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ESBG general comments to ESMA's Consultation Paper on Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) for MiFID II and MiFIR

The European Savings and Retail Banking Group (ESBG) welcomes the opportunity to comment on the draft Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) for MiFID II and MiFIR. ESBG would like to provide some comments on the definition of liquid market for non-equity financial instruments, information relating to execution of orders, organisational requirements for investment firms and clock synchronisation.

Regarding **the definition of liquid market** for fixed income financial instruments, ESBG strongly disagrees with ESMA's proposal for the definition of a liquid market. As a general remark, ESBG urges ESMA to take adequate account of market realities when setting the thresholds. It would be wrong to set the thresholds at a level which aims at a certain coverage ratio (*i.e.* to set the threshold with the aim of having a certain percentage of bonds above the threshold).

It is true that MiFIR aims at increasing market transparency in the non-equity market, however it is equally true that MiFIR does not intend to create such transparency at the price of unreasonable risks, in particular for systematic internalisers. Defining a liquid market wrongly would result in the risk for systematic internalisers of such instruments becoming prohibitive. Liquidity would then dry up completely and this is not in the interest of issuers or clients.

Furthermore, ESBG urges ESMA to take into consideration that a key feature of the life cycle of bonds is that trading takes place – if at all – in the first four weeks after issuance. To take this into account in the liquidity criteria, these first four weeks should be excluded when calculating the thresholds. The same goes for the 'number of trading days' and the 'average daily volume' criteria. This will ensure that only permanently liquid bonds are deemed liquid. ESBG notes that with respect to the liquidity criteria for derivatives, ESMA has also taken into account the life-cycle by referring to the time to maturity.

The graphics on pages 105 and following of the Consultation Paper suffer from the fundamental flaw that they do not take into account the life cycle. If the first four weeks after the issuance were disregarded, these graphics would show a completely different picture.

The ESBG would like that for covered bonds further clarification be provided. In chapter 3.5 (page 102, para. 48) ESMA suggests as a result of its own calculations that covered bonds with an issuance volume of EUR 750 million be classified as liquid. This assumption does not, however, tally with the liquidity classification of covered bonds in accordance with Regulation (EU) No. 575/2013 (CRR) in the context of the LCR (Liquidity Coverage Ratio). According to Article 11(1)(f)(iv) of the Delegated Regulation (EU) 2015/61 covered bonds within the context of the CRR are classified as liquid from an issuance volume of EUR 250 million and up. This assumption is based on an analysis by the European Banking Authority. A statement in the RTS to the effect that the liquidity requirements pursuant to MiFID and CRR are based on different assumptions and calculation methods and are therefore different, would be required.

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In addition, ESBG wishes to point out that the MiFID assumptions regarding the liquidity classification of covered bonds are higher than the assumptions for other bonds (corporate bonds issued by financials), which are classified as liquid from an issuance volume of EUR 500 million onwards. The assumption that such bonds are more liquid than covered bonds does not correspond to the general market perception.

Regarding <u>the definition of liquid market for securitised derivatives</u> ESBG does not agree with ESMA's proposal. The existence of a market maker is not a suitable criterion for establishing liquidity when trading in securitised derivatives (certificates). This is because the market-maker model in securitized derivatives differs substantially from the market-maker model in a regulated market. In actual fact, the market maker in certificates is a market model designed to ensure that an investor can return the purchased financial instrument to the issuer. It therefore does not amount to active trading such as would be characteristic of systematic internalisation. At the same time, it should be noted that no other market participant apart from the issuer would repurchase these financial instruments. Rather, the following parameters should be used as the criterion to determine which instruments are actually liquid should be whether actual trading takes place and the time since issuance.

In addition, ESBG does not agree with ESMA's proposals on <u>the definition of liquid market for interest rate derivatives</u>. ESBG thinks that it is necessary to distinguish between exchange traded and non-exchange traded derivatives. The methodology proposed to determine which classes of interest rate derivatives are classified as liquid results in a definition of the liquid market which is too broad. The methodology used assumes that, for example, euro-denominated swaps with payment swap fixed against variable are always plain vanilla transactions which in reality are not. In this regard, there are also plain vanilla swaps whose prices are easily observable on the trading screens. The swaps that share all major characteristics with those tradable swaps (base, frequency, paying conventions...) could be the ones considered as liquid. However, a large number of transactions are structured to specific client or hedging requirements, and therefore it would be wrong to talk about liquidity with regard to these transactions.

ESBG considers average frequency and size of transactions as useful indications, while size of spreads, which for derivatives often strongly depends on their respective risk sensitivity and is therefore not in a linear and simple relationship to notional, is generally not a useful parameter for the definition of liquidity of derivatives. In the analysis of frequency and size, it is crucial to correctly group instruments. Often, there are relatively standardised and frequently reasonably liquid 'plain vanilla' derivatives which, using the criteria employed by ESMA, would be indistinguishable from highly customised transactions.

Finally, regarding <u>the definition of liquid market for equity derivatives</u> ESBG believes that none of the options presented by ESMA are supported sufficiently by the statistical survey. ESMA's survey refers solely to listed futures and options and consequently does not include OTC-traded equity derivatives, which account for approximatively 40% of the total nominal volume. If all equity derivatives with a tenor of up to six months were categorised as liquid, this would not take into account the illiquidity of OTC equity options with this tenor; consequently option 1 cannot be followed. The maturity-independent categorisation of all equity derivatives traded on venue as liquid, as suggested by option 2, would contradict ESMA's findings in charts 12-15 (pp. 129 CP), according to which most trading is accounted for by products with a tenor of up to three months. Against this backdrop, we support a differentiated approach were only listed futures and options with a tenor of no more than six months can thus be considered as liquid.

On **information relating to execution of order**, ESBG considers the broad based duty of systematic internalisers and market makers to provide the market with granular data concerning execution volumes und execution quality as not appropriate to the purposes of evaluating the execution quality of possible venues as it is not compliant with the principle of proportionality. ESBG therefore recommends applying the proposed requirements exclusively to systematic internalisers with significant market shares. ESBG does not consider it necessary to establish a percentage-based threshold, since market participants have an interest in presenting themselves as an execution venue with significant market share. The extension in the definition of an "execution venue" in Article 2(3) draft RTS 6 on systematic internalisers should therefore be combined with the requirement of a significant market share and the execution of a substantial volume of shares. Furthermore, for market makers as well as liquidity providers (in particular the latter, who lack a formal definition) it is not practicable to have the same reporting requirement as a trading venue. So both market makers and liquidity providers should be deleted in the definition of an 'execution venue' in Article 2(3) draft RTS 6.

On the topic of **organisational requirements for investment firms**, ESBG welcomes the fact that ESMA has clarified that 'kill switches' are to be used as an emergency measure, *i.e.* only when absolutely necessary. Nonetheless, ESBG would like to point out that making a kill switch available may involve significant risks for unrelated trading desks that would be affected by the use of a kill switch as well. In line with the principle of proportionality, any emergency measure should only affect the trading-channel which has been identified as causing a problem without having to cut trading-channels that are not exposed to any risks.

Regarding **clock synchronisation**, ESBG disagrees with the proposed criteria for calibrating the level of accuracy required and considers that the only suitable criterion for defining the degree of timing precision is whether the member or participant is engaged in high-frequency algorithmic trading ("HFAT"). In ESBG's opinion, there is no need to harmonise business clocks of non-HFATs. Systems that are able to react within a fraction of a second of order entry and lifetime of the orders within that timeframe do not exist outside HFAT. In addition, ESBG strongly criticises the fact that the scope of application is not set to be exhaustive as it must be be finalised on Levels 1 and 2.