MiFID II/MiFIR Review Report

MiFID II/ MiFIR review report on the transparency regime for non-equity instruments and the trading obligation for derivatives

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Table of Contents

1 Executive Summary

Reasons for publication

This Final Report covers three mandates of ESMA. More specifically, ESMA is mandated by Article 52(1) to (3) of MiFIR to submit a report to the European Parliament and to the Council on the impact in practice of the transparency obligations established pursuant to Articles 3 to 13. The articles related to equity and equity-like instruments have been addressed in the separate review report published on 16 July 2020[1], and this report covers mainly Articles 8 to 11 MiFIR relating to bonds, structured finance products, emission allowances and derivatives.

Furthermore, Article 52(6) of MiFIR requires ESMA to submit a report to the European Parliament and to the Council on the progress made in moving trading in standardised OTC derivatives to exchanges or electronic trading platforms pursuant to Articles 25 and 28 of MiFIR. This mandate is also covered in the below report.

Under Article 17 of Commission Delegated Regulation (EU) 2017/583 (RTS 2) 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 (ADNTE) threshold used for the quarterly liquidity assessment of bonds, and (ii) the trade percentile used for determining the pre-trade size specific to the financial instrument (SSTI) thresholds. If that move is deemed appropriate, ESMA is required to submit to the Commission an amended version of the regulatory technical standard adjusting the thresholds for the relevant parameters. This review and ESMA's conclusions have been published in a separate report on 23 July 2020[2].

The ESMA review of the MiFIR transparency regime for non-equity instruments has been conducted with the aim of both (i) ensuring that the provisions have delivered on their objectives and (ii) where possible, proposing legislative amendments to ensure more effective application of the rules while simplifying a regime that has proved to be rather complex to apply and supervise in practice. However, the ESMA review does not intend to redefine the general objectives and goals that have been set by co-legislators when deciding on the MiFID II/MiFIR regime.

Contents

It is structured as follows: after a brief introduction in Section 2, Section 3 tackles the review of Level 1 provisions and starts with the proposals concerning the pre-trade transparency regime for non-equity instruments (Section 3.1) which aim at simplifying the regime and, at the same time, increasing transparency in the markets.

Section 3.2 deals with the post-trade transparency regime. This section concludes that also the level of post-trade real-time transparency remains very limited after the implementation of MiFID II/MiFIR which is exacerbated by the complex deferral regime which is subject to national discretion leading to different rules applying in the Union. In this regard, the ESMA proposals aim at simplifying the regime in order to increase post-trade transparency. Section 3.3 concludes with the trading obligation for derivatives for which ESMA suggests some targeted amendments.

The second part of the paper focuses on the Level 2 review (Section 4). In particular, Section 4.1 refers to ESMA's recommendations already published in the annual review report of the move to stage 2 of (i) one of the parameters to assess bond liquidity and (ii) the percentile used to calculate the pre-trade SSTI thresholds for bonds and other non-equity instruments. The paper concludes with the way forward related to the review of the liquidity assessment and the methodology to determine the pre-trade LIS threshold for commodity derivatives.

Next Steps

This report is submitted to the European Commission and is expected to feed into any review of the transparency regime in MiFIR.

ESMA stands ready to provide any additional technical advice on the legislative amendments suggested in the report.

Disclaimer

Data analyses are based on data from the Financial Instruments Transparency System (FITRS) which is provided by trading venues, approved publication arrangements (APAs) and National Competent Authorities.

Therefore, ESMA has to rely on those reporting entities in respect of the completeness and accuracy of the submitted data. Delayed or incorrect provision of the relevant data may affect the completeness and accuracy of the information.

[1] MiFID II/MiFIR Review Report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares, ref. ESMA70-156-2682 (here).

[2] MiFID II/MiFIR Annual Report under Commission Delegated Regulation (EU) 2017/583 (RTS 2), ref. ESMA70-156-3300 (here).

Acronyms used

ADNA	Average daily notional amount
ADNTE	Average daily number of trades
AIOI	Actionable indication of interest
APA	Approved publication arrangement
CA	Competent Authority
CO	Clearing obligation
CP	Consultation paper
CTP	Consolidated tape provider
DTO	Derivatives trading obligation
ESMA	European Securities and Markets Authority
EU	European Union
FIRDS	Financial Instruments Reference Data System
FITRS	Financial Instruments Transparency System
LIS	Large in scale
MiFID I	Directive 2004/39 of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611/EC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC
MiFID II	Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
MiFIR	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
MTF	Multilateral trading facility
NFC	Non-Financial Counterparties
NCA	National Competent Authority
OMF	Order management facility
OTC	Over-the-counter
OTF	Organised trading facility
RFQ	Request for quote
RTS 2	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
SI	Systematic internaliser
SSTI	Size specific to the financial instrument
SFC	Small Financial Counterparties
SFP	Structured finance product
TOTV	Traded on a trading venue
Q&A	Question and answer

2 Introduction

1. MiFID II/MiFIR requires the European Commission, after consulting ESMA, to submit reports to the European Parliament and the Council reviewing many provisions in MiFID II/MiFIR. This report covers the mandate relating to the impact of the transparency obligations (Article 52(1) to (3) of MiFIR) with a specific focus on non-equity instruments. The report also analyses the changes observed in EU market structures following the entry into application of the trading obligation for derivatives (Article 52(6) of MiFIR) and whether this has effectively led to more derivatives being traded through exchanges or electronic trading platforms.

2. In order to help producing informed proposals of the issues to be considered and addressed in its report to the European Commission, ESMA published a Consultation Paper (CP) on 10 March 2020[3] with an initial assessment of the impact of the transparency obligations for non-equity instruments and of the trading obligation for derivatives seeking stakeholders' views on some suggested amendments to the legal texts. The consultation period had been extended to give stakeholders more time to respond in light of the impact of the Covid-19 crisis on financial markets.

3. ESMA received more than 50 responses to the CP. A summary of the responses received is provided in Annex II and the feedback from market participants is also described in each specific section below.

4. Regarding the more general feedback received, all market participants appeared to share the view that MiFID II/MiFIR has so far failed to achieve its objective to create meaningful transparency for non-equity markets. However, respondents had split views on the required remedial actions to be taken.

5. Those views are described in more details in each specific section below. Two groups of respondents can however be identified.

6. The first group includes a handful of sell-side firms/trade associations. Those respondents stressed the need to maintain the delicate balance between transparency and liquidity, insisting on the role played by banks and SIs putting their capital at risk. In their view, transparency should not be considered as an objective in itself but rather the mean to ensuring market liquidity, efficiency and integrity. Rather than embarking on a complex MiFIR review, they considered that the priority should be given to working on accessibility, readability and quality of market data which would already significantly improve non-equity transparency. For them, ESMA should refrain from reviewing the transparency requirements based on such inaccurate and incomplete data and in particular in the context of both the Covid-19 crisis and Brexit which events should rather call for caution as well as a robust impact assessment.

[3] Consultation Paper on MiFID II/ MiFIR review report on the transparency regime for non-equity instruments and the trading obligation for derivatives, ref. ESMA70-156-2189 (here).

7. A much larger group of respondents, including trading venues and proprietary traders, broadly supported ESMA's proposal for a simplified pre-trade transparency regime, including by deleting the SSTI waiver, and a more demanding post-trade transparency regime with deferrals being limited to a much smaller percentage of transactions and for a much shorter period of time. Within this group, diverse views were expressed on the opportunity of a consolidated tape. More general comments on the need to improve the standardisation, the accessibility, and the quality of MiFIR market data were made by some data providers/analysts[4].

8. Other points of concerns were raised by market stakeholders in relation to:

    a. The unlevel playing field between trading venues and fintech and technology providers operating multilateral systems outside the regulatory perimeter;

    b. Post-trade name give-up arrangements used on certain Multilateral Trading Facilities (MTF) and Organised Trading Facilities (OTF), which should be forbidden to allow market participants to access all trading venues and in particular those that are offering trading in derivatives subject to the trading obligation;

    c. The necessity to extend the derivative trading obligation to bespoke instruments that have limited bespoke qualities (e.g. Look-alike products);

    d. Market making agreements, which duplicate the monitoring and reporting requirements for Primary Dealers (i.e. for platforms that are considered "designated platforms" by the relevant Debt Management office/sovereign issuer and where Primary Dealers have agreed to satisfy their quoting obligations on those platforms);

    e. RTS 26 on straight-through processing where the deadline for the clearing of electronically and non-electronically traded derivatives is considered overly demanding, damaging innovation, restriction competition and potentially increasing risks;

    f. Certain listed structured products that are insufficiently transparent (sprinters, turbos, warrants funds and contracts for difference) and that suffer from significant conflicts of interest with quotes provided by a single market maker affiliated with the issuer;

    g. The best execution reports required under RTS 27 and RTS 28 and which currently do not provide sufficient benefits to investors to justify the cost of producing these reports.

9. While certain of those topics are covered within the sections below, most of these issues are not directly related to the MiFIR transparency regime and are therefore not covered in

[4] Issues regarding the possibility to create a consolidated tape for non-equity instruments or more generally the quality of and access MiFIR pre-trade and post-trade data are dealt with as separate workstreams and are not covered in this report.

this review report. ESMA is working on several review reports in parallel and market participants are invited to refer to the other and more relevant reports for further discussion on these topics.

3 Level 1 review

3.1 Pre-trade transparency regime for trading venues in respect of non-equity

3.1.1 Assessment of the current level of pre-trade transparency

3.1.1.1 General approach and legal framework

10. The pre-trade transparency regime for non-equity instruments shares some similarities with the pre-trade transparency regime for equities. However, it also includes some specific features to accommodate some distinct characteristics of non-equity trading compared to equity trading and, in particular, the use of different trading protocols and the heterogeneity of asset classes and instruments covered.

11. Article 8 of MiFIR requires market operators and investment firms operating a trading venue to make public current bid and offer prices and the depth of trading interests at those prices advertised on their systems for bonds, structured finance products (SFPs), emission allowances and derivatives (non-equity instruments). This information must be made available to the public on a continuous basis during normal trading hours and is calibrated for different types of trading systems, as further specified in Annex I of Commission Delegated Regulation (EU) 2017/583 (RTS 2). Moreover, the MiFID Quick Fix[5] also complemented the transparency regime for non-equity instruments with specific rules applicable to package and exchange for physical orders.

