the LIS threshold.
- The regime is ill-fitted for commodity derivatives markets and we therefore welcome ESMA's willingness to review the current design at both Level 1 and 2. We believe that the hedging exemption available in Art. 8(1) of MiFIR should be extended to cover all market participants managing risks arising from activity in the physical market, including financial counterparties. Such a solution would allow the building of liquidity in the order book to continue without jeopardising the ability of commodity derivatives markets to fulfil their function. Secondly, such a change should be combined with relevant amendments in Level 2 which would remove the current factors leading to inappropriate illiquid ('IL) and Large in scale ('LIS') thresholds (e.g. using notional values which are highly reliant on market prices).
- We agree with ESMA's proposal to require SIs to make available data free of charge 15 minutes after its publication. To improve the quality of published pre-trade transparency information, in particular in traditionally opaque markets, the requirements of SIs should be on the same level as those of trading venues. This would not only level the playing field between SIs and trading venues further but would also improve the overall level of pre-trade transparency in financial markets.

On post-trade transparency:

- We share ESMA's views on the need to create a less complex post-trade transparency regime. While we agree with the removal of the SSTI deferral, we would not support a lowering of post-trade LIS thresholds uniformly across all asset classes to compensate for the adaption to the waiver regime.
- Only a fraction of all non-equity transactions should be eligible for deferred publication i.e. for bonds, the illiquid and LIS deferrals should be maintained. Other than that, we suggest that the number of other options available in the post-transparency regime should be reduced, in particular waivers that enable only partial publication or no publication of trades as well as the 4-week waiver. For derivatives, we propose to introduce a harmonised and simplified regime, requiring the publication of all transaction-related data by the next business day (no later than t+2).

On the liquidity calculations for bonds:

- To enhance transparency, we believe that the criteria for assessing the liquidity of bonds need to change so as to increase the number of bonds that are deemed liquid and therefore subject to the transparency requirements. The amended criteria should take into account market reality, as highlighted in our response to Q25.
- We support the move to stage 2 for the liquidity assessment of bonds and the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs). However, we think it is only a small step into the direction of increasing transparency for bonds markets.

Level 1 Review

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?

It is clear that the requirements set out in MiFID II to increase pre- and post-transparency for non-equity have not achieved the objectives. This is acknowledged by ESMA in the consultation document when referring to '*the level of pre-trade transparency in non-equity markets remains limited following the application of MiFID II*' and '*the overall level of real-time post-trade transparency appears to be very limited*'.

We would like to thank ESMA for the insightful analysis conducted in the paper, in particular on the traded nominal and number of trades executed under a waiver. However, we believe that two important figures should be added to properly assess the functioning of the transparency regime, especially for what it concerns bonds and securitised derivatives whose trading remains very opaque. These are:

- The ratio of traded nominal and number of trades executed in the dark (i.e. executed OTC, and under a pre-trade transparency waiver) to total traded nominal, and
- The number of trades.

As of today, the large majority of bonds and securitised instruments is traded OTC (more than 90% percent of traded nominal is reported by APAs) hence with limited access for market participants and less transparency compared to multilateral venues. Moreover, trading in these instruments remains very fragmented, i.e. takes place on 166 bond SIs, 45 securitised derivatives SIs and 293 non-equity trading venues.

Therefore, we urge ESMA to support initiatives that would shift a significant share of trading of bonds and securitised derivatives to transparent and multilateral trading venues. For what it concerns bonds markets, the biggest benefit would be to provide investors with increased visibility on the most liquid bonds – the ones that actively trade. We should be aiming to increase this number so that the trading activity is visible in the

market and the advantages of a transparent price formation process can be achieved. This transparency will benefit investors, both professional and retail, and also entities such as pension funds and insurance companies which are very beneficial to the real economy.

To enhance transparency, we believe that the criteria for assessing the liquidity of bonds needs to change so as to increase the number of bonds that are deemed liquid and therefore subject to the transparency requirements. In addition, in terms of changes to Level 1, we suggest a more simplified waiver regime so that they are used only where they are clearly necessary.

Furthermore, for both bonds and securitised derivatives we would recommend using the 100,000 EUR denomination threshold to delineate lit (RM, MTF and OTF) trading from dark (OTC and SI) trading. We would recommend allowing trades which are at and below a threshold of 100,000 EUR on transparent RMs, MTFs and OTFs only. This would significantly reduce market fragmentation, aggregate liquidity and increase pre- and post-trade transparency, in particular for retail investors. The delimitation based on the 100,000 EUR denomination threshold would be consistent with the threshold used for the wholesale disclosure regime defined by the Prospectus Regulation. Furthermore, this threshold would also be in line with the one currently used for the calculations to determine whether a bond is liquid or not. For securitised derivatives, this delimitation would simplify the fragmented execution landscape. We expect that this change would be beneficial for investors – especially retail investors – as it would allow for a better interaction on multilateral markets.

