



European Securities and
Markets Authority

MiFID II/MiFIR Annual Report

under Commission Delegated Regulation (EU) 2017/583 (RTS 2)





Table of Contents

1	Executive Summary	2
2	Introduction	3
3	Average daily number of trades for the determination of bond liquidity	4
3.1	General approach and legal framework.....	4
3.2	Feedback from the consultation.....	9
3.3	ESMA's assessment and recommendations.....	10
4	Trade percentile for the determination of the pre-trade SSTI threshold.....	10
4.1	General approach and legal framework.....	10
4.2	Feedback from the consultation.....	11
4.3	ESMA's assessment and recommendations.....	11
5	Annexes	13
5.1	Annex I.....	13
5.2	Annex II.....	15

1 Executive Summary

Reasons for publication

This final report covers the mandate under Article 17 of Commission Delegated Regulation (EU) 2017/583 (RTS 2) whereby ESMA is required to analyse whether it is appropriate to move to the following stage in terms of transparency with regard to (i) the average daily number of trades (ADNT) threshold used for the quarterly liquidity assessment of bonds, and (ii) the trade percentile used for determining the pre-trade SSTI thresholds.

If that move is deemed appropriate, ESMA is required to submit an amended version of the regulatory technical standard to the Commission adjusting the thresholds for the relevant parameters.

Contents

After an introduction (Section 2), this report analyses the feedback received to the proposal to change the thresholds for the liquidity criterion 'average daily number of trades' for bonds in (Section 3) as well as the trade percentiles that are used to determine the size specific to the financial instruments for non-equity instruments (Section 4).

Next Steps

This report is submitted to the European Commission and the amended regulatory technical standards are expected to be adopted and published in the Official Journal (OJ).

2 Introduction

1. Article 17 of Commission Delegated Regulation (EU) 2017/583 (RTS 2) requires ESMA to submit to the Commission an assessment of the operation of the thresholds for the liquidity criterion 'average daily number of trades' for bonds as well as the trade percentiles that are used to determine the size specific to the financial instrument (SSTI) thresholds for non-equity instruments.
2. The transparency regime for non-equity instruments is currently subject to a four-stage phase-in for the determination of the liquidity status of bonds (based on the criterion 'average daily number of trades') and the level of the pre-trade SSTI thresholds for non-equity instruments (based on trade percentiles). Therefore, ESMA's assessment below is intended to inform the decision of the Commission to move to the next stage or to remain on the current stage for the mentioned criteria.
3. The first assessment was due to be delivered in July 2019. However, due to the uncertainties around the UK leaving the Union which has a substantial impact on the liquidity and threshold tests to be performed under RTS 2, ESMA had to postpone the submission of the first report.
4. Therefore, currently the thresholds for both the liquidity determination of bonds and the pre-trade SSTI are at the first stage of the phase-in. Consequently, ESMA has to propose if the move to the second stage is appropriate at this point in time.
5. For such assessment, according to Article 17(5) of RTS 2, ESMA should take the following factors into account:
 - The evolution of trading volumes in non-equity instruments covered by the pre-trade transparency obligations;
 - The impact on liquidity providers of the percentile thresholds used to determine the SSTI; and
 - Any other relevant factors.
6. Where, based on this assessment, ESMA considers that the thresholds should be adjusted to the next stage, it should submit to the Commission an amended version of RTS 2.
7. To inform its decision ESMA published a Consultation Paper (CP)¹ on 10 March 2020. The consultation period ended on 14 June after an extension of the initial deadline and in total 57 replies were received.