12. Compared to the pre-trade transparency requirements for equity instruments, Article 8 of MiFIR includes some different specific provisions. Firstly, and most notably, it introduces an exemption from pre-trade transparency obligations for "derivative transactions of non-financial counterparties which are objectively measurable as reducing risks directly relating to the commercial activity of the non-financial counterparty or of that group". This "hedging exemption" was introduced during the Trilogue of the Level 1 negotiations, and noting that, in contrast with the transparency regime for equity instruments, the non-equity transparency regime does not provide for a dedicated negotiated transaction waiver.

13. Secondly, in addition to order-book, quote-driven, hybrid and periodic auction trading systems, the MiFIR transparency regime introduces two new types of trading systems (i.e. voice trading systems and request-for-quote (RFQ) systems) to be taken into account

[5] Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories (OJ L 175, 30.6.2016, p. 1–7).

specifically for the calibration of pre-trade transparency requirements. This reflects the significance of alternative trading patterns in non-equity instruments and the aim of MiFIR to ensure that those particularities are taken into account, thereby contributing to the MiFID II/MiFIR objective of having more non-equity trading taking place in a transparent way on multilateral venues.

14. Similar to equity instruments, Article 9 of MiFIR recognises the need for waivers from pre-trade transparency obligations for non-equity instruments. However, in order not to undermine the sound transparency framework and the efficiency of price formation, and as clarified by Recital (14) of MiFIR, exemptions from pre-trade transparency should be available only in certain limited and clearly defined cases.

15. Article 9 of MiFIR provides for five different types of waivers. As for equity instruments, pre-trade transparency requirements may be waived for orders that are large in scale (LIS) compared with the normal market size and for orders held in an order management facility (OMF) of the trading venue pending disclosure (Article 9(1)(a) of MiFIR).

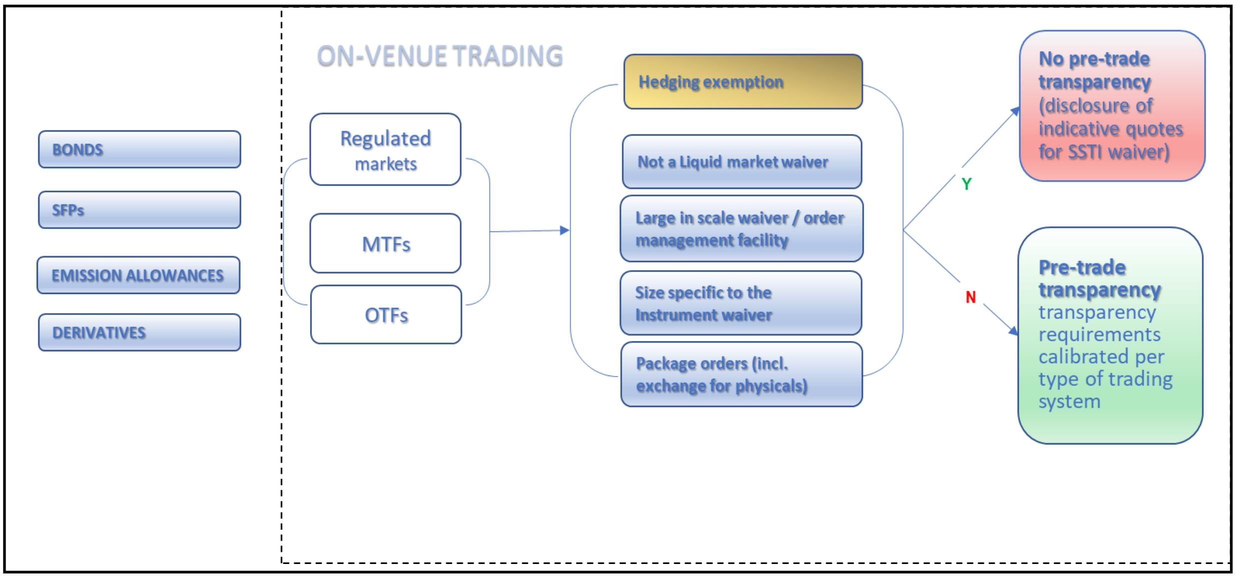
16. MiFIR introduces a pre-trade transparency waiver for actionable indications of interest (AIOIs) in RFQ and voice trading systems above a size specific to the financial instrument (SSTI) which would expose liquidity providers to undue risks and takes into account whether the relevant market participants are retail or wholesale investors (Article 9(1)(b) of MiFIR). In ESMA's understanding this waiver aimed at accommodating and incentivising the move from OTC trading to on-venue trading. The SSTI waiver is only a partial waiver as Article 8 of MiFIR requires a trading venue benefitting from such a waiver to still make available some minimum level of pre-trade transparency information. In such circumstances, the trading venue is required to make public at least indicative pre-trade bid and offer prices which are close to the price of the trading interests advertised through its systems and as further defined in Article 5(2) of RTS 2.

17. Pre-trade transparency obligations may also be waived for non-equity financial instruments for which there is not a liquid market (Article 9(1)(c) of MiFIR). This waiver is not available for derivatives that are subject to the trading obligation for derivatives (DTO) which is consistent with the purpose of the DTO of allowing for efficient competition between eligible trading venues, including through displayed pre-trade information.

18. To address some specific trading patterns not initially accommodated in the first version of MiFIR, the MiFID Quick Fix of June 2016 complemented the non-equity transparency regime by introducing new waivers for (i) orders for the purpose of executing an exchange for physical or EFP (Article 9(1)(d) of MiFIR) and for (ii) package orders where at least one component is above LIS or does not have a liquid market, provided that the package order does not have a liquid market as a whole or where all components are executed on a RFQ or voice trading system and are above SSTI (Article 9(1)(e) of MiFIR).

19. Figure 1 below provides for an overview of the pre-trade transparency requirements for trading venues.

FIGURE 1 THE PRE-TRADE TRANSPARENCY REGIME FOR TRADING VENUES



20. The procedure to be followed by an NCA before granting a waiver is similar to the one established for equity instruments.

21. CAs may also decide to temporarily suspend pre- and post-trade transparency requirements on a trading venue they supervise for a class of bonds, SFPs, emission allowances or derivatives (Articles 9(4) and 11(4) of MiFIR, see Section 3.2.2 for more details).

22. The MiFIR transparency regime for non-equity instruments has been further calibrated through Level 2 measures. In particular, RTS 2 calibrates the pre-trade transparency requirements applicable to the different types of trading systems and determines which orders or quotes may be eligible for one of the waivers described above.

23. Notably, RTS 2 specifies how to determine whether a financial instrument has a liquid market. Three main approaches, depending on the type of instrument, are set out: (i) the liquidity status for bonds is determined quarterly on an instrument-by-instrument basis, (ii) for most other instruments the liquidity status is determined on an annual basis and in the large majority on a class of instruments basis; and (iii) lastly, the static determination of the liquidity status in the RTS itself is provided for the remaining asset classes (i.e. all foreign exchange derivatives are deemed illiquid for the time being; all equity derivative instruments, excluding swaps and portfolio swaps, are considered liquid and securitised derivatives are all deemed liquid).

24. RTS 2 also sets out the methodology for determining the thresholds for the SSTI- and LIS-waivers (pre-trade transparency) and deferrals (post-trade transparency) on an annual basis. As a general rule, the pre-trade SSTI and LIS-thresholds are respectively lower or equal to the post-trade SSTI and LIS-thresholds. Moreover, the SSTI thresholds are lower than or equal to the LIS thresholds for waivers and deferrals respectively. RTS 2 sets out different approaches for determining the SSTI- and LIS-thresholds: (i) a percentile

approach for bonds as well as for the most liquid derivative classes; (ii) an approach based on the average daily notional amount traded for most liquid equity derivatives; and (iii) fixed thresholds for illiquid classes of instruments.

25. The Commission introduced a phase-in for the liquidity assessment of bonds and the pre-trade SSTI-thresholds that are determined based on the percentile approach. The phase-in consists of 4 stages gradually lowering the criteria for determining a bond as liquid and increasing the pre-trade SSTI-thresholds.

General approach

26. In the CP, ESMA assessed the pre-trade transparency regime along three dimensions. Firstly, by comparing pre-trade transparency post-MiFID II to the level of pre-trade transparency prior to MiFID II. Secondly, by comparing the notional trading volume and number of transactions traded on venue compared to the volume and number of transactions not executed on-venue. And thirdly, by assessing the types of waivers used across the different waiver types, overall and per asset class.

27. Concerning the first dimension, while there had been no EU-wide transparency regime for non-equity instruments prior to MiFID II some individual jurisdictions in the Union (e.g. Italy, France and Greece), already had a pre-trade transparency regime for (at least some) non-equity instruments. Furthermore, most trading venues (regulated markets and MTFs) in other jurisdictions trading non-equity instruments published some information about buying and selling interests in non-equity instruments traded on their platforms. It should be noted that overall the trading volume of non-equity instruments traded OTC, and hence not subject to pre-trade transparency, was very high under MiFID I.

28. Concerning the second dimension assessing the notional trading and notional amount traded on venue and OTC since MiFID II, ESMA concluded in the CP that the overall level of pre-trade transparency after MiFID II/MiFIR appeared to be limited due to (i) the high share of financial instruments benefitting from the illiquid waiver and (ii) the high market share of transactions concluded OTC or on SIs (in particular in terms of notional amount, close to 30% whereas in terms of number of transactions, 90% of transactions were concluded on trading venues, in particular regulated markets). More generally, the analysis indicated that the average transaction size for OTC and SI trades is significantly higher than for on-venue trades. ESMA also noted that the situation significantly differed across asset classes. For some asset classes, a significant amount of trading, due to different reasons, is executed on trading venues (e.g. commodity derivatives, interest rate derivatives), whereas for other asset classes only little trading activity in terms of notional amount is concluded on trading venues (e.g. bonds and credit derivatives). However, in terms of number of transactions, with the exception of credit derivatives, most trading activity is on-venue, reconfirming the initial observation that trading activity on-venue focusses in particular on many transactions of a smaller size compared to OTC trading.

