This letter was sent to the EC's DG FISMA and ESMA

12 February 2025

Subject: ICMA feedback on ESMA MiFIR review Final Report (ESMA74-2134169708-7775)

We are writing to you regarding ESMA's final report on RTS2 published on 16 December, including final proposals on the forthcoming EU bond transparency framework.

Firstly, we would like to highlight that ICMA very much welcomes the changes with respect to the groupings of bonds and calibration of deferrals incorporated following the initial ESMA proposal (as per MiFIR Review Consultation Package) and subsequent consultation feedback from respondents including ICMA's response (and joint trade association statement), highlighting the need for a more data driven approach as explained here. ICMA has been a longstanding advocate for the introduction of a Consolidated Tape for bonds in Europe, supported by a well-designed and suitably calibrated deferral framework aimed at increasing transparency in the European bond markets in optimizing the scope of real-time post-trade transparency while also providing protection of the liquidity provision of the more sensitive transactions (such as for example in larger trades and illiquid instruments).

However, whilst ICMA members broadly welcome ESMA's final proposal, there remain significant concerns, in particular with respect to certain less liquid categories of bond transactions and the calibration of issue size and trade size thresholds thereunder, resulting in **substantial** discrepancies between the estimated time to trade out ('ToT') and deferrals as proposed by ESMA. The most significant examples can be found under ESMA deferral category 1 in bond group 3 (for example an IG corporate bond transaction with a bond issue size of €0.8bn and trade size of €5mn), where the ToT is over 300 times higher than the ESMA deferral time, as well as in other bond groups under deferral category 1.

ICMA would therefore like to ask ESMA/the EC to amend the final proposal as follows:

1) Amend the calibration in category 1 that currently displays a substantially high ToT to deferral ratio. Specifically as highlighted in the heatmap under Annex I below, these would be category 1 for groups 3,4,5, and 2. These exhibit particularly high ToT to deferral ratios. These ratios are reduced either by lowering the upper trade size thresholds in category 1 or increasing the issuance size threshold (ie the liquidity determinant). More concrete proposals can be found in ICMA's response to ESMA's consultation. We would like to highlight that if those amendments to the calibration were not to be made, ICMA sees a high risk of risk intermediation to be deterred as liquidity providers might either quote wider prices for those transactions affected, or not provide liquidity altogether. Alternatively, trading activity adversely impacted by the high ToT ratios could migrate away from the EU. In this context, it is worth highlighting that in the UK, under the new FCA transparency framework, the treatment of those deferral

categories is different in some instances. Precise examples can be found in Annex I. The amendment of the EU framework as proposed by ICMA seeks to minimise those discrepancies.

2) The discrepancies versus the UK regime can be broadly attributed to either the issue size liquidity thresholds being too low, or the upper deferral category trade size thresholds being too high. Additionally, recalibrating these thresholds would better protect 42% of corporate volumes and 15% of sovereign volumes, whilst still enabling circa 90% of the number of trades to be published in real time, which we understand from the ESMA consultation was ESMA's intended target.

3) ICMA members would like to re-iterate that the above measures are not intended to drastically reduce transparency. ICMA has always advocated for transparent markets. It is very important to note here that by adapting the framework accordingly and as suggested under our points above, the framework would still allow for around 90% of number of trades to be published "real time". In other words: A small change would go a very long way in terms of helping the provision of liquidity, while keeping the overall framework relatively unchanged. Changing the regime as per our proposals outlined in Annex I would not significantly impact the overall outcome in terms of real-time trade count percentages (as calculated by ESMA in the final report in paragraphs 127 to 156), whilst protecting the relatively small, but important, percentage of transactions that would otherwise be adversely impacted.

Please find below under Annex I a deep dive analysis and our detailed findings.