¹ https://www.esma.europa.eu/sites/default/files/library/esma70-156-2189_cp_review_report_transparency_non-equity_tod.pdf

3 Average daily number of trades for the determination of bond liquidity

3.1 General approach and legal framework

8. The quarterly liquidity assessment for bonds (except ETCs and ETNs) is currently performed on the basis of three parameters:
- Average daily notional amount greater or equal to EUR 100,000;
 - Average daily number of trades greater or equal to 15;
 - Percentage of days traded over the period considered greater or equal to 80%.
9. Under the phase-in, the parameters for the average daily notional amount and the percentage of days traded remain unchanged. Only the average daily number of trades is foreseen to be gradually reduced. More precisely, when moving from stage 1 to stage 2, the average daily number of trades would be reduced from 15 to 10. The four stages for the average daily number of trades and the liquidity parameters are presented in the table below.

FIGURE 1 - LIQUIDITY DETERMINATION OF BONDS (EXCEPT ETCs AND ETNS)

Average daily notional amount	Average daily number of trades				% of days traded
EUR 100 000	S1	S2	S3	S4	80%
	15	10	7	2	

10. In the CP, ESMA analysed the current number of bonds considered to be liquid from 2018Q4 to 2019Q3. Most of them were classified as illiquid and only between 0.15% and 0.31% of total bonds were considered liquid (see Figure 2).

FIGURE 2 - LIQUID BONDS PER BOND TYPE, 2018Q4-2019Q3

	2018Q4	2019Q1	2019Q2	2019Q3
Liquid	439	987	594	611
of which				

Convertible	-	18	1	-
Other public	22	44	27	38
Sovereign	279	553	381	404
Covered	-	-	-	3
Corporate	86	257	136	125
Other	20	40	27	26
Illiquid	297,224	316,854	320,198	320,085
Total	297,663	317,841	320,792	320,696
% of liquid bonds	0.15%	0.31%	0.19%	0.19%

Source: FITRS

11. Furthermore, ESMA simulated the impact of moving to stage 2 (S2) of the phase-in by calculating how many bonds would have qualified as liquid, during the four consequential quarters (Q4 2018, Q1 2019, Q2 2019 and Q3 2019)², using an average number of daily trades equal to 10 (S2) instead of 15 (S1) (see Figure 3).

FIGURE 3 - BONDS LIQUIDITY STATUS UNDER S1 AND S2 – THE EU AND THE UK VS. THE EU³

2018Q4	2019Q1	2019Q2	2019Q3
--------	--------	--------	--------

² The EU27 calculations exclude ISINs admitted to trading/traded only on UK trading venues. Furthermore, for the ISINs admitted to trading/traded in the EU27 exclude the trading volume is calculated excluding trading activity executed on the UK trading venues, by UK SIs (and reported to any APA) and OTC volume reported to UK APAs.

³ The difference in the number of liquid bonds between Figure 2 and Figure 3 is due to the fact that the former is based on the quarterly results published by ESMA and the latter to a simulation performed outside the IT system. There reasons explaining such differences are (i) corrections on quantitative data performed after the quarterly bond liquidity assessment are taken into account under the re-calculations; (ii) corrections on reference data, including the start trading date or the classification of the instrument, performed after the quarterly bond liquidity assessment are taken into account under the re-calculations; (iii) corrections on the calendars for days open in a trading venue; (iv) the difficulty to exactly replicate the calculation of the third parameter, i.e. the percentage of days traded, outside the IT system.

A. Num of liquid bonds in the EU 28 under S1	622	996	793	845
B. Num of liquid bonds in the EU 27 under S1	258	377	330	353
C. Difference in num of liquid bonds EU27-EU28 under S1 [B – A]	-364	-619	-463	-492
(%)	(-58.52%)	(-62.15%)	(-58.39%)	(-58.22%)
D. Num of liquid bonds in the EU28 under S2	966	1515	1258	1310
E. Num of liquid bonds in the EU27 under S2	383	563	477	527
F. Difference in num of liquid bonds EU27-EU28 under S2 [E – D]	-583	-952	-781	-783
(%)	(-60.35%)	(-62.84%)	(-62.08%)	(-59.77%)
G. Difference in the num of liquid bonds in the EU28 between S2 and S1 [D – A]	344	519	465	465
(%)	(55.31%)	(52.11%)	(58.64%)	(55.03%)