29. ESMA explained that the relevance of on-venue trading activity for interest rate derivatives and commodity derivatives, in terms of both notional amount and number of transactions, could be explained by the fact that the strict interpretation of the traded on trading venue

(TOTV) concept (see dedicated section below) seems to exclude an important part of OTC derivative transactions from the scope of the transparency regime. In addition, in the case of interest rate derivatives, the importance of on-venue trading reflects the important share of typical ETD contracts, such as interest rate futures as well as the application of the derivative trading obligation for certain fixed-to-float single currency interest rate swaps, even if the interest rate derivatives subject to the trading obligation are offered by MTFs and OTFs. Last but not least, this result might also be exacerbated by data quality issues. In this regard, ESMA is committed to continue working with NCAs and market participants to improve data quality which is key for the performance of the transparency calculations.

30. Concerning the third dimension, the use of waivers, ESMA highlighted in the CP a link between the liquidity status of an instrument (as determined under the methodology of RTS 2) and the overall notional trading volume being subject to pre-trade transparency. This is also reflected in the use of waivers, where for asset classes with mostly illiquid instruments, the illiquid waiver is mainly used. While most waiver notifications received by ESMA were for LIS waivers, more than 75% of the notional trading volume concluded under a waiver benefitted from an illiquid waiver.

31. As far as the other types of waivers are concerned, ESMA noted that only little trading volumes were executed under the SSTI, OMF, package order/EFP waivers and the hedging exemption. In terms of number of transactions, the OMF waiver was significantly used for equity derivatives and many transactions in commodity derivatives benefitted from the hedging exemption.

32. Overall, ESMA considered that the level of pre-trade transparency in non-equity markets remained limited following the application of MiFID II resulting in real-time transparency being the exception rather than the norm.

33. ESMA considered in the CP how the level of pre-trade transparency may be increased. One possibility considered was to lower the thresholds for determining the liquidity status of (classes of) instruments, via an amendment of RTS 2, thereby resulting in a higher share of liquid instruments, which would not be eligible for an illiquid waiver. At the same time ESMA recognised that for non-equity instruments other than bonds, the first regular transparency calculations had not yet been published[6] and that these calculations may already result in a higher share of liquid instruments. Moreover, ESMA stressed that there remain data quality issues which, at times, might undermine the quality and validity of the results.

34. Finally, ESMA saw benefit in making the Level 1 text significantly less complex by considering reducing the number and scope of available waivers.

[6] The first regular calculations were published on 15 July 2020 [link].

3.1.1.2 Feedback to the consultation

35. In the CP ESMA asked stakeholders about: (i) the benefits or impacts of increased pre-trade transparency for non-equity markets and how such effects could be achieved/mitigated via changes to the Level 1 text; and (ii) proposals for improving the level of pre-trade transparency and whether a simplification of the regime would improve such pre-trade transparency.

36. Concerning the first question, stakeholders' views were split. In particular, on the one hand trading venues considered that a higher level of pre-trade transparency would be beneficial and would limit the negative impact of fragmented markets and increased price competition by allowing new liquidity providers to enter the markets. Those respondents were of the view that a higher share of instruments should be considered to have a liquid market. On the other hand, the sell-side did not support Level 1 changes to achieve a higher level of pre-trade transparency and suggested that more time should be given to the new regime to settle in.

37. Many respondents who were not in favour of increased pre-trade transparency considered that ESMA should focus on post-trade transparency and on improving data quality rather than the pre-trade transparency regime. Those respondents were concerned that a higher level of pre-trade transparency would result in information leakage and expose liquidity providers to predatory trading. Furthermore, those respondents were of the view that there was no demand for more pre-trade transparency since wholesale market participants already have access to indicative streams or composite feeds. They also insisted on the fact that RFQ responses and the SI quotes are irrelevant for market participants since most quotes are tailor-made and making them public information would not provide meaningful information.

38. Concerning proposals to increase the level of pre-trade transparency, a number of stakeholders did not consider it necessary to simplify the legal framework at this stage. Proposals made by stakeholders in favour of more pre-trade transparency included: (i) requiring all trades in bonds and securitised derivatives below 100,000 EUR to be concluded on lit trading venues; (ii) removing the SSTI-waiver and in parallel lowering the LIS-threshold; (iii) removing the illiquid waiver; (iv) removing the concept of TOTV; and (v) increasing the number of liquid instruments (e.g. by declaring that derivatives subject to the clearing obligation are liquid or by moving earlier to stage 4 of the phase-in for bonds).

39. Finally, a number of additional proposals on the pre-trade transparency regime were made, including: (i) recalibrating the determination of a liquid market and the LIS-thresholds for non-equity instruments in RTS 2, in particular for commodity derivatives; (ii) introducing a negotiated trade waiver for non-equity instruments to cover bilaterally negotiated transactions, especially in commodity derivatives; (iii) allowing for lower transparency thresholds in highly volatile market conditions to facilitate orderly trading and hedging.

3.1.1.3 ESMA's assessment and recommendations

40. ESMA takes note of the mixed feedback received by stakeholders. While ESMA concurs with the view that it is important to improve the post-trade transparency regime, ESMA does not consider that it prevents the improvement and simplification of the pre-trade transparency regime to achieve meaningful pre-trade transparency that works for the market.

41. In particular, and as presented in the following sub-sections, ESMA therefore recommends a number of targeted changes, and in particular to remove the SSTI waiver and, in exchange, to lower the LIS-threshold thereby compensating for potential negative effects. This would require an amendment of the Level 1 text as well as of RTS 2 to delete the references to the SSTI and lower the LIS-threshold. Furthermore, ESMA recommends replacing the reference to SSTI in the SI quoting obligations by a reference to the (lowered) LIS-threshold via a Level 1 amendment.

42. ESMA read with interest the additional proposals presented by stakeholders for improving the pre-trade transparency. Some of the proposals, e.g. on TOTV, removal of the SSTI waiver, were already highlighted by ESMA in the CP and are also discussed in this report.

43. Concerning the suggestion to require all trades in bonds and securitised derivatives below EUR 100,000 to be concluded on lit trading venues, ESMA has analysed this proposal. However, the impact of this new requirement would be significantly different across bond types. In particular, covered and convertible bonds have a high percentage of trades below EUR 100,000 executed off-venue (by SIs or OTC), i.e. 85% and 64% respectively in 2019. Similar percentages are recorded for the nominal amount. For these bond types, an obligation to trade on lit trading venues would therefore have significant impact on trading market structures. Therefore, ESMA does not suggest following such a proposal.

3.1.2 SSTI waiver

3.1.2.1 General approach and legal framework

44. The SSTI waiver under MiFIR is only available for a subset of trading systems (RFQ and voice trading systems) and pre-trade transparency is only partially waived since trading venues are required to publish indicative information on the level of prices available. In 2018, the SSTI waiver accounted for 6% of the total waiver notifications and roughly 8% of the notional trading volume executed over that year. This waiver is used particularly for the trading of bonds, credit derivatives and interest rate derivatives.[7]

45. In the CP, ESMA presented several disadvantages of the SSTI waiver, notably:

[7] See section 3.1.2.2 of the CP for a detailed analysis.

a. it adds further complexity to an already complex pre-trade transparency regime by adding another threshold to be assessed;

b. quotes benefitting from the SSTI waiver provide limited transparency to market participants;

c. it grants a preferential treatment to RFQ and voice trading systems compared to other trading systems for no apparent reason;

d. due to the many elements to be assessed, notifications for the SSTI waivers are burdensome to process for all: market participants, NCAs and ESMA.

46. At the same time, ESMA recognised in the CP that it is important to provide liquidity providers with the necessary protection against market risks in thin markets since otherwise, there is a risk that liquidity providers may withdraw from those.

47. Therefore, ESMA proposed in the CP to delete the SSTI waiver and to compensate for this, by lowering the pre-trade LIS thresholds. ESMA considered that such approach would (i) significantly simplify the pre-trade transparency regime while allowing to continue protecting liquidity providers, (ii) provide for a level-playing field across the different trading systems, since the LIS waiver is available for any type of trading systems, (iii) provides more clarity to market participants and (iv) reduces unnecessary bureaucracy.

48. Furthermore, ESMA was seeking feedback from stakeholders on whether (i) the SSTI waiver should be deleted, (ii) with the deletion of the SSTI waiver, the reference to the SSTI should be kept in the SI quoting obligations of Article 18 of MiFIR or it should rather be replaced by a different concept, e.g. the LIS-threshold, in this case the quoting obligations should be applicable up to a certain percentage of the LIS-threshold.

3.1.2.2 Feedback to the consultation

49. With respect to the question of whether the SSTI waiver should be deleted, views of respondents were split.

50. One group of respondents, mainly regulated markets but also representatives of the buy side, proprietary traders and some data vendors, were supportive of the proposal. This group of stakeholders considered that the transparency regime would be significantly streamlined by combining the SSTI and LIS waivers into one size-based waiver and that this would contribute to a more equal level playing field across the different trading systems.

51. A number of respondents supporting the deletion of the SSTI waiver suggested that for fixed income derivatives, the pre-trade LIS thresholds should be determined only on the basis of volume percentiles and no longer take trade percentiles into account. Concerning the LIS determination for equity derivatives, one respondent suggested to introduce an additional class in the upper end of the Average Daily Notional Amount (ADNA) bands to

capture the most liquid EU index futures and index options and to review (and reduce) the level of the pre-trade LIS thresholds for index futures and index options.

52. Another group of respondents, mostly sell-side firms, MTFs and some buy-side firms, opposed the deletion of the SSTI waiver. These stakeholders considered that it is too early for significant changes to the waiver regime before reaching the last stage of the phase-in regime. Further concerns were raised, including that removing the SSTI waiver might expose liquidity providers to undue risks and could incentivise trading to move OTC.

53. Some respondents also called for a cautious approach stressing that while the SSTI waiver may currently be used to a lesser extent, it may become more relevant for bond trading once the phase-in of the liquidity assessments moves to the next stages and more bonds will be determined to have a liquid market. Respondents against the proposal to delete the SSTI waiver recommended to focus first on establishing a post-trade consolidated tape.