Aside from the transparency regime analysis and proposals, we would like to stress a few other important observations:

1. Transactions in Structured Finance Products (SFPs) as per final proposal (paragraph 164) benefit from a T+2 price deferral and a 2 week volume deferral (as per category 4). ICMA members have expressed very strong concerns regarding the T+2 price deferral,[1] ICMA members would like to highlight that the secondary market for SFPs is a highly illiquid market with exclusively institutional (not retail) investors. According to the new UK bond transparency framework, SFPs have been taken out of scope, when traded outside a trading venue, as part of the UK MiFIR review, and as such will no longer be subject to post-trade transparency requirements as per 1 December 2025. The main concern is therefore the divergence with the UK market once the new regimes apply. We would urgently request an amendment to the existing proposal (in form of removal of SFPs from scope, longer deferrals, a delayed application allowing for

[1] It is important to note that in the case of illiquid securities, such as SFPs, publication of price alone provides a significant amount of detail, including whether the trade was a 'risk trade' (ie a liquidity provider has taken a position), the direction of the trade (ie is the liquidity provider now long or short), and the relative size of the transaction. Hence it is the price deferral, and not the size deferral, that matters more.

more time to review and analyse the market structure, etc) and would be very happy to further discuss details with you, if suitable.

2. In the context of trade out times, ICMA members would like to comment on ESMA's rationale under paragraph 134 of the final proposal which states: "ESMA considers that the ToT to be a good proxy to measure the time for liquidity providers to unwind their positions and as such to evaluate liquidity providers risk. Nevertheless, the use of ToT should not create a deferral regime in such a way that liquidity providers or market makers trade out of a position "risk-free" and as such the analysis was performed with this in mind." ICMA would like to point out that when holding a position, market makers must manage a series of different risks already, before even considering the impact of a trade publication. Such risks include but are not limited to:

    a. Interest rate risk
    b. Credit risk
    c. Financing risk

    And while market makers / liquidity providers can hedge these types of risk via different instruments (eg sovereign bonds/IRS/Futures, I-CDS, repo), there still remains the so-called <u>basis risk</u> (ie any remaining difference between the position and the hedge, which is not static). Accordingly, there is no such thing as a 'risk free' transaction when it comes to market-making.
    What transparency does, however, is introduce a **<u>new</u>** idiosyncratic risk, which is specific to the actual security they hold a position in, and which cannot be hedged. Especially in the case of more illiquid securities, where, for example, if it is known that that there is a larger long position one of the market makers is holding, the price of such security may be marked lower (by other dealers). If it is known that there is large short position, the price of such security may be marked higher. And this is especially why, from a market making and liquidity provider's perspective, the time to trade out is so important. As this type of risk is un-hedgeable, dealers either need to price in the likely impact of information leakage or pass on the trade completely, both of which would ultimately lead to worse client outcomes, which is contradictory to the aim of the transparency regime and introduction of a consolidated tape.

3. Timing of RTS2 application. We currently understand from ESMA that the timing for RTS2 to apply is planned for the end of 2025. ICMA members are concerned that this would not allow for sufficient time to implement the new requirements. Furthermore, there is no information yet about various areas such as for example credit ratings, which will be subject to further work done at Level 3. Furthermore, in order to process necessary changes at firm level, it would much be appreciated if members could work on the basis of legal certainty with respect to the timing. From our member's perspective, a specific timeline which is set from entry into force (such as 6-12 months from entry into force) would be very much welcome.

ANNEX I

ToT to deferral time ratio

In order to illustrate and elaborate on the concerns raised, ICMA members have identified the ratio between the maximum time to trade out (ToT), as defined by ESMA, and the deferral time, as a key metric in assessing the framework. This ratio provides an indication of how many times larger the maximum ToT is, compared to the deferral time. The higher the ratio, the higher the number of deferrals needed to "trade out" a position. For example, with a 15-minute deferral and a hypothetical ToT of one day, the ratio would be 32. Based on an 8-hour trading day, it would take 32 15-minute periods to trade out (8/0.25=32).
ICMA calculated this ratio for all groups and categories. It emerges that for the first category (15-minute deferral), all groups exhibit very large ratios. Specifically, for group 3, the maximum ToT is 307 times the deferral time. Groups 3 and 4 exhibit ratios above 200, and finally, Group 2 has a ratio of 51.