H. Difference in the num of liquid bonds in the EU27 between S2 and S1 [E – B]	125	186	147	174
(%)	(48.45%)	(49.34%)	(44.55%)	(49.29%)

Source: FITRS

12. It is noted that the move from stage 1 to 2 would on average increase the number of liquid bonds by about 50%, both for the EU and the UK (slightly above 50%) and the EU alone (slightly below 50%). The overall share of liquid bonds and of the level of transparency remained however modest even after this 50% increase. ESMA calculations showed that, when using an average number of daily trades equal to 10, the percentage of liquid bonds over the total number of bonds were in a range from 0.32% to 0.48% (in the EU plus the UK).
13. Furthermore, in the CP ESMA also analysed the trading volume executed under the waivers for bonds for which ESMA received the large majority of waivers requests in 2018 (27%).
14. Before the application of MiFID II/ MiFIR, non-equity instruments were not subject to a mandatory pre-trade transparency regime. Nevertheless, ESMA compared the pre-trade transparency in the EU before and after MiFID II/ MiFIR by collecting data on the trading activity executed across trading venues on the use of waivers in place in 2017 on a national level.
15. When comparing the orders/quotes benefitting from a waiver in 2018 to those not subject to pre-trade transparency in 2017 (see Figure 4 and Figure 5 below), it can be observed that in 2017 orders/quotes not subject to pre-trade transparency covered mainly equity derivatives (28%) and commodity derivatives (71%), with the share of the other asset classes being marginal. In 2018, it can be noted that most notional trading volume under waivers was concluded in sovereign bonds (50%), interest rate derivatives (20%), bonds other than sovereign (18%) and credit derivatives (12%).
16. However, ESMA considers that it is difficult to draw conclusions since, as mentioned above, there was no mandatory regime in 2017 and the data collected might not give a comprehensive picture of dark trading in non-equity instruments before the application of MiFIR.