54. The majority of those in favour of the deletion of the SSTI waiver also supported the reduction of the LIS threshold.

55. Feedback of stakeholders on how to deal with the reference to the SSTI in the SI-quoting obligations reflected broadly their position expressed on the deletion of the SSTI waiver. Respondents in favour of deleting the SSTI waiver were also supportive of deleting the reference to SSTI in the SI quoting obligations and replacing it by a threshold reflecting a high percentage of the LIS pre-trade threshold. Respondents against deleting the SSTI-waiver were supportive of keeping the concept of SSTI for the SI-quoting obligations. A few respondents in favour of keeping the concept of SSTI suggested using a fixed threshold for the SSTI (at the same absolute level as the current threshold) instead of the current annual determination of the SSTI-level based on trade percentiles.

3.1.2.3 ESMA’s assessment and recommendations

56. Considering the limited pre-trade transparency available to market participants, the complexity of the current transparency regime and the support to the deletion of the SSTI waiver from a substantial number of respondents, ESMA maintains its proposal to delete the SSTI waiver. As a consequence, ESMA also proposes to delete the SSTI package waiver as provided for in Level 1.

57. In order to adequately counterbalance the effects of such proposal, ESMA also suggests lowering the pre-trade LIS threshold. If such proposal was adopted by the Commission and co-legislators, ESMA would further engage with stakeholders to determine appropriate pre-trade LIS thresholds, possibly with different levels depending on the asset class.

58. Regarding the references to the SSTI threshold in Article 18 of MiFIR (quoting obligations for systematic internalisers in non-equity instruments), ESMA has already proposed to delete the first paragraph of Article 18(6) in its review report on systematic internalisers in

non-equity instruments[8]. Regarding the reference in Article 18(10), ESMA proposes to replace it by a reference to the pre-trade LIS threshold, which, as explained in the preceding paragraph, will be recalibrated at a lower level.

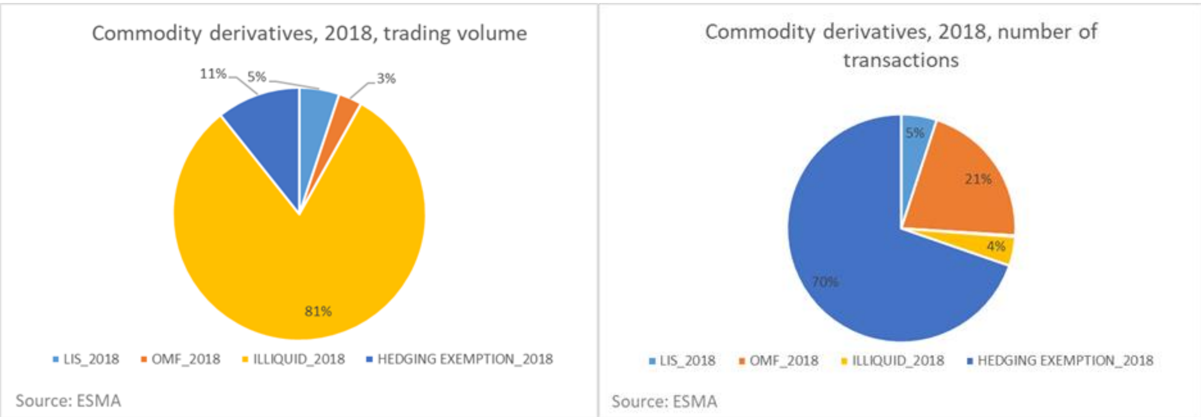
59. These changes require the amendment of Level 1 and, eventually Level 2.

3.1.3 Hedging exemption and negotiated trades

3.1.3.1 General approach and legal framework

60. Based on data received by ESMA, currently the hedging exemption is only used for commodity derivatives. In particular, 11% of the notional trading volume and 70% of the number of transactions in commodity derivatives executed without pre-trade transparency is benefitting from the hedging exemption (see Figure 2 below).

FIGURE 2 USE OF HEDGING EXEMPTION FOR COMMODITY DERIVATIVES COMPARED TO WAIVERS



61. The pre-trade transparency exemption for hedging derivative transactions executed by non-financial counterparties under Article 8 of MiFIR has been a source of uncertainty for some market participants and trading venues as pre-trade transparency typically applies to orders whilst transactions are subject to post-trade transparency.

62. To ensure a converging application of this exemption and to contribute to a level playing field across trading venues, ESMA published a Q&A clarifying that this pre-trade transparency exemption may only be used for the formalisation of pre-arranged derivative transactions where (i) at least one of the counterparties to the transaction is a non-financial counterparty, (ii) the transaction is in derivative instruments, and (iii) the transaction results in reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group. ESMA further clarified that the exemption is not applicable to orders and quotes.

[8] MiFIR report on systematic internalisers in non-equity instruments, ref. ESMA70-156-2756 (here).

63. ESMA considers more clarity and legal certainty should be provided for the application of the hedging exemption and asked in the CP whether the exemption provided for in Article 8 of MiFIR should be turned into a pre-trade transparency waiver under Article 9(1) of MiFIR.

64. The scope of such a new pre-trade transparency waiver for negotiated transactions would mirror the conditions currently set out in Article 8 for the pre-trade transparency exemption. It would apply to pre-arranged or negotiated transactions in derivatives where at least one counterparty to the transaction is a non-financial counterparty and where the transaction results in reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group.

3.1.3.2 Feedback to the consultation

65. A large majority of respondents representing a variety of stakeholders, including trading venues, energy traders, large sell side firms, did not support the proposal to turn the hedging exemption into a negotiated trade waiver, stressing that this would increase paperwork and procedural obligations, thereby outweighing any potential benefit that the waiver approach may bring. Most of those respondents however supported either extending the hedging exemption in Article 8 of MiFIR to financial counterparties or introducing a broadly available negotiated trade waiver under Article 9(1) of MiFIR on top of the hedging exemption, or both, so that all participants can manage risks arising from activity in the physical market and more trades can be brought on venue for clearing purposes.

66. A smaller group of respondents supported turning the hedging exemption into a negotiated trade waiver for the sake of clarity and legal certainty. They had split views as to whether this negotiated trade waiver should cover all derivatives or commodity derivatives only.

3.1.3.3 ESMA's assessment and recommendations

67. ESMA took note of the feedback received from stakeholders and, on further consideration, agrees that turning the hedging exemption into a negotiated trade waiver may be a source of additional complexity for trading venues that would not be outweighed by sufficient additional benefits. ESMA will therefore not take forward the proposal to turn the hedging exemption under Article 8 of MiFIR into a negotiated trade waiver under Article 9(1) of MiFIR.

68. ESMA also considered the suggestions made to extend the hedging exemption to financial counterparties. However, and in line with the general thrust of this report aiming at improving transparency in non-equity instruments, ESMA does not consider that it would be appropriate to take any step that would impair the level of pre-trade transparency currently available for non-equity instruments. ESMA will therefore not follow-up on the suggestions made to extend the hedging exemption to financial counterparties.

3.1.4 Liquidity determination for bonds

3.1.4.1 General approach and legal framework

69. Article 2(1)(17)(a) of MiFIR establishes the general criteria to be used to determine whether non-equity financial instruments have a liquid market. It clarifies in particular that an instrument should be considered liquid "where there are ready and willing buyers and sellers on a continuous basis, and where the market is assessed in accordance with the following criteria, […]: (i) the average frequency and size of transactions […]; (ii) the number and type of market participants […]; (iii) the average size of spreads, where available".

70. The specific methodology and thresholds to be applied to determine whether a bond is liquid has been further specified under Article 13 of RTS 2. After extensive consultation, ESMA has opted for a dynamic approach often referred to as the Instrument by Instrument Approach (IBIA). The liquidity of bonds is assessed on a quarterly basis and taking into consideration the following parameters: (i) average daily notional amount, (ii) average daily number of trades and (iii) percentage of days traded over the period considered. The calculations are based on the transactions executed in the Union during the preceding calendar quarter.

71. In the CP, ESMA asked markets participants whether the current quarterly liquidity calculation for bonds was appropriate or whether (and how) the liquidity determination of bonds should be simplified and provide for more stable results[9].

3.1.4.2 Feedback to the consultation

72. Respondents expressed a broad variety of views. Overall, though, a majority of respondents appeared to be in favour of making targeted changes to the current methodology rather than undertaking a comprehensive overhaul. Trading venues appeared more concerned about the low number of bonds qualifying as liquid while, for banks, this low number is justified considering the specific market structures and trading patterns of bonds.

73. One area for improvements often mentioned is the quality of data. While respondents welcomed the progress made by all parties, some stressed that many transactions appear not to be, or only partially, reported which impacts the overall number of bonds considered liquid.

74. In order to further improve data quality, many respondents suggested ESMA to collaborate more closely with market participants who could help identifying issues and misreporting. For instance, some respondents invited ESMA to share its data (and not only the results)

[9] In the CP, the question on the methodology used for the liquidity determination of bonds was raised in Q25 within the section on the RTS 2 review. However, since the question of bonds liquidity goes beyond the RTS 2 framework (the definition of what constitutes a liquid market is stipulated in MiFIR), ESMA has therefore decided to integrate the feedback received in the section analysing the review of level 1.

with market participants to allow them to better understand the calculations performed and more easily spot possible anomalies.

75. Some respondents noted that not all bonds have similar liquidity patterns and recommended to apply different tests to bonds, differentiating by bond types (e.g. sovereign bonds, corporate bonds, private placement, emerging markets, high yield, etc…) or ratings (e.g. investment grade vs non-investment grade bonds). Finally, since the liquidity of bonds is very cyclical, some considered that different thresholds could be used depending on the life stage of the bond (e.g. the longer the time to maturity / from issuance, the tighter the thresholds) or to change the frequency of the calculations (e.g. on a monthly basis or to assess liquidity after issuance and over the last month of the bond's life).

76. No specific comments were made regarding the criteria currently used and the concerns raised focused on the values of the liquidity thresholds rather than on the criteria used. However, some suggested to postpone their revision considering the current context (e.g. Covid-19 crisis, Brexit). Some members also invited ESMA to take into account transactions below EUR 100,000 when performing the liquidity calculations. However, ESMA wishes to clarify that those transactions are actually taken into account for the liquidity test but excluded for the purpose of SSTI and LIS computations.