Concerning commodity derivatives markets, we fully agree with the objectives of MiFID II/MiFIR and the G20 Pittsburgh commitments to *'improve the functioning and transparency of financial and commodity markets and address excessive commodity price volatility'*. While we support the policy aim of the pre-trade transparency regime, we believe the current regime is not appropriately calibrated for commodity markets. In particular, we believe that a number of relatively illiquid commodity products have been wrongly classified as liquid.

Art. 8 of MiFIR rightly recognises that certain exceptions from the general requirements to publish pre-trade transparency data are necessary to preserve an orderly price discovery process and to allow nascent and niche markets to develop. However, FESE believes the current methodology for calculating the Illiquid Instrument ('IL') waiver and Large in Scale ('LIS') waiver has proven unworkable in practice. The reason for this is that a number of niche and nascent products are incorrectly classified as liquid based on the two liquidity criteria in table 7.1, Annex III, RTS 2, thus becoming subject to significant broader transparency requirements and made subject to excessive LIS thresholds. These thresholds need to be revisited and analysed further to find a proper level that better reflects the nature of the commodity market.

Against the background of the review of the MiFIR pre-trade transparency regime and RTS 2, transparency requirements need to be balanced to avoid damaging liquidity, undermining the price discovery process and pushing market participants towards more bilateral (OTC) trading outside of transparent and regulated venues and outside central clearing.

Such developments clearly contradict the G20 objectives to create more transparent and resilient derivatives markets and go directly against the policy objectives of the European Commissions and ESMA.

It should be taken into account that non-equity markets are fundamentally different from equity markets and that there are significant differences across the underlying non-equity markets themselves. This is inter alia reflected in differences such as how market participants use non-equity derivatives instruments for hedging and commercial purposes.

Furthermore, some important elements need to be taken into account regarding commodity derivatives:

- Compared to other financial instruments, commodity instruments are generally less liquid. In order to achieve execution, market participants often trade via brokers organising transactions through a pre-executed agreement, subject to and executed under the rules of a specific exchange with immediate clearing at the exchanges' respective central counterpart (CCP), rather than in a central order book where a satisfactory execution would be less likely.
- Trades are concluded outside the regulated venues, though according to the rules of the relevant Trading Venue (TV), subject to being registered by and cleared in a dedicated venue/clearing house, to ensure maximum transparency for these nascent markets.
- Additionally, these markets are used by professional investors to hedge risk connected to the production or consumption of an actual commodity. This often requires liaison via a broker to find a counterparty, without incurring undue risk. Alternatively, trades can be pre-arranged directly between two parties and reported for clearing for reduced counterparty risk.
- Trade registration has been, and still is, essential to bringing more volumes to the cleared market under the exchange rules. We consider that the current pre-trade transparency regime is not fit for purpose and cannot be applied to trade registration facilities in energy derivatives markets without compromising their vital role in supporting the hedging activity of commercial market participants and in mitigating wider systemic risks.
- As observed by ESMA in section 3.1.2.1, bullet point 41, commodity derivatives stand for 42.87% of the number of transactions per asset class in 2018, which is significantly high compared to the other asset classes under the non-equity segment. ESMA rightly concludes that the reason lies in the difference in the average size of the transactions, which is smaller for commodity derivatives (small notional amount and many transactions of small sizes) than, for instance, for interest rates derivatives (high notional amount and few transactions of a high size), which have the second largest share of transactions. This is especially true for the energy derivatives and confirms that commodities are substantially different from the other non-equity asset classes. It also confirms that the current design of pre-trade transparency regime (PTT) for commodity derivatives is not fit for purpose, especially due to the high LIS threshold floor and the parameters that decide if a market is liquid or not (the Average Daily Notional Amount – ADNA, and the Average Daily Number of Transactions -ADNT). In result, the current vital mix of pre-arranged transactions and order book trading is heavily under threat. As mentioned above, these pre-arranged transactions are often catalysts for volume in the lit order book, especially the case for energy markets. Moreover, as the pre-arranged transactions are included in the overall assessment of market liquidity, contributing to both ADNA and ADNT, calculations done in the electricity derivatives space clearly shows that the size of the pre-arranged trades is on average slightly above the average of the order book and that the majority of both pre-arranged and order book transactions in notional value are often below the predetermined LIS minimum floor. Markets could be, and often are, in theoretical terms (based on ADNA and ADNT) liquid. However, as the liquidity in the market is based on the symbiosis of pre-arranged and order book transactions, the current regime significantly impairs the liquidity of such vital derivatives contracts.
- In addition, the fact that the commodity derivatives are traded in 'lots' makes it even more difficult for pre-arranged trades to qualify for a waiver, such as LIS, as the minimum LIS value is Euro denominated. In the commodity derivatives space, the notional value of the contract is of little concern, as stakeholders in the market are concerned about the volume, such as therms, megawatts or metric tonnes. The

notional value is dependent on price, which can fluctuate heavily. Derivatives contracts in the energy space are in most cases also designed as weeks, months, seasons, quarters etc. where the inherent volume in each contract differs substantially. This again results in extremely variable notional values, making the LIS minimum threshold denominated in Euro ill fit for purpose, even though one can convert the notional value to lots.