FIGURE 4 - NOTIONAL TRADING VOLUMES UNDER WAIVERS, PER ASSET CLASS, 2018

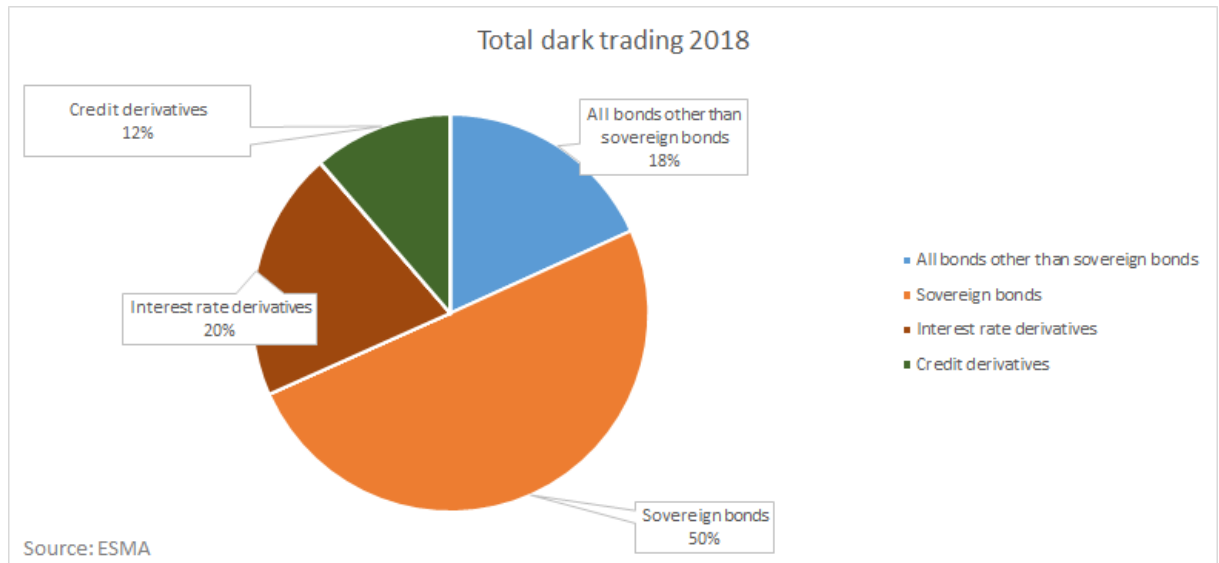
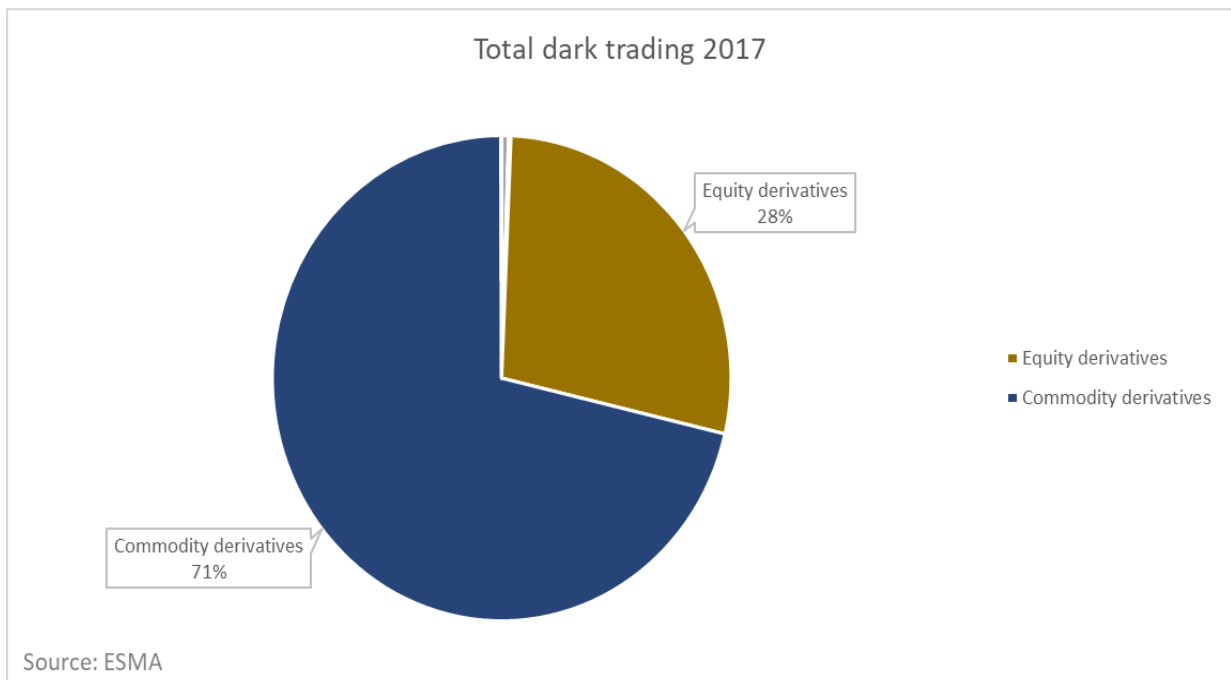