77. Lastly, some respondents suggested to simply abandon the concept of liquidity for bonds and to only calibrate transparency based on the size of transactions.

3.1.4.3 ESMA's assessment and recommendations

78. ESMA welcomes the feedback made which confirmed that the liquidity test, if maintained, should not be substantially changed but, if anything, only subject to targeted adjustments.

79. ESMA acknowledges the remarks made on data quality and other data related issues. While significant progress has been made in this respect over the first years of application of MiFIR, ESMA is aware there is still some margin for improvement and is working continuously with all involved parties to this end.

80. Regarding, more specifically, the bond liquidity test, ESMA welcomes the suggestions made. However, regarding the possibility to differentiate depending on the types of bonds, ESMA considered that this is already somewhat the case since the issuance sizes used to assess liquidity during the first months after issuance of a bond are calibrated to the different types of bonds. Similarly, SSTI and LIS thresholds are calculated per bond types. ESMA does not consider it necessary at this stage to introduce further differentiated treatment between bond types.

81. ESMA is also not convinced about using the rating as a differentiating criterion. Past experiences have shown that using ratings in pieces of EU legislation was not always appropriate and could have unintended consequences. In particular, during a financial crisis, downgrades might create cliff effects for the concerned companies and the use of ratings might therefore introduce procyclical effects for concerned entities.

82. ESMA also agreed that, under an extreme scenario, the first liquid determination might remain applicable for a period of 5.5 months while the liquidity after issuance usually drains within a shorter period. ESMA is however reluctant to revisit the calculation frequency at this stage. Performing the calculations on a quarterly basis was considered the best possible compromise between the need to take into account the cyclicality of bond liquidity, the importance to have a certain degree of stability of the results and the reporting processes and infrastructures to be set to achieve these objectives. ESMA does not consider that the comments have presented new arguments in this respect and is therefore minded maintaining the current calculation frequency.

83. Many respondents also suggested that transactions below EUR 100,000 should be taken into account when performing the liquidity calculations. However, as mentioned above, ESMA would like to clarify that this is already the case and that transactions below EUR 100,000 are only excluded for the calculation of the SSTI and LIS thresholds.

84. Regarding the possibility to consult stakeholders, ESMA recognises that market participants have not only very valuable knowledge of the fixed income markets but also access to other sources of data which could allow to cross-check ESMA calculations. However, ESMA remains sceptical about introducing a mandatory consultation before the publication of the transparency results for bonds. Not only would this raise some confidentiality issues, but it would also require reconsidering the publication timeline and postponing the publication date. The consultation has already highlighted the volatile liquidity profile of bonds and such a postponement does not appear appropriate.

85. ESMA however intends, where appropriate or necessary, to check with relevant stakeholders some of the data or results. Market participants are also invited to continue submitting comments they might have on the published results since ex post verifications and comments are always very helpful and contribute to the general increase of data quality.

86. In conclusion, having carefully considered the comments made, ESMA sees merit in changing the current methodology to determine liquid bonds.

87. As highlighted in the CP, less than 0.5% of bonds are liquid which means in practice that more than 99.5% of bonds are not subject to pre-trade transparency (unless the CA has not allowed trading venues within its jurisdiction to use this waiver, which is the exception rather than the norm in the EU). The transparency regime is therefore currently not ensuring a meaningful level of pre-trade transparency in those markets.

88. With the goal to increase the level of transparency available to market participants, different approaches could be considered. The liquidity determination test could be removed and a simplified regime could be created relying only on the LIS threshold. This approach would require a change of Level 1. Alternatively, Level 2 could be changed, so that ESMA would move directly to stage 4 (from stage 1 or 2) in RTS 2 and thus, increase the number of liquid bonds. Another option, which again would only require a change of RTS 2, would be to perform the liquidity assessment by using a different liquidity measure, such as the issuance size parametrised for each bond type. However, any change should

only be made following a detailed impact analysis, also taking into account the consequences of Brexit.

3.1.5 Emergence of new trading systems and inconsistent classification of trading systems

3.1.5.1 General approach and legal framework

89. Article 8(2) of MiFIR sets out a list of different types of trading venues for which pre-trade transparency requirements must be calibrated, including continuous auction order books, quote-driven, hybrid, periodic auction trading and voice trading systems. Annex I of RTS 2 provides a short description of each of those trading systems, as well as of RFQ systems, together with the related pre-trade information to be made public.

90. Concerning RFQ systems, ESMA considered that the description provided in Annex I of RTS 2 proved insufficient to ensure a uniform interpretation of the characteristics of such systems, requiring ESMA to issue various Q&As further clarifying that the definition did not foresee the possibility for a participant initiating an RFQ to further negotiate the quote received from the RFQ respondent and that such second-step negotiation would be considered as a separate trading process outside the initial RFQ session. This clarification of the definition of RFQ systems was necessary in particular with respect to pre-trade transparency as only RFQ systems, together with voice trading systems, are eligible to benefit from the SSTI waiver.

91. When processing pre-trade transparency waiver notifications, ESMA noted that trading venues operate a variety of functionalities that share some of the characteristics of RFQ systems whilst not exactly meeting the description of RFQ systems as set out in Annex I of RTS 2 (e.g. Request-for-Trade (RFT) functionalities[10] or quote posting functionalities (QPF)[11]). Currently those trading functionalities are qualified as "hybrid" systems and offer significant leeway to trading venues to decide on the level of pre-trade-transparency they consider appropriate.

92. With regards to periodic auctions, the description provided in Annex I of RTS 2 was initially intended to cover the long-established opening and closing auctions used to set the price of an instrument at the beginning or end of the trading day as well as intra-day auctions that aggregate liquidity at a couple of points in time throughout the day or that are used to resume trading after a market volatility interruption. However, it may not be adequately calibrated to cover fixed price auctions or frequent batch auctions.

93. ESMA therefore concluded in the CP that the description of trading systems in Annex I of RTS 2 does not appear to provide the necessary flexibility for ESMA to accommodate market developments and the potentially novel regulatory issues they raise, including with respect to pre-trade transparency. As proposed for the equity and equity-like instruments

[10] In an RFT functionality a participant would send an AIOI to another participant without being requested to submit an AIOI.
[11] In a QPF one participant posts AIOIs to other eligible participants.

regime, ESMA therefore proposed that when a new trading system emerges that is not, or was not intended to be, covered by the first five rows of Annex I of RTS 2, ESMA would issue an opinion specifying its definition and the pre-trade information to be made public in accordance with Article 2 of RTS 2 and building on the pre-trade transparency requirements for existing trading systems.

94. In addition, ESMA suggested to amend the last row in Annex I of RTS 2 to review the definition of a hybrid system and to clarify that a trading system that falls within two or more of the five rows, such as a trading system that combines an opening auction followed by continuous order book trading and a closing auction has to comply with the transparency requirements of both combined systems. In other words, in ESMA's view such trading system would have to meet the pre-trade transparency obligations that apply to each relevant row or component part of the overall system. Therefore, ESMA proposed to further clarify the definition of a hybrid system in Annex I of RTS 2.

3.1.5.2 Feedback to the consultation

95. Overall, stakeholders expressed sympathy for regularly reviewing the description of trading systems and the applicable pre-trade transparency requirements.

96. The majority of respondents expressed reservations against ESMA's proposal to issue an opinion clarifying the applicable pre-trade transparency requirement for new trading systems not matching the trading systems specified in Annex I of RTS 2. Most of these stakeholders considered that the current description of trading systems and their respective transparency requirements, as set out in Annex I of RTS 2, are sufficiently calibrated. They were also concerned that issuing an opinion on each new trading system would be a burdensome and time-consuming process, which could negatively impact the innovation capacity of trading venues. This could also result in an increasingly fragmented regulatory treatment of (similar) trading systems without the proper involvement of market participants when developing the opinion. Some stakeholders suggested that issuing such opinions would go beyond ESMA's perimeter and should be rather a task of NCAs in charge of supervising trading venues.

97. Some of the respondents agreed though that the current catalogue of trading systems in Annex 1 of RTS 2 does not fully capture all available trading systems resulting in several systems being classified as hybrid systems and in an inconsistent application of pre-trade transparency across the Union. Those respondents suggested clarifying and extending the current descriptions of trading systems so that they also cover the variations of trading systems observed. ESMA opinions could then serve as a complementary solution, only for new trading systems which are genuinely innovative.

98. A minority of respondents agreed with ESMA's proposal on issuing an opinion for each new trading system and considered it the best approach to ensure both timely review and a level playing field across trading systems operated in the EU. Those respondents stressed the need to allow for the necessary flexibility for new types of trading systems, to consult the operating trading venue and other stakeholders when working on such opinion

and to issue the opinion as soon as possible and in any case no later than six weeks after submission to ESMA.

99. A majority of the respondents to the consultation agreed with ESMA's proposal to further clarify the description and the applicable pre-trade transparency requirements of a hybrid system in RTS 2. Respondents overall agreed that hybrid systems should not be used as a catch-all category or facilitate the avoidance of transparency. In particular, where a hybrid system simply covers a combination of other systems, that system should meet the pre-trade transparency obligations applicable to each relevant component part of the overall trading system.

100. A minority of respondents expressed objections to the proposal and considered that the current definitions and their respective transparency requirements are sufficient. For them, adjustments should be made by introducing new categories of trading systems, leaving the hybrid category untouched in order not to unduly hinder innovation and not to jeopardize the continued existence of established market models currently falling into this category.

101. Similar to the feedback on how to deal with the emergence of new systems, respondents indicated that variations of trading systems could be covered in the description of Annex I of RTS 2 or that ESMA could use a more system agnostic approach which calibrates the transparency requirements based on the price determination process employed.

3.1.5.3 ESMA's assessment and recommendations

102. ESMA took note of the concerns raised by stakeholders on the proposal to amend Level 1 to issue an opinion for each new trading system defining its characteristics and the transparency requirements. ESMA therefore proposes to retain the flexibility provided by the hybrid trading system definition in RTS 2.