- The second observation made by ESMA under bullet point 42 is, unfortunately, not reflecting the whole reality. It is stated that '*With MiFID II being applied for two years it can be concluded that these concerns (impaired available liquidity and market efficiency) have not materialised and that the impact on most market participants from PTT was rather limited*'. Due to the high likelihood that the current PTT regime would significantly impair available liquidity and undermine the efficient functioning of markets (based on the above argumentation and numerous talks with market participants), a number of energy derivatives exchanges did not impose the PTT regime for liquid markets between 3rd January 2018 and 2nd January 2020. The statement could though be the case for bonds and interest rate derivatives, where stakeholders apparently have urged for more instruments to be classified as liquid, but again, these markets are vastly different from commodity derivatives.

We, therefore, welcome that ESMA stands ready to review the current design of the pre-trade transparency regime for commodity derivatives contracts on both Level 1 and 2. A better tailored transparency regime would help promote and foster EU commodity markets, notably regarding energy markets denominated in Euro, and contribute to the international role of the Euro.

To solve the problems highlighted above, we propose that changes are introduced at both Level 1 and 2. First, the hedging exemption available in Art. 8(1) of MiFIR should be extended to cover all market participants managing risks arising from activity in the physical market, including financial counterparties. Such a solution would allow the building of liquidity in the order book to continue without jeopardising the ability of commodity derivatives markets to fulfil their function.

Secondly, such change should be combined with relevant amendments in Level 2 which would remove the current factors leading to inappropriate thresholds (e.g. using notional values which are highly reliant on market prices).

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?

FESE believes the pre-trade transparency regime needs to be simplified and made more coherent for the market. Therefore, we support the proposal to remove the SSTI waiver and to recalibrate the methodology to determine LIS thresholds where appropriate and reduce them in some asset classes to make them fit for purpose, e.g. for commodity derivatives and bonds. In addition, we believe a tailored approach finetuning - possibly lowering - the current threshold could be investigated for some ETDs.

These measures should be accompanied by removing the SSTI-concept also for the SI-quoting obligation and replacing it by a reference to (a high percentage of) the LIS threshold.

As already mentioned, it is important that the liquidity calculations are also reviewed so that bonds that actively trade fall within scope of the transparency requirements. This should improve the level of pre-trade transparency available to the benefit of investors and the market in general. We also recommend that, in terms of timing, the market should be given sufficient time to implement any changes proposed by ESMA.

For commodity markets, in order to improve the level of pre-trade transparency, we believe that the current regime has to change so that it is fit for purpose. Following market reality, FESE proposes that the hedging exemption available in Art. 8(1) of MiFIR is extended to cover all market participants, including financial counterparties. Furthermore, as also detailed in Q5, we would support the proposal to add an additional limited negotiated trade waiver for non-equity in general covering financial counterparties hedging their risk exposure.

The 'one size fits all' approach is extremely damaging for commodity markets as they are vastly different from both equity and other non-equity derivatives markets. Currently, MiFIR rightly recognises that certain exemptions can be granted from the general requirements to preserve orderly price discovery processes and allow in particular illiquid and nascent markets to develop. As highlighted in Q1, we believe the current calibration of the IL and LIS waiver thresholds severely limits the development of niche and nascent contracts. Because of this, a number of niche and nascent products are incorrectly classified as liquid, thus becoming subject to significant broader transparency requirements and made subject to excessive LIS thresholds. The current shortcomings of the regime for illiquid/nascent commodity derivatives have hampered the shift of market participants from bilateral (OTC) trading towards transparent and regulated venues and outside central clearing.

As stated above, a reasonable step to support the simplification of the pre-trade transparency regime generally is removing the SSTI waiver. Moreover, FESE calls to keep package order waivers and OMF waivers available to further complement LIS and IL waivers, which are the most essential ones to mitigate adversely affects in the order book from large sizes. In the broader context, waivers shall support the transfer of products traded OTC, to central infrastructures, as envisaged by the G20 in 2009.

In addition to allowing the market to manoeuvre in established markets on trading venues by waivers, it is also imperative for exchanges to support the migration of OTC derivatives markets to a regulated trading environment and central clearing by product development and well-integrated trading and clearing practices which cater for the specific liquidity profiles and needs of the concerned products. This is especially true where products and entire asset classes are prone to higher OTC shares, such as for example FX derivatives (via futurization). The current classification of FX derivatives as illiquid, serving as an example for new asset classes or product types particularly designed to offer an alternative to prevailing OTC trading, provides trading venues with the necessary leeway to design their FX offering in a way such that the shift of trading volumes from OTC to on-venue trading can be actively supported. Thus, FESE does not agree with ESMA's opinion that a reclassification of FX derivatives as liquid instruments at this point in time would lead to improved pre-trade transparency. ESMA should allow trading venues to build sufficient share of trading volumes and hence a sufficient liquidity in such products first, to provide market participants with a convincing alternative to trading these products OTC.