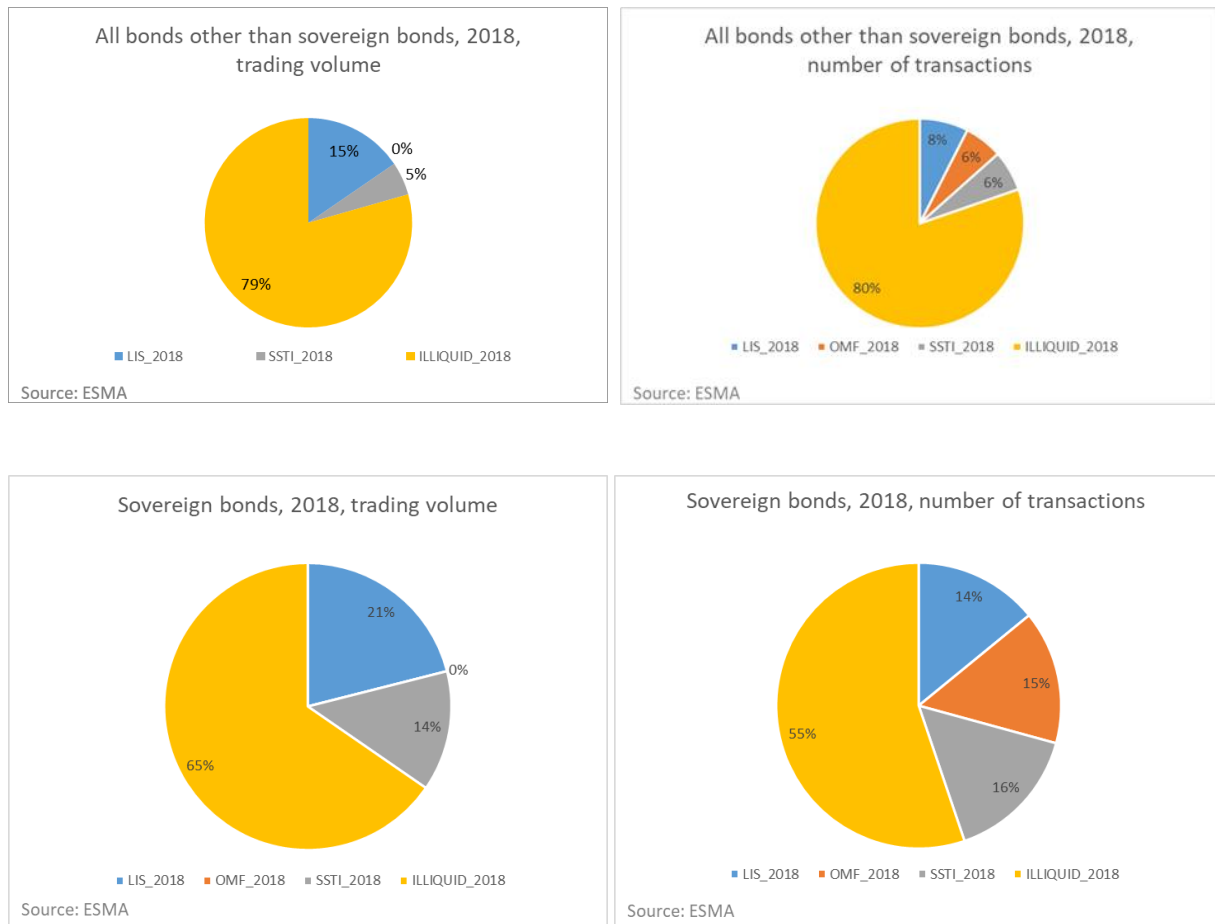
FIGURE 5 - NOTIONAL TRADING VOLUMES UNDER WAIVERS, PER ASSET CLASS, 2017



17. Last but not least, as can be seen from Figure 6 below, the use of waivers is quite different between sovereign bonds and other types of bonds. Whereas for other types of bonds nearly 80% of the trading volumes were executed under the illiquid waiver, the illiquid waiver for sovereign bonds covered only 65% of the total notional trading volume (and only 55% of transactions). For sovereign bonds the use of other waivers was more important than for other types of bonds. In particular, 21% of notional trading volume and 14% of transactions for sovereign bonds was executed under the LIS waiver compared to 15% of notional trading volume and 8% of number of transactions for other types of bonds. As far

as the SSTI waiver is concerned, 16% of notional trading volume was executed under the SSTI waiver for sovereign bonds compared to 6% for other types of bonds.