103. However, ESMA is of the view that the definition of "hybrid trading systems" would still benefit from a clarification to include only pure hybrid systems (with a bespoke transparency obligation) and to ensure that the definition is not used to avoid transparency obligations.

104. Accordingly, for a future RTS 2 review ESMA intends to clarify that trading systems that combine multiple components should meet the relevant transparency obligations to each separate component part of the overall trading system. All other suggestions to revise the table in Annex I and amend the definitions will also be looked at in detail during a future RTS 2 review which ESMA is planning to conduct in parallel to a review of RTS 1 to ensure alignment across different asset classes where such alignment is deemed adequate. In this context, ESMA points out that a Call For Evidence to gather input and views on practical issues related to the application of RTS 1 and RTS 2 that market participants have identified since the application of MiFID II/ MiFIR was published on 1 September 2020 (link).

105. In conclusion, these proposals require a change of Level 2.

3.1.6 Quality of pre-trade transparency information published

3.1.6.1 General approach and legal framework

106. Article 8 of MiFIR requires trading venues to publish the range of bid and offer prices and the depth of trading interest at those prices in accordance with the type of trading system they operate as specified in Annex I of RTS 2.

107. Moreover, according to Article 18 of MiFIR SIs also have to make public firm quotes for liquid non-equity instruments below the SSTI-threshold. ESMA clarified in a Q&A that SIs – as for equity instruments – are required to make the information available through at least one of the following means: proprietary arrangements, APAs or the facilities of a regulated market which has admitted the financial instrument in question to trading. There is currently no further specification concerning the information (content and format) to be published by SIs. However, ESMA provided guidance in a Q&A that pre-trade transparency information published by trading venues and SIs should allow identifying unequivocally the financial instrument to which the information published refers, for instance via the use of ISINs.

108. Trading venues and SIs are required to make real-time pre-trade data available on a reasonable commercial basis. Moreover, 15 minutes after publication trading venues are required to make the information available free of charge.

109. In the CP, ESMA assessed the quality of pre-trade transparency based on information from trading venues (made available free of charge 15 minutes after publication), APAs (when publishing quotes for SIs) and SIs operating in the Union, taking into account the size of the entities (small and big entities) and the geographical scope of activity (national vs EU-wide). The analysis focused on the asset classes of bonds (both sovereign and other types of bonds), equity derivatives and interest rate derivatives.

110. ESMA had identified shortcomings of pre-trade information published in the Union along two dimensions:

a. Accessibility: (Delayed) pre-trade information is difficult to find and it appears that a number of trading venues and APAs are not complying with the requirement to make available pre-trade data free of charge 15 minutes after publication. There are various challenges for accessing pre-trade data in terms of access restrictions, language issues and formatting of data published. In particular, quotes from SIs can often not be accessed free of charge, including delayed quotes. Finally, many data users challenge whether the data is charged on a reasonable commercial basis.

b. Content: There are various challenges concerning the content of the data published. In particular, the absence of a common standard results in a patchwork of pre-trade information that is difficult to access and compare.

111. In the CP, ESMA highlighted that, as set out in the MiFID II review report on the cost of market data, it would work on supervisory guidance further specifying ESMA's expectations on how trading venues, APAs and SIs should comply with the obligation to publish market data on a reasonable commercial basis and on improving compliance of trading venues and APAs with the obligation to provide market data free of charge 15 minutes after publication.

112. Concerning the remaining issues identified in the area of quality of pre-trade data, ESMA made two proposals in the CP on which feedback from stakeholders was sought: 1) to require SIs to make pre-trade data available free of charge 15 minutes after publication (to ease access to SI-quotes and further strengthen the level playing field between the requirements for trading venues, APAs and SIs concerning market data; and (2) to harmonise the content and format of pre-trade transparency to be published, taking into account the different trading systems operated as well as the specificities of the different non-equity asset classes, to improve the usability of pre-trade data. Both suggestions would require an amendment of the Level 1 text.

3.1.6.2 Feedback to the consultation

113. The great majority of respondents agree with ESMA's proposal to require SIs to make pre-trade data available free of charge 15 minutes after publication. According to these respondents, such obligation would further level the playing field between SIs and trading venues and would also contribute to improving the overall level of pre-trade transparency for all market participants.

114. A few stakeholders supported the proposal under the condition that the obligation would be limited to instruments that are TOTV. Some stakeholders also highlighted that trading venues should not consider that published SI quotes are derived data and charge for it.

115. Some stakeholders expressed reservations against the proposal and stressed the need for carrying out a full cost-benefit analysis covering demand for such a change, the costs of building the system and the creation of any undue risk, before proceeding with this proposal. This group of stakeholders considered that there had been only very limited demand for delayed data and stressed the complexity and costs of implementing such an obligation. Finally, these respondents stressed the different characteristics of trading venues and SIs and considered that Article 18 of MiFIR already exhaustively covers the quoting obligations for SIs.

116. Concerning the proposal to harmonise the content and format of pre-trade transparency disclosed, the majority of respondents to the CP considered that such proposal would be of benefit. However, a number of respondents supporting the proposal stressed the need to limit the number of fields to a minimum, to ensure that the different specificities of non-equity instruments are taken into account and to consult such market participants on the appropriate fields and formats to be included. Some respondents suggested that such standardisation could be developed on the basis of the existing standards for publishing post-trade information.

117. A number of respondents considered that the establishment of a consolidated tape for post-trade data would also support higher quality of pre-trade data since pre-trade transparency relies on high-quality post trade data.

118. About one third of respondents were not supportive of the proposal and stressed that it would be operationally complex to implement. Many of those respondents suggested to focus on improving the quality of post-trade data and some suggested to delete the pre-trade transparency requirements for non-equity instruments, since in their view the information is of little use for market participants given the heterogeneous nature of non-equity markets and the fact that most prices cannot be transposed from one client to another.

119. One respondent suggests requiring the disclosure of pre-trade transparency via APAs as an alternative way to improve the quality of data disclosed.

3.1.6.3 ESMA's assessment and recommendations

120. ESMA took note of the feedback from stakeholders on the proposal to make available data free of charge 15 minutes after publication, in particular the arguments that there had been only very limited demand for delayed data and the complexity and implementation costs this proposal would entail for SIs. ESMA acknowledges that at this stage work should focus on ensuring the compliance of trading venues with the provision to provide pre-trade data free of charge 15 minutes after publication before expanding the provisions to other market participants.

121. Therefore, ESMA considers it premature to propose an amendment of Level 1 requiring SI quotes to be made available free of charge 15 minutes after publication. ESMA intends to provide further guidance on its expectation on making available delayed pre-trade data free of charge by trading venues and to improve compliance with this requirement. ESMA will reassess the need to expand this provision to SIs at a later stage.

122. Concerning the suggestion to harmonise the content and format of pre-trade transparency, ESMA will keep its proposal to specify the fields to be populated for the pre-trade transparency disclosure, taking into account the different trading systems operated as well as the specificities of the different non-equity asset classes.

123. ESMA also proposes to limit the number of fields to a minimum in order to achieve an appropriate level of standardisation without over-complicating the requirements.

124. Therefore, this proposal requires amending the Level 1 text to incorporate an empowerment for ESMA to develop technical standards in that sense.

3.2 Post-trade transparency requirements for trading venues and investment firms in respect of non-equity instruments

125. As part of the objective of enhancing the efficiency, resilience and integrity of financial markets, MiFIR introduces post-trade transparency requirements for trading venues and investment firms in respect of non-equity instruments traded on a trading venue, whilst recognising the need for adaptations of the regime through deferred publication.

126. After setting out the legal framework for post-trade transparency requirements in respect of non-equity instruments under MiFIR, this section of the report provides an assessment of the level of post-trade transparency currently available for those instruments as well as of the quality, and therefore the usefulness, of available post-trade transparency. On that basis, ESMA makes proposals for improvements, including possible ways to streamline the deferral regime and to have a more harmonised regime across the EU.

127. This section also further considers the TOTV concept that underpins transparency requirements for non-equity instruments and the challenge raised by its application to OTC transactions in derivative instruments. Finally, proposals are made to remove the possibility of unilateral suspensions of the transparency regime for one or more non-equity classes when there is a drop of liquidity at EU level for such class(es) due to its unclear purpose, its complex application, and also considering the fact that no NCA has made use of it until now.

3.2.1 Assessment of the current level of post-trade transparency and the deferral regime

3.2.1.1 General approach and legal framework

Legal framework

128. Article 10 of MiFIR requires market operators and investment firms operating a trading venue to make public the price, volume and time of transactions executed in non-equity instruments. The details of all such transactions must be made public as close to real-time as technically possible and in any case within 15 minutes after the execution of the transaction for the first three years of application of MiFIR and within 5 minutes thereafter.

129. Under Article 11 of MiFIR, CAs may allow for the deferred publication of the details of transactions in non-equity instruments based on the size or type of transactions. Deferred publication may be authorised in respect of transactions that are (i) LIS compared with normal market size, (ii) related to a financial instrument or a class of instruments for which there is not a liquid market, and (iii) above the applicable SSTI threshold. The methodology for determining the respective LIS and SSTI thresholds as well as whether a financial instrument or a class of financial instrument has a liquid market is set out in RTS 2.

130. Article 8 of RTS 2 clarifies that transactions benefitting from a deferral only need to be published by 19.00 local time on the second working day after the date of the transaction (T+2). Furthermore, RTS 2 clarifies that package transactions where at least one of the components is a financial instrument that is illiquid, LIS compared with normal market size or above SSTI, can also benefit from deferred publication for all their components.

131. In conjunction with an authorisation of deferred publication, each CA has the discretion to decide whether a certain level of information has to be disclosed during the initial deferral time period and allow for an extended deferral period with the publication of limited information within the boundaries set out in Article 11(3) of MiFIR and as further specified in Article 11 of RTS 2. In particular:

a. During the initial deferral period of two days, CAs may request the publication of either the details of each transaction except volume or of transactions in a daily aggregated form for a minimum number of 5 transactions executed on the same day, the following working day before 09.00 local time;

b. CAs may allow the omission of the publication of the volume of an individual transaction for an extended time period of four weeks;

c. In respect of non-equity instruments that are not sovereign debt, CAs may allow, for an extended time period of deferral of four weeks, the publication of the aggregation of several transactions executed over the course of one calendar week on the following Tuesday before 09:00 local time;

d. In respect of sovereign debt instruments, CAs may allow, for an indefinite period of time, the publication of the aggregation of several transactions executed over the course of one calendar week on the following Tuesday before 09.00 local time.