Furthermore, with respect to the ETD markets, we support ESMA's current approach and methodology which aims to increase the proportion of lit trading while preserving the needs of market participants for pre-arranged transactions based on an analysis of the instruments' liquidity.

However, for certain ETD products or sub-asset classes, the current LIS thresholds have detrimentally impacted the liquidity of these products. In the respective products, higher thresholds for off-book on-exchange trading, compared to pre-MiFID II conditions, have moved trading volumes away from exchanges and into the OTC market. Therefore, the recalibration of LIS thresholds for ETDs should address in particular the launch of new products on trading venues, and the time and measures needed to establish exchange

trading as viable alternative to the OTC market, where these or similar products might currently be traded.

Further, in light of the recent market conditions and in particular to the Covid-19 crisis, we believe the current rules are appropriate and that higher thresholds would have considerably complicated the situation. Volatility, however, impacted the broader market, as well as market makers ability to quote, and hence there seem to be two points where some flexibility could benefit to the hedging needs:

(i) Some flexibility to lower minimum thresholds in high volatile market conditions would facilitate hedging. We suggest halving the existing minimum sizes in these cases. As a reminder, in stressed markets market makers can double the spread and halve the quantities.

(ii) Independently of the market conditions, the liquidity criteria to set the minimum volumes thresholds could be fine-tuned. Considering option contracts for instance, liquidity does not concentrate equally in function of the strike price or the maturity. For example, the level of liquidity is much lower in (a) deep in-/out-of-the-money options and (b) Long-dated options. Based on this discrepancy in the distribution of liquidity, we recommend to lower the LIS threshold deep in-/out-of-the-money options (Strike price > ±10% of the opening price) and long-dated options (maturity > 12 months).

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?

As ESMA correctly stated, the SSTI-waiver missed its mark of providing a focused product-specific transparency threshold for instruments that are not traded in the usual definition of 'large in scale'. We are therefore supportive of its deletion for the sake of a simpler, more effective and fairer transparency regime.

To compensate the deletion of the SSTI-waiver FESE recommends a re-calibration of the existing methodology to determine LIS-thresholds where appropriate, including a reduction in some asset classes, e.g. commodity derivatives and bonds, to help to mitigate the adaption of waivers. We believe a tailored approach finetuning the current threshold could be investigated as proposed for ETDs in the answer to Q2. A re-calibration of the existing methodology for those asset classes where problems with prevailing LIS-thresholds have been observed would allow ESMA to determine LIS thresholds, tiered even more specifically to individual market specifics, and to avoid unintended side effects, such as moving trading away from exchanges (and exchanges' trade registration functions) and into the OTC space.

These measures should be accompanied by removing the SSTI-concept also for the SI-quoting obligation and replacing it by a reference to (a high percentage of) the LIS threshold (as regards Q4).

Furthermore, we suggest that this has to be done in conjunction with redesigning the liquidity assessment framework in order to deliver an optimal outcome in terms of bonds that should be subject to the transparency requirements.

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.

FESE believes that there is an unlevel playing field between SIs and multilateral venues active in non-equity instruments. MiFID II did not bring an increased transparency level for bonds and securitised derivatives trading, as they are still opaque. This is in particular the case for SI trading where there is seemingly no pre- and post-trade transparency available, especially to the detriment of retail investors. Transparency is established by SIs via proprietary means, via their websites, via ECN-like networks or does not need to be established in the first place (i.e. in the case of illiquid bonds).

While SIs are regulated under MiFID II as execution venues providing bilateral trading, they provide less transparency for non-equity instruments than on-exchange trading. Although it is true that SIs have to disclose their identity when quotes are made public and have to put their own capital at risk, it is questionable whether trading on an SI instead of a regulated exchange benefits the overall financial market. On regulated markets, liquidity is disclosed to, and available to, all participants of the exchange, while remaining anonymous. Furthermore, information is made available to the public as well. SIs are only required to disclose and offer liquidity to a much smaller sub-set of market participants than multilateral venues.

While we do not question the merit of SIs forming part of the EU financial market's landscape, to create a level playing field across all types of execution venues FESE strongly recommends closing the gap between SSTI thresholds and LIS thresholds. It is counterintuitive that current SSTI thresholds applicable to SIs are below LIS thresholds applicable to regulated exchanges. Any changes to the quoting and disclosure requirements for SIs should cater for a level playing field compared to the transparency provided by multilateral venues.

As mentioned in our response to Q3, we prefer Option 2. We support the removal of the SSTI concept also for the SI quoting obligation, replacing it by a reference in the SI quoting obligation to a high percentage of the LIS threshold. It would be the most pragmatic approach for both regulators and the market to reuse (a percentage of) the LIS threshold for SI quoting obligations. FESE believes that this approach would increase overall transparency and reduce complexity of the current pre-trade transparency regime.

Furthermore, as highlighted in Q1, we would suggest to allow trading of sizes at and below 100,000 EUR on transparent multilateral venues only as this would significantly reduce market fragmentation, aggregate liquidity and increase pre- and post-trade transparency, with particular benefits for the retail market. As detailed above, the 100,000 EUR threshold is used in the Prospectus Regulation for the wholesale disclosure regime for bonds and for the liquidity calculations as per RTS2. Therefore, this threshold is suited to delineate lit trading from dark trading and to bring more liquidity onto orderbooks on transparent markets.