FIGURE 6 - TRADING VOLUME AND NUMBER OF TRANSACTIONS PER WAIVER TYPE FOR SELECTED ASSET CLASSES, 2018



18. Therefore, ESMA recommended in the CP to move to stage 2 for bonds.

3.2 Feedback from the consultation

19. The large majority of respondents, including major bond markets and bond associations, were in favour of the move to stage 2 for bonds. They supported the proposal since the percentage of liquid bonds would remain, under stage 2, far below ESMA’s original estimate of around 2% of bonds deemed liquid in the Union (this estimate was performed when designing RTS 2) and increasing the number of bonds considered to be liquid will improve overall real-time market transparency.

20. Those against the proposal supported their view with the following arguments:

- the need to improve first data quality in the post-trade transparency before broadening its scope;
- the need of a tape facilitating access to the data and providing a comprehensive overview of the market activity to all market participants;
- the uncertainties around Brexit and the lack of visibility on possible agreements between UK and EU regulators;
- the uncertainties arising from the current Covid-19 crisis.

3.3 ESMA's assessment and recommendations

21. In light of the strong support received in response to the consultation and considering that the move from stage 1 to stage 2 will increase the transparency in the market only marginally, ESMA maintains its proposal to move to stage 2 in order to make progress towards a more transparent trading environment for bonds.
22. Furthermore, the expected effect of Brexit will be a further decrease of the number of liquid bonds in the EU. Therefore, while waiting for any remaining Brexit uncertainties to be resolved does have some merit, ESMA considers that in this case Brexit should not serve as an argument to delay moving to stage 2 and with that to a more transparent environment.
23. Last but not least, the need for better data quality before taking the decision to move to stage 2 also cannot be considered as a valid argument against moving to the next stage. The quarterly liquidity assessments for bonds are published since 2018 and constant improvements have been made by ESMA with the cooperation of NCAs and market participants to identify data quality issues and promptly correct them.

4 Trade percentile for the determination of the pre-trade SSTI threshold

4.1 General approach and legal framework

24. Article 17 of RTS 2 requires ESMA to assess by 30 July of each year if the percentile to be used for the pre-trade SSTI thresholds for non-equity instruments should be changed and set to the value provided for the following stage.
25. Considering in particular that ESMA still has to provide the first annual transparency calculations for all non-equity instruments other than bonds, ESMA considered it premature in the CP to assess whether it is appropriate to move to stage 2 for those instruments at this point in time. The completeness and the quality of the data were insufficient to perform the annual transparency calculations in the year 2019 which has forced ESMA to postpone the first publication of transparency calculations for those instruments. In the absence of



data to conduct solid impact analysis ESMA considered that, at this point in time, it was not in a position to propose the move to the following stage for the pre-trade SSTI thresholds for other non-equity instruments than bonds.

26. However, as far as bonds (excluding ETCs and ETNs) are concerned, ESMA already performed the annual transparency calculations related to the determination of the pre- and post-trade LIS and SSTI thresholds in 2019. Therefore, in the CP, the pre-trade SSTI thresholds for bonds (excluding ETCs and ETNs) using the 40th percentile instead of the 30th percentile on the basis of data reported to FITRS for the year 2018 was simulated.
27. The increase in absolute value of the SSTI was relevant mainly for sovereign bonds and covered bonds. Considering that both types of bonds usually trade in big sizes, ESMA considered it appropriate to move to stage 2.

4.2 Feedback from the consultation

28. The large majority of the respondents agreed with ESMA assessment not to move to stage 2 for non-equity instruments other than bonds, mainly due to the fact that data quality is still limited, and no annual transparency calculations have been performed yet. Therefore, such decision could not be taken on an informed basis.
29. As far as the proposal for bonds is concerned, the large majority of respondents, including major bond trading venues and associations, were in favour of moving to stage 2.
30. However, a few respondents, despite being in favour of the move, suggested to wait until 2021 to move to stage 2 due to the current macroeconomic environment affected by the Covid-19 crisis and Brexit.