		Most liquid sov (big 6)	Other sov	Corp IG	Corp HY	Covered
Category	Deferral	Group 1	Group 2	Group 3	Group 4	Group 5
1	Liquid/15 mins	12.8	51.2	307.2	262.4	214.4
2	Illiquid/EOD	1.6	6.5	18.8	12.7	12.7
3	Liquid/P: T+1 / V: 1W	0.16	0.8	3.84	3.28	3.36
4	Illiquid/P :T+2 / V: 2W	0.54	1.62	4.7	3.18	2.54

NB: In the above table for each deferral category and each group of bonds, we calculate the max ToT (as defined and reported by ESMA) to deferral time ratio. Example: for category 1 in group 3, ESMA published a max ToT of 9.6 days (paragraph 148 of ESMA's final report). Assuming a period of 8 hours per day, that would equate to 76.8 hours. Which divided by 15 minutes leads to a ratio of 307.2. A ratio of one would indicate that the maximum time to trade out is equal to the deferral period.

To lower these ratios, issuance size thresholds can be increased, or category trade size thresholds can be lowered.

Different deferral treatments

Additionally, ICMA members have flagged the interplay between the EU and UK deferral regimes and noted that some transactions will receive significantly different deferral treatment depending on where they are traded.

Staying with the above example, an IG corporate bond (group 3) issued with a size of >€0.5bn and traded in a size of €7mn would be published after 15min in the EU but would benefit of a 2 weeks deferral in the UK.

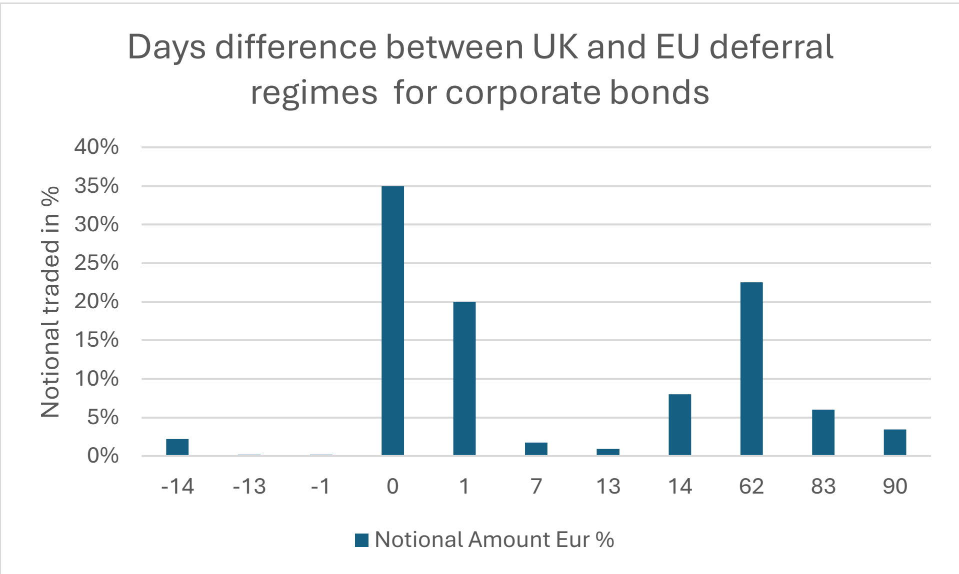
To give another example, a sovereign bond issued by an EU member state (excluding Germany, France, Italy, and Spain*)*, with a fixed coupon payment, a maturity of 11 years, an issue size of €1bn, and a trade size of €15mn, would have a deferral of 15 minutes in the EU, but a deferral of three months in the UK. If the issue size is considerably bigger (say €20bn), the EU deferral remains 15 minutes whilst the UK still allows for two weeks.