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.

No, FESE does not agree with the proposal to turn the hedge exemption into a limited negotiated trade waiver. We do though support the proposal to add an additional limited negotiated trade waiver for non-equity in general, as described in Option 1, and the extension of the hedging exemption as such to become available for financial counterparties.

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.

We agree that the definitions in Annex 1 of RTS 2 do not capture all available trading systems, resulting in several systems being classified as hybrid systems. However, having an Opinion issued by ESMA every time a potentially new trading system is introduced might result in very extensive acknowledgement processes. Such long-lasting approval processes bear the risk to delay innovation and to result in longer periods of trading in less regulated environments (OTC markets).

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.

FESE would, on a general line, agree with the proposal to further clarify the definition of hybrid system without, however, changing the substance of the existing definition.

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

Yes, FESE fully agrees with this proposal as it is essential that SI data is available to investors and that SIs are subject to the same obligations as trading venues. A requirement for SIs to publish their quotes free of charge after 15 minutes would increase the available pre-trade information for all investors and facilitate investment decisions. In a market where few trades are executed (also historic), pre-trade information is of added value.

Last but not least, this would ensure a level playing field between trading venues and SIs in regard to delayed pre-trade transparency. Under the current regime, in fact, SIs can leverage delayed, free of cost pre-trade data of trading venues to determine their prices; however, trading participants of trading venues are not able to access pre-trade information SIs free of charge.

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

Yes, FESE would support ESMA's approach to further define requirements for making pre-trade transparency information more accessible and comparable. However, in order to ensure a level playing field across venues and increase transparency especially regarding SI trading, which is still very opaque, the proposed standardisation of pre-trade information should be applicable to all types of venues, including SIs. Together with the requirement for SIs to publish their quotes free of charge after 15 minutes (as trading venues are required to do) this measure would be a significant step forward to increase pre-trade transparency.

Having said this, we would also urge caution as trading venues have already invested considerable resources into ensuring compliance with the current requirements, and therefore, a cost-benefit analysis should be undertaken on any further changes in order to keep costs to a minimum. Amendments should only be proposed where there is clear benefit demonstrated. Furthermore, it should be required by the regulator that pre-trade information is not only available on a website and requires a registration of the user. Instead, the information should be provided in a machine-readable format.

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.

We agree with ESMA that more post-trade transparency information should be made available to enhance competition among market participants, reduce information asymmetries, deliver high quality information for market users to enable them to make better informed investment decisions, and to ensure a level playing field across jurisdictions.

While we acknowledge that some of the different deferral mechanisms are beneficial, it seems sensible to reduce the number of different deferrals that can be availed of as this will simplify the framework. Only a minor fraction of all transactions in non-equities, especially in exchange traded derivatives, should be eligible for deferred publication to maximize post-trade transparency. Furthermore, we believe that OTC look-alike contracts should not be eligible for deferrals.

In addition, we would support a timely publication of post-trade transparency data, i.e. within 15 minutes currently, 5 minutes in the future, across all asset classes to enhance competition among market participants, reduce asymmetries of information and deliver high quality information for market users.

We suggest reducing the complexity of the current framework by only allowing one timeframe for deferred publication, no matter which waiver was used. Deferral periods of up to four weeks immensely decrease the value of the respective data for market participants, as data will be outdated and thus irrelevant. For derivatives, we support a harmonised and simplified deferral regime, requiring the publication of all transaction-related data by the next business day (and no later than t+2).

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

Yes, FESE agrees with ESMA's proposal to delete the SSTI-waiver and to simplify the post-trade transparency framework. Analogously to our answer to Q3, FESE would not support a lowering of post-trade LIS thresholds uniformly across all asset classes to compensate for the adaption to the waiver regime. FESE would prefer to ensure appropriate levels of post-trade information and is of the view that only a fraction of all non-equity transactions should be eligible for deferred publication (please also see our response to the previous question), i.e. for bonds, the illiquid and LIS deferrals should be maintained.

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 sup-port another alternative, please explain which one and why.

We share ESMA's comments on the need to create a less complex post-trade transparency regime. As highlighted in Q11, we agree with the removal of the SSTI deferral while the illiquid and LIS deferrals should be maintained in fixed income markets. Other than that, we suggest that the number of other options available in the post-transparency regime should be reduced, in particular waivers that enable only partial publication or no publication of trades as well as the 4-week waiver. For derivatives, we propose to introduce a harmonised and simplified deferral regime, requiring the publication of all transaction-related data by the next day (and no later than t+2).

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?

We agree there is a need for the price and volume to be published for transparency purposes, and we suggest that if the deferral is for too long then it is of no use to market participants. Therefore, it is preferable for the delay period to be shortened but it still needs to be sufficiently long to protect the brokers from undue risk in revealing their positions. The delay period should be short enough for it to be meaningful to the market when made visible – otherwise the data becomes useless except for compliance purposes.