4.3 ESMA's assessment and recommendations

31. Regarding first non-equity instruments other than bonds, the respondents concurred with ESMA that it would be premature to move to stage 2 for the pre-trade SSTI thresholds. ESMA agrees that all efforts should focus on improving the quality and completeness of data reporting to ensure that annual calculations are published in due course and based on solid input.
32. This year, ESMA therefore does not recommend moving to stage 2 and using the 40th percentile for the calculation of the SSTI thresholds of non-equity financial instruments other than bonds (i.e. SFPs, interest rate derivatives, commodity derivatives, credit derivatives, C10 derivatives, CFDs, emission allowances and emission allowance derivatives).
33. With respect to bonds, while there is a consensus for moving to the next stage (S2), a minority of respondents raised questions about the timing of this amendment. ESMA appreciates that Brexit and the Covid-19 crisis create some uncertainties for market participants and financial markets in general. However, despite this particular context,



ESMA does not consider it appropriate to delay the moving to the next stage by one additional year.

34. As demonstrated in the CP, the general transparency in the bond market remains limited contradicting declared policy objectives. A recent study from Finansinspektionen (FI) presented in the CP even concluded that for interviewed market participants, the situation has even deteriorated with the advent of MiFID II. ESMA therefore considers it important to move the next stage (S2) without delay.
35. In addition, while this amendment and the consequent increases of SSTI thresholds for bonds should strengthen transparency in the bond market, ESMA is confident that this should not create significant disruption for market participants. The MiFIR framework offers other possible pre-trade waivers which in combination will continue to offer protection to a large proportion of orders in bonds (see section above on the liquidity for bonds).
36. Therefore, ESMA maintains its proposal from the CP, to move to stage 2 for the pre-trade SSTI for bonds but not for other non-equity instruments.

5 Annexes

5.1 Annex I

Legislative mandate to develop technical standards

Article 17 of COMMISSION DELEGATED REGULATION (EU) 2017/583 (RTS 2)

Provisions for the liquidity assessment for bonds and for the determination of the pre-trade size specific to the instrument thresholds based on trade percentiles

[...]

4. ESMA shall, by 30 July of the year following the date of application of Regulation (EU) No 600/2014 and by 30 July of each year thereafter, submit to the Commission an assessment of the operation of the thresholds for the liquidity criterion 'average daily number of trades' for bonds as well as the trade percentiles that determine the size specific to the financial instruments covered by paragraph 8. The obligation to submit the assessment of the operation of the thresholds for the liquidity criterion for bonds ceases once S4 in the sequence of paragraph 6 is reached. The obligation to submit the assessment of the trade percentiles ceases once S4 in the sequence of paragraph 8 is reached.

5. The assessment referred to in paragraph 4 shall take into account:

- (a) the evolution of trading volumes in non-equity instruments covered by the pre-trade transparency obligations pursuant to Article 8 and 9 of Regulation (EU) No 600/2014;
- (b) the impact on liquidity providers of the percentile thresholds used to determine the size specific to the financial instrument; and
- (c) any other relevant factors.

6. ESMA shall, in light of the assessment undertaken in accordance with paragraphs 4 and 5, submit to the Commission an amended version of the regulatory technical standard adjusting the threshold for the liquidity criterion 'average daily number of trades' for bonds according to the following sequence:

- (a) S2 (10 daily trades) by 30 July of the year following the date of application of Regulation (EU) No 600/2014;
- (b) S3 (7 daily trades) by 30 July of the year thereafter; and
- (c) S4 (2 daily trades) by 30 July of the year thereafter.

7. Where ESMA does not submit an amended regulatory technical standard adjusting the threshold to the next stage according to the sequence referred to in paragraph 6, the ESMA assessment undertaken in accordance with paragraphs 4 and 5 shall explain why adjusting

the threshold to the relevant next stage is not warranted. In this instance, the move to the next stage will be postponed by one year.