<u>Further examples</u>

- Sovereign bond, issued by an EU member (not FR,DE,IT, ES) or non-EU member with a size of €5bn and traded in a size of €30mn. T+1 price & 1 week volume deferral in EU. 3 months in UK.
- Sovereign or other public bond with a non-fixed coupon type, issued within the UK, US, DE, FR, IT, ES, with an issue size of €2bn and traded with a size of €20mn. T+1 price & 1 week volume deferral in EU. 3 months in UK.
- Covered HY bond issued in EUR, GBP or EUR, with a size of €0.8, and traded with a size of €14. 15 minutes deferral in the EU, 3 months in the UK.
- Corporate IG bond, issued in EUR, GBP or EUR, with a size of €0.5, and traded with a size of €14. T+1 price & 1 week volume deferral in EU. 3 months in UK.
- Corporate HY bond, not issued in EUR, GBP or EUR but with an equivalent € size of €0.5bn and traded in a size of €3mn. 15 minutes deferral in the EU, 2 weeks in the UK.

To provide a complete overview, ICMA analysed a sample dataset of trades executed within the EU between 2023 and 2024, calculating deferral times under both regimes and comparing the differences both in terms of trade count and volumes.

For both sovereign and corporate bonds, circa 90% of trades would receive the same treatment (or very similar) in both the EU and the UK. But traded volumes would see significant differences. We estimate that for sovereign bonds, approximately 15% of volume traded in Europe would face a deferral period that is 7 to 90 days longer in the UK. For corporate bonds, this figure rises to 43%.



NB: In the chart above, the X-axis represents the difference in days between the UK and EU deferral regimes. This is calculated by determining the deferral time for both jurisdictions and then subtracting the EU deferral from the UK deferral. A positive value on the X-axis indicates that the deferral time is longer in the UK. The bars represent the percentage of volume traded in the EU for each point on the X-axis.

Driving factors

The driving factors behind these discrepancies are difficult to isolate since the regimes differ and the variables are numerous. However, we can identify a few broad drivers.

In the case of sovereign bonds, especially those issued within one of the big six markets, if the time to maturity is 11 years or more, these would fall under group 2 in the EU instead of group 1. In group 2, the liquidity threshold is €1bn, whereas in group 1, it is €5bn. Due to the nature of these bonds and the typical issue sizes (typically well above €5bn) lowering the threshold causes the deferral difference to widen.
In contrast, the liquidity threshold in the UK remains £2bn (approximately €2.4bn).

Additionally, for liquid bonds in group 2, trades between €20mn and €50mn have a T+1 price deferral (with a one-week volume deferral) in the EU, while in the UK, trades between £25mn and £250mn qualify for a two-week deferral. Increasing the liquidity threshold or lowering the trade size category threshold would allow for more deferral in the EU.

For all other European countries (regardless of tenor), trades are deferred under Group 2 in the EU. In the UK, however, the issue size threshold remains £2bn, but trade size requirements are **considerably lower**. A trade size of £25mn for liquid bonds or £10mn for illiquid bonds qualifies for a three-month deferral.

In the case of corporate bonds, we can easily observe that trade size thresholds in the UK are considerably lower for liquid IG corporate bonds (which happen to be the most traded within this market[2]) compared to what we see in category 1 of group 3. In fact, whereas for liquid IG bonds transactions up to €7.5mn would have a deferral of only 15mins in the EU, trades bigger than £1mn will benefit of a 1-day deferral or 2 weeks if bigger than £5mn in the UK.

[2] https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/ICMA-Secondary-Market-Practices-Committee-European-Secondary-Market-Data-Report-H1-2024-Corporate-Edition-December-2024-041224.pdf

Contacts:

Nina Suhaib-Wolf
Director, Market Practice & Regulatory Policy (ICMA)
Nina.Suhaib-Wolf@icmagroup.org

Simone Bruno
Associate Director, Market Practice and Regulatory Policy (ICMA)
Simone.bruno@icmagroup.org

Aman Gill
Associate, Market Practice & Regulatory Policy (ICMA)
Aman.gill@icmagroup.org