We see option 3 as excessively complex. Post-trade information published after t+2 is of no commercial use, except for statistic studies or compliance purposes.

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 post-trade data? What changes to the transparency regime in Level 1 could lead to a substantial improvement of data quality?

FESE agrees in general that ESMA should focus on enforcing compliance with post-trade transparency requirements and correct trade flagging to increase the quality of post-trade transparency. This is even more critical in an OTC environment, where markets are of limited transparency. As outlined in the previous questions, FESE recommends a number of amendments to the pre- and post-trade transparency requirements which would maximise the amount and quality of data released.

Furthermore, we would like to raise attention on a number of areas that need to be considered further by ESMA before progressing the enforcement route. In relation to the data that trading venues are required to submit, there have been numerous issues since these requirements came into force which we have previously highlighted to ESMA. Certain issues still have not been fully resolved – in particular we would highlight the following:

<u>Incorrect CFI Assignment</u>

- The incorrect assignment of inappropriate CFIs by the National Numbering Agencies (NNA) remains the most common data issue we experience.
- FESE Members often receive CFI codes assigned by the NNA which do not match the type of instrument listing.
- This results in the impossibility to report all appropriate fields as they may not be required for the incorrect CFI type assigned.
- On occasion, it has resulted in errors as fields of data which do not exist cannot be reported (for example, equity like characteristics for a bond). Also, there are still unresolved errors on FIRDs data due to this issue.
- FESE Members also have a number of errors in relation to CFI codes created by the NNAs which are not valid CFI types. Again, these errors cannot be resolved until the NNA amends the CFI.
- In addition, the NNAs responsible for assigning CFI codes will often amend the CFI post-listing. This creates further issues for Exchanges as it can mean different trading venues have different CFI codes depending at what point they sourced the data and this creates a significant number of inconsistency warnings for bonds admitted to European markets.

These issues in relation to CFI assignment continue and we would suggest ESMA liaises with ANNA to try to resolve them in order to improve the accuracy of bond data. In addition, in relation to ESMA FIRDS and FITRS databases, these are extremely difficult to query and

interrogate from a user perspective. We suggest changes are made to these databases to make them more user-friendly.

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

The analysis of the evolution of the EU non-equity market structure suggests that policy measures, aimed at bringing trading out of the dark, have not been as successful as originally expected. Non-equity trading is still very opaque compared to equity and there was no increase in transparency triggered by MiFID II / R vis-à-vis MiFID I.

Bonds and derivatives markets with deep pools of high-quality liquidity are a crucial component of healthy ecosystems as well as an important contributor to competitive, transparent and stable EU financial markets. Ensuring transparency in these markets requires tailored and flexible rules that balance the need for enhanced transparency whilst recognising the specificities, differences and nuanced working of such markets.

Under the current regulation, there is hardly any sensible transparency in bonds available. Besides overly long delays, the possibility to publish selected data points of one single transaction in bonds over a certain period is not only overly complex, but it prevents usable transparency to the public rather than providing it. This is to the disadvantage of EU investors, as proper transparency data in bonds could enable passive investment as well in bonds for the benefit of investors and issuers alike.

MiFiD II contains multiple options for post-trade deferrals. As the fixed income market is fragmented and there is no 'one-size-fit-all', there should still be different options available, but we believe these could be reduced and simplified. We suggest that the number of options available in the post-transparency regime should be reduced, in particular waivers that enable only partial publication or no publication of trades as well as the 4-week waiver.

It should be evaluated whether reducing the number of alternatives could be beneficial. One reason for this is that the more optionality, the higher the cost of adapting IT-systems and operational procedures. This will especially apply for service providers such as APAs as these will need to be flexible on their offering in order to attract business. Similarly, the more options, the more work market participants will need to put into their internal procedures as they would need to know which deferrals are used in each market they are trading on, in order to control their own risk. Another reason is that if publication of trades may be postponed significantly (e.g. 4 weeks or partial publication), the information is outdated at time of publication, except for compliance purposes. Similarly, the indefinite deferral for government bonds means that market participants will not have insight into these transactions. Market participants should, though, still have the possibility to defer publication, and a few various options should still be possible as there may be national needs that the regulators should be able to accommodate. Therefore, we do not recommend a full harmonisation across all markets, but rather a more simplified framework.

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

Yes, FESE agrees with ESMA's assessment that the TOTV definition is very narrow in its current form. FESE believes that a broader TOTV definition would be in line with the MiFIR transparency objectives.

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.

Yes, FESE agrees with ESMA's proposal that the TOTV interpretation and the transparency and transaction reporting requirements should be kept aligned for the sake of efficiency and reduced complexity.

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.

FESE is in favour of Option 3. While acknowledging that both Option 2 and 3 would extent the scope of the transparency and transaction reporting framework to more OTC-derivatives compared to Option 1 (i.e. maintaining the status quo), FESE believes a broad TOTV concept would be in line with the MIFIR transparency objectives. It would promote a broadly applicable transparency and transaction reporting regime for derivatives to increase overall transparency and the level playing field between both worlds.