8. ESMA shall, in light of the assessment undertaken in accordance with paragraphs 4 and 5, submit to the Commission an amended version of the regulatory technical standard adjusting the threshold for trade percentiles according to the following sequence:

(a) S2 (40th percentile) by 30 July of the year following the date of application of Regulation (EU) No 600/2014;

(b) S3 (50th percentile) by 30 July of the year thereafter; and

(c) S4 (60th percentile) by 30 July of the year thereafter.

9. Where ESMA does not submit an amended regulatory technical standard adjusting the threshold to the next stage according to the sequence referred to in paragraph 8, the ESMA assessment undertaken in accordance with paragraphs 4 and 5 shall explain why adjusting the threshold to the relevant next stage is not warranted. In this instance, the move to the next stage will be postponed by one year.



5.2 Annex II

Draft technical standards

COMMISSION DELEGATED REGULATION (EU) No .../..

of [date]

amending Delegated Regulation (EU) 2017/583 to adapt the liquidity thresholds and trade percentile used to determine the size specific to the instrument applicable to certain non-equity instruments

(Text with EEA relevance)

THE EUROPEAN COMMISSION

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012⁴,

Having regard to Commission Delegated Regulation (EU) 2017/583⁵ of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council⁶ with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives and in particular Article 17 thereof,

Whereas:

- (1) Commission Delegated Regulation (EU) 2017/583 sets out the transparency regime applicable to bonds, structured finance products, emission allowances and derivatives. In order to ensure a smooth implementation of this new regime, the application of certain transparency thresholds has been phased-in allowing in practice to gradually broaden the application of the new transparency obligations. This concerns, in particular the 'average daily number of trades' criterion used for the determination of bonds for which there is a liquid market as well as the trade percentiles used to determine the size specific to the instrument which allow for pre-trade transparency obligations to be waived.
- (2) Under this phased-in approach, moving to the next stage is not automatic but based on an assessment that the European Securities and Markets Authority (ESMA) is required

⁴ OJ L 173, 12.6.2014, p. 84.

⁵ Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives (OJ L 87, 31.3.2017, p. 229–349).

⁶ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84–148).



to submit annually to the Commission. The ESMA's assessment has to analyse the evolution of trading volumes for the concerned financial instruments under the current stage and to anticipate the possible impact a move to the next stage could have on both available liquidity and market participants. If appropriate, ESMA is required to submit, together with its report, a revised regulatory standard to move to the next stage.

- (3) ESMA has conducted its assessment and considers that it is appropriate to move to stage S2 and accordingly amend Commission Delegated Regulation (EU) 2017/583 for bonds for which there is a liquid market and the size specific to the instrument for bonds. This should increase the level of transparency available in the bond market without a negative impact on liquidity. ESMA considers that at this point in time there is not enough evidence to move to stage S2 for other classes of financial instruments.
- (4) This Regulation is based on the draft regulatory technical standards submitted by ESMA to the Commission.
- (5) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council⁷,

HAS ADOPTED THIS REGULATION

Article 1

Amendments to Delegated Regulation (EU) 2017/583

Article 17 of Delegated Regulation (EU) 2017/583 is amended as follows:

(a) paragraph 1 is replaced by the following:

‘1. For determining the bonds for which there is not a liquid market for the purposes of Article 6 and according to the methodology specified in Article 13(1)(b), the approach for the liquidity criterion ‘average daily number of trades’ shall be taken applying the ‘average daily number of trades’ corresponding to stage S2 (10 daily trades).’;

(b) paragraph 3 is replaced by the following:

⁷ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).



‘3. For determining the size specific to the financial instrument for the purposes of Article 5 and according to the methodology specified under point (i) of Article 13(2)(b), the approach for the trade percentile to be applied shall be used applying the trade percentile corresponding to the stage S2 (40th percentile).

For determining the size specific to the financial instrument for the purposes of Article 5 and according to the methodology specified under points (ii) to (iv) of Article 13(2)(b), the approach for the trade percentile to be applied shall be used applying the trade percentile corresponding to the stage S1 (30th percentile).’.

Article 2

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission

The President

Ursula von der Leyen