132. When the deferral period lapses all details of all individual transactions must be published. RTS 2 specifies the list of flags to be used when reporting under the various deferrals. However, the relevant CA can authorise points b. and d. to be used consecutively, i.e. after the lapsing of the volume omission for four weeks, transactions are aggregated for an indefinite period. A similar post-trade transparency framework applies to investment firms when executing transactions in financial instruments traded on a trading venue outside a trading venue. Investment firms are required to make public the details of such transactions through an APA on the same conditions as the ones applicable to trading venues (Article 21 of MiFIR and Article 64 of MiFID II).

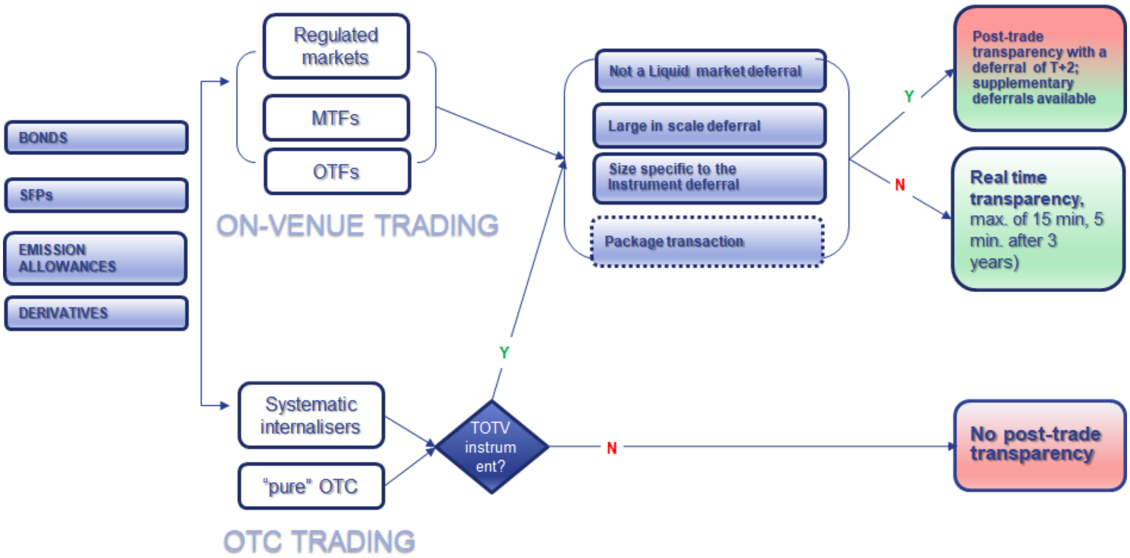
133. Likewise, NCAs may authorise investment firms to provide for deferred publication or may request the publication of limited details of a transaction or details of several transactions in an aggregate form and may temporarily suspend post-trade disclosure by investment firms on the same conditions as the ones set forth in respect of trading venues in Article 11 of MIFIR.

134. By contrast to on-venue transactions, post-trade transparency requirements do not apply to non-price forming transactions executed outside a trading venue, such as

transfers of financial instruments for collateral or lending purposes or "give-ups" and "give-ins" (Article 12 of RTS 2).

135. FIGURE 3 below, provides a description of the post-trade transparency regime on- and off-venue.

FIGURE 3 - THE POST-TRADE TRANSPARENCY REGIME FOR TRADING VENUES



General Approach

136. In the CP, ESMA assessed the current level of post-trade transparency along two dimensions. Firstly, by comparing post-trade transparency before and after the application of MiFID II/MiFIR and, secondly, by assessing the types of deferrals used overall and per asset class.

137. The overall level of real-time post-trade transparency after the application of MiFID II/MiFIR still appears to be very limited, also considering that several jurisdictions already had post-trade transparency requirements in place before MiFID II (e.g. France, Italy, the UK, Greece, Sweden and Denmark).

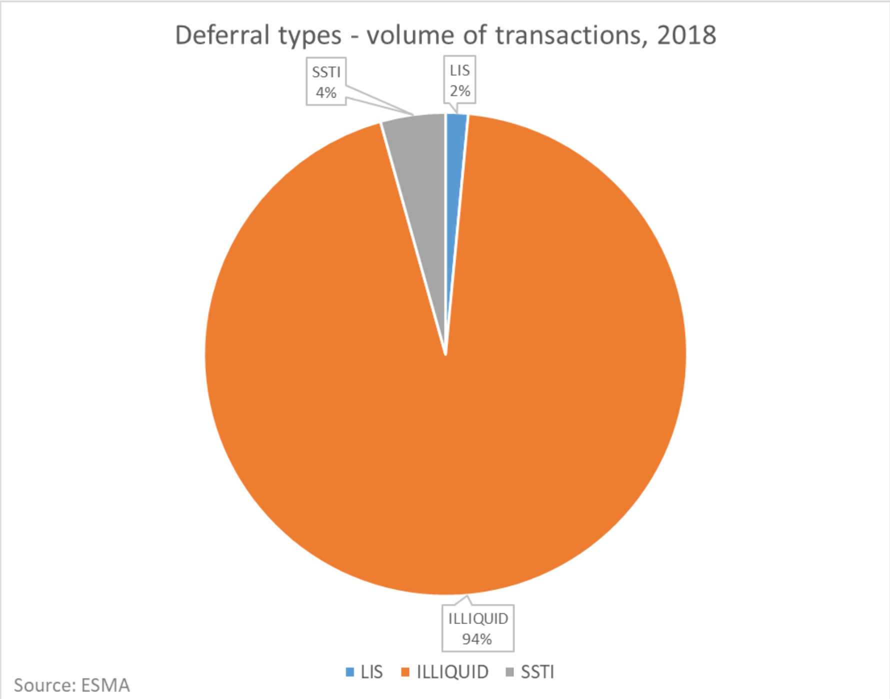
138. This conclusion was also confirmed in a study[12] of Finansinspektionen (FI) on the impact of the MiFID II post-transparency regime on the Swedish markets for government, covered and corporate bonds. For the large majority of Swedish market participants participating in this survey, transparency decreased since the application of MiFID II. However, the study concluded that MiFID II delivered on its objective to move more trading of bonds on trading venues while at the same time noting that significant trading flow also moved to SIs. Last but not least, the study concluded that the new transparency rules have not had an impact on the trading volume and that trading patterns remained largely the

[12] https://www.fi.se/contentassets/0174249373f1415bb14bd2bd14a77307/fi-tillsyn-15-transparens-obligationsm-engn.pdf

same, which is consistent with the findings of an analysis carried out by ICMA covering the EU market[13].

139. Based on ESMA analysis, in 2018 the illiquid deferral is by far the most used deferral type, covering 94% of notional trading volume of deferred transactions, 4% is covered by the use of the SSTI deferral and the remaining 2% by the LIS deferral (see Figure 4). It should be noted that transactions using the illiquid deferral may also include transactions that are above SSTI or LIS.

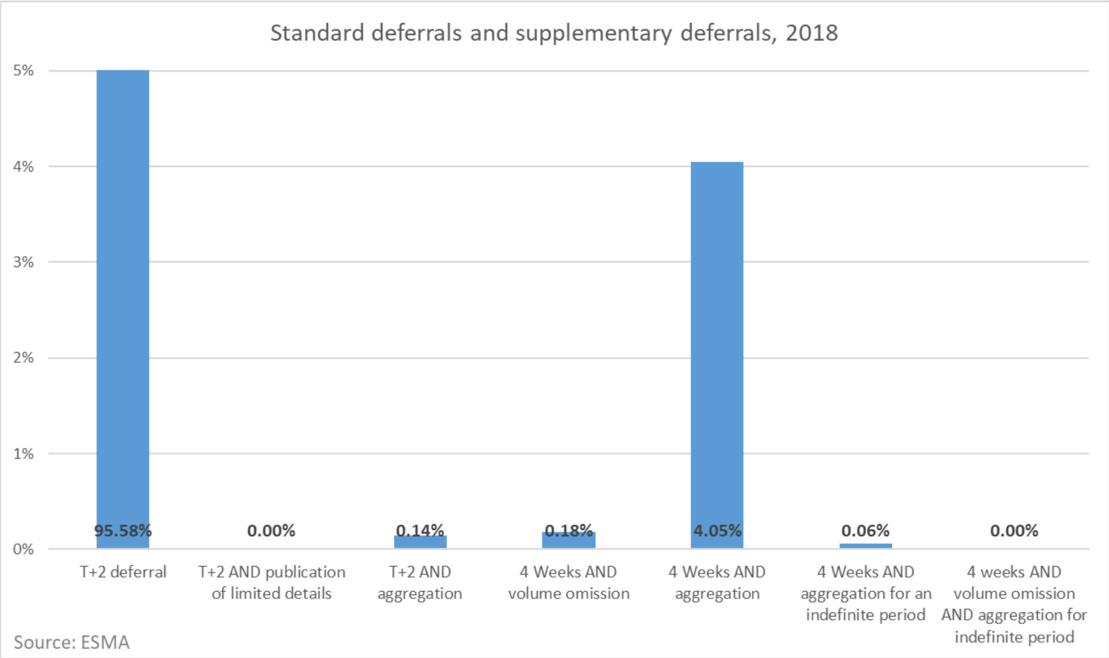
FIGURE 4 - USE OF DIFFERENT DEFERRAL TYPES, BASED ON NOTIONAL TRADING VOLUME OF TRANSACTIONS IN 2018 BENEFITTING FROM A DEFERRAL



140. Most transactions in non-equity instruments (95.6% of notional amount trading volume) benefitting from deferred publication are published on T+2, i.e. using the standard deferral period. As far as the supplementary deferrals are concerned, the possibility to publish transactions in aggregated form during a period of 4 weeks is also used frequently (4.1% of notional amount trading volume of deferred transactions), whereas the trading volumes for the other types of supplementary deferrals are marginal (Figure 5).