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

Given this has not been used to date, it is unclear to us if it is a necessary requirement to retain. We also would suggest that such a temporary suspension could be hard to implement from a systems perspective.

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

In general, FESE holds the view that any exemption from key rules agreed by the G20 with a view to making our markets more stable and resilient should be based on a thorough impact assessment in order to avoid any unintended side effects.

We acknowledge that the targeted changes to the clearing obligation under EMIR Refit were provided to relief smaller market participants from unnecessary burden. We also understand ESMA's proposal to ensure that the MiFIR provisions for the trading obligation are aligned with the new scope of counterparties subject to the clearing obligation under EMIR Refit.

Potential loopholes in the interplay between the clearing rules under EMIR for OTC derivatives and under MiFIR for Exchange-Traded Derivatives (ETDs), as well as the trading obligation under MiFIR, should be avoided as these would threaten to drive ETD volumes to OTC venues and to 'pure OTC' (contracts traded bilaterally, not on an MTF or OTF).

While all derivatives traded on a RM are subject to an obligation to centrally clear, look-alike contracts traded OTC (i.e. those contracts that mimic the economic value of the ETDs but are traded OTC as defined in EMIR) would be only subject to the requirement to clear if ESMA mandates the products for clearing. By extension, these contracts are also not subject to the trading obligation under MiFIR.

There are, therefore, 'incentives' to move these contracts OTC, not only to MTFs and OTFs, but also to 'pure OTC' to avoid central clearing. In addition, contracts that are traded 'pure OTC' only are also not subject to MiFIR transparency requirements or even certain reporting requirements. For example, it has been reported that in the Nordics, the introduction of MiFID II, along with the lack of EMIR clearing obligation for standardised derivatives contracts, has forced some commodity trading from venue to OTC, and has also seen a slump in equity ETDs.

These remarks are not applicable to securitised derivatives, which are not contracts and are underpinned by a different type of market structure where both central and bilateral clearing coexist.

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.

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.

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

FESE would welcome if ESMA would also take into consideration an assessment of the interplay between the transparency regime and the trading obligation for OTC derivatives under MiFIR.

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

Level 2 Review

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.

FESE agrees with ESMA's assessment that current level of pre- and post-trade transparency for bonds is very low. On a general basis, we believe that the number of bonds classified as liquid (around 0,2% of total bonds in Q3 2019) shows that the liquidity determination process is not delivering. As flagged by ESMA, these low figures fall below ESMA's expectations when calibrating the regime, which were about 2% of bonds being classified as liquid in S1. This clearly indicates that the regime is not reflecting MiFIR objectives to increase transparency.

In FESE's view, this limited number of liquid bonds can be attributable to (i) criteria that have been incorrectly defined, (ii) numerical parameters that are not appropriate or (iii) an inaccurate or incomplete reporting from market stakeholders. Therefore, FESE has identified a series of proposals that could help amend these misleading calculations which do not reflect the initial aim of MiFID II for fixed income markets (i.e. to increase transparency, notably at the post-trade level). These suggestions include:

- Market reality shows that certain bonds never trade. This is due, for instance, to the level of structure, the size of the issued amount, the short-term maturity, the private placement target, etc. FESE recently run an internal survey which showed that, on a total number of about 107,000 listed bonds listed on 12 exchanges for 2019, 82% of bonds never traded in the electronic order book (EOB). Furthermore, in the consultation paper, ESMA confirms that most bonds that have been determined as illiquid in one quarter, remain illiquid through the next quarter, accounting for 90-95% of illiquid bonds. FESE would, therefore, suggest differentiating the types of bonds, for the purpose of the transparency calculations, excluding bonds that do not trade.

- A bond is currently classified as liquid when it is traded on a percentage of days greater or equal to 80%. However, evidence published by the AMF ('Measuring liquidity on the corporate bond market', March 2019) on the distribution of the number of different bonds traded in the course of a day points out to an average number of days traded substantially lower than the current 80% threshold. The current parameter is therefore distant from market reality.
- A bond is currently classified as liquid when it has an average daily notional amount (ADNA) greater or equal to 100,000 EUR. Based on the results of the FESE internal survey cited above, we identified that approximately 30% of EOB trades in 2019 had a notional amount equal or above 100,000 EUR. The wide gap between this figure and the 0.2% of liquid bonds found in the Q3 2019 quarterly assessment casts doubt into this threshold.
- A FESE internal study shows that over 700,000 trades executed on European RMs are not considered for the liquidity test. We see no reason why a trade below 100.000 EUR on a RM would not support the liquidity of a bond. Therefore, we would recommend including trades below 100.000 EUR into the liquidity test.
- In order to better understand the impact of the thresholds included in MiFID II, simulations with different transparency thresholds should be conducted.
- In addition, a full assessment of the underlying data should be performed, and the data adjusted when required (before running new transparency calculations).
- Since the criteria are reviewed on a yearly basis, we would recommend running a series of simulations with next year's calibration, in order to understand whether the impact on the number of liquid bonds will be substantial or not.
- Finally, ESMA should consider reviewing how to access its database as it currently cannot be accessed via an API and the files are generally heavy and difficult to download. This would serve the purposes of increasing post-trade information availability, as envisaged by MiFID II.

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

The move from Stage 1 to Stage 2 for the liquidity assessment of bonds would, overall, increase the level of transparency for bonds. Therefore, FESE welcomes ESMA proposition to move from Stage 1 to Stage 2 for the determination of the liquidity assessment for bonds. Having said that, FESE wishes to remark the limited impact that this move will produce in regard to market transparency (an increase of 50% which is still very minimal if we look at the total number of liquid bonds in S1), a broader review of RTS 2 for the methodology to perform the transparency calculations might be increasingly necessary.

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.

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.

Yes, we agree with this proposal to 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.

As outlined in our response to Q1, MiFIR rightly recognises that certain exemptions can be granted to trading venues from the general requirements to preserve orderly price discovery processes and allow in particular illiquid and nascent markets to develop. However, the current calculation methodology of corresponding waivers is flawed. The Illiquid ('IL') and LIS waivers do not fit all non-equity markets, especially commodity and energy derivatives markets.

The current methodology has led to a significant number of niche and nascent products being incorrectly classified as liquid, based on the two liquidity criteria in table 7.1 Annex III, RTS 2, and thus becoming subject to significantly broader transparency requirements, which were previously reserved for developed markets as referenced in the answer to Q1 and Q2.

IL thresholds are determined on the basis of the average traded daily notional amount (or average daily amount in case of emission markets). However, this current calibration methodology does not reflect market reality:

- First, for a market to be considered liquid, a sufficiently high number of trades should be executed on each trading day. 10 trades a day does not reflect a liquid market. Given that trading is rarely uniformly distributed throughout the day, higher thresholds are a better basis for determining liquidity and, thus, an indication of the ability to find a counterparty in a relatively short period of time within a given trading day.
- Second, ADNA does not automatically reflect a large number of trades, and thus a high level of liquidity. We suggest to rather look at trade frequency and standard size to determine liquidity, excluding unrelated vectors such as price and currency.
- Third, commodity trading venues and market participants are also challenged by the fact that the LIS thresholds are set in Euro instead of lots. Prices do not determine the liquidity of a market and notional values do not reflect trading practice. Notional values include a significant amount of 'noise' which does not help to conduct a proper analysis of a market's depth and liquidity. Moreover, market participants typically hedge their production and consumption in trading in lots and not in notional value. Thus, we recommend that the liquidity analysis is normalised to a base quantity unit that is native to the asset class.

Therefore, we propose:

- For commodity derivatives sub-asset class, metals and energy commodity futures/forwards and options, the ADNA is set to 100 million EUR and 100 trades for ADNT.
- For the same sub-asset class, the LIS pre-trade threshold floor is set to 50,000 EUR and the trade percentile is set to 30%.

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.

FESE supports ESMA's proposal SC2, securing the liquidity calculation/assessment for contracts sharing the same delivery/cash settlement location.

The proposal SC1 sounds logical, to the extent possible, to harmonise the reporting from different venue listing similar contracts. It should, however, be left blank in case there is no standard delivery/cash settlement location available.

We do not support proposal SC3, as the essential criteria (delivery/cash settlement location) would be covered by proposal SC2 for electricity derivatives in particular.

We are of the view that the current segmentation criteria for commodity derivatives are insufficiently granular. This leads to certain commodity derivatives contracts being wrongly classified as liquid or subject to excessive LIS thresholds. This is the case for Oil commodity derivatives in particular as a number of contracts in that asset class, with the same grade underlying but delivered to different delivery points, have been made subject to the same requirements, resulting in discriminatory treatment of less liquid delivery points.

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.

As elaborated on in our response to Q1, trade registration is an important way to allow transactions in illiquid/nascent commodity markets in the most transparent way. However, excessively high LIS thresholds lead market participants to revert to more bilateral trading outside transparent and supervised venues, and outside CCP clearing.

To avoid this from happening and to allow for a more natural move to 'on venue' trading, the current methodology for setting the LIS thresholds should be replaced with a more appropriately tailored and market-based approach. FESE welcomes ESMA's assessment on the counterintuitive effects arising from the current percentile approach. However, should ESMA not find this feasible, we would also welcome a less comprehensive amendment of the methodology by recalibrating the current parameters.

In a similar fashion, for many commodity markets, the minimum threshold of 500,000 EUR is too high and should be decreased significantly. By bringing the LIS value more closely in line with the actual market, the overall negative market impact should be reduced.

As indicated above, commodity trading venues and market participants are also challenged by the fact that the LIS thresholds are set in Euros instead of lots. Liquidity should therefore not be measured only by using the notional value of the transactions, but a liquidity assessment should be based on a combination of thresholds including measures normalised to a base quantity unit that is native to the asset class. For commodities, this will typically be a specific unit of measure (e.g. barrels, tons, MW, etc.).