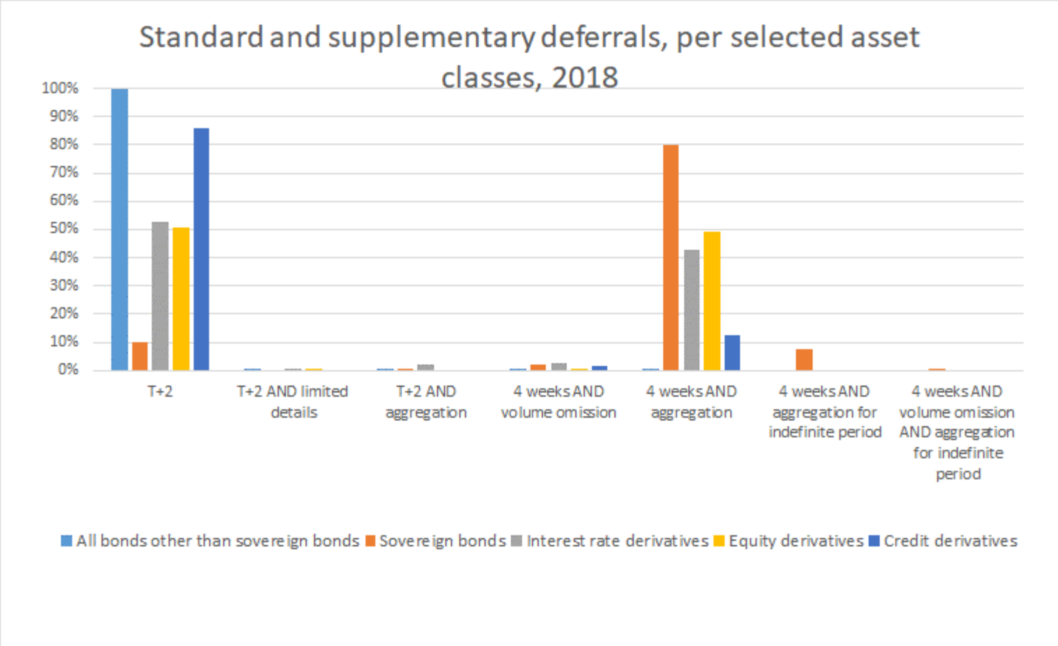
[13] ICMA, MiFID II/R and the bond markets: the first year, An analysis of the impacts and challenges of MiFID II/R implementation since January 2018, December 2018; accessible at: https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/secondary-markets-regulation/mifid-ii-r/

FIGURE 5 - USE OF STANDARD AND SUPPLEMENTARY DEFERRALS ACROSS ALL NON-EQUITY INSTRUMENTS, NOTIONAL AMOUNT TRADING VOLUME, 2018



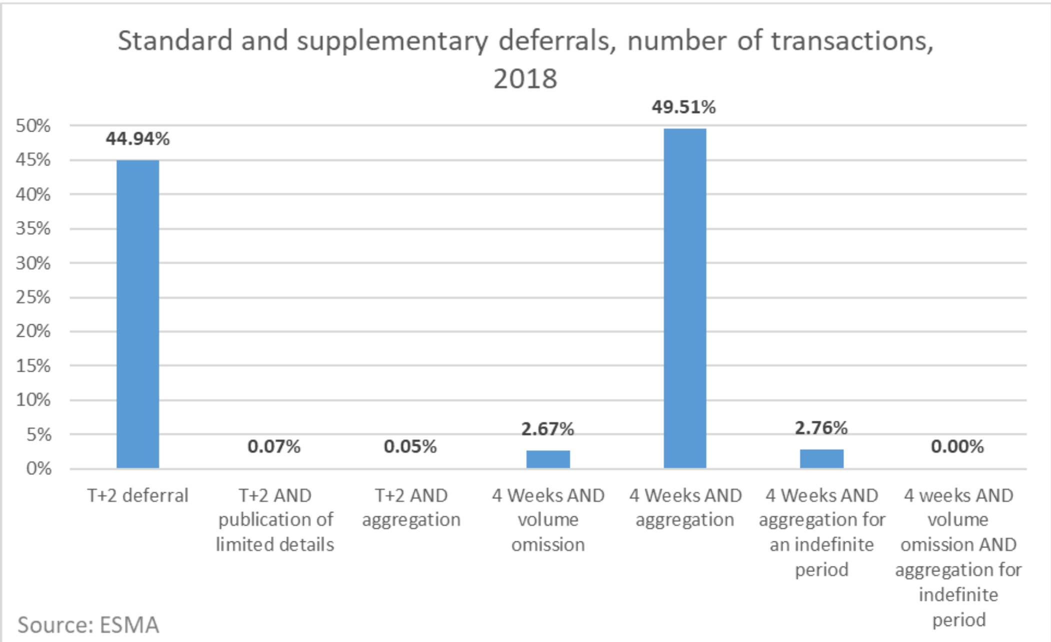
141. However, it can be noted that the deferrals are used differently across asset classes (Figure 6). While nearly all nominal amount trading volume in bonds, other than sovereign bonds, benefitting from a deferral is subject to the standard deferral period of 2 days, most sovereign bonds benefitting from a deferral use the option to aggregate transactions for a period of 4 weeks and/or indefinitely. Moreover, it can be observed that the trading volumes in equity and interest rate derivatives benefitting from a deferral are almost evenly split between transactions published after 2 days (standard deferral) and those published after 4 weeks (supplementary deferrals, using the option to aggregate transactions during the 4 weeks deferral period). Finally, about 85% of the notional amount traded in credit derivatives benefitting from a deferral is published after 2 days, and the remaining 15% after 4 weeks (in most cases it consists in publishing aggregated transactions for 4 weeks).

FIGURE 6 - USE OF STANDARD AND SUPPLEMENTARY DEFERRALS, SELECTED ASSET CLASSES, NOTIONAL AMOUNT, 2018



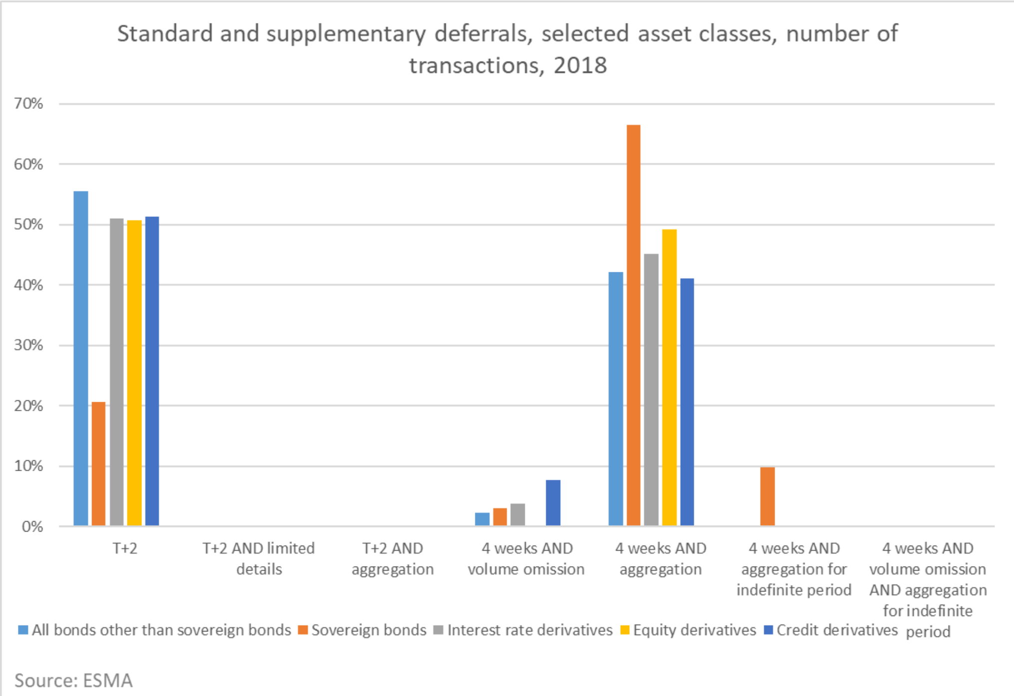
142. Looking at the use of the different deferrals based on the number of transactions (Figure 7) reveals a more equal split between the standard deferral of T+2 (45%) and the supplementary deferral of 4 weeks (55%). For the latter (as for the notional amount trading volume) most transactions benefit from the option to aggregate transactions for a period of 4 weeks (49.5%).

FIGURE 7 - USE OF STANDARD AND SUPPLEMENTARY DEFERRALS, NUMBER OF TRANSACTIONS, 2018



143. This observation also holds true when looking at selected asset classes (Figure 8), where it can be observed that deferrals for most asset classes are broadly equally split between the T+2 and 4 weeks aggregated deferrals. However, it can be noted that the use of deferrals is different for sovereign bonds, where 75% of transactions benefit either from a 4 week or indefinite deferral (while publishing aggregated transactions) and only about 25% of transactions from the T+2 deferral.

FIGURE 8 USE OF STANDARD AND SUPPLEMENTARY DEFERRALS, SELECTED ASSET CLASSES, NUMBER OF TRANSACTIONS, 2018



144. Based on the above, ESMA concluded that the use of different deferrals, both in terms of number of transactions and notional amount trading volume, seems to indicate that many small transactions in illiquid instruments are published only after an extended period of deferral.

145. Furthermore, when the transaction takes place on a trading venue, the trading venue must comply with the deferral regime applicable in the Member State where it is authorised. However, when a member of that trading venue would be trading the same financial instrument OTC, the applicable deferral regime is the one in place in the Member State where the investment firm in charge of post-trade publication is located. This is a source of complexity, non-alignment of obligations and a source of errors for market participants, particularly for APAs to which investment firms often outsource compliance with the timing and content of post-trade publication.

146. In summary, ESMA concluded that the overall level of real-time post-trade transparency after MiFID II/MiFIR appears to be very limited and would benefit from a greater level of uniformity across the Union.

General approach for SSTI deferral

147. Whilst MiFID II/MiFIR aimed at providing an updated harmonised legal framework to enhance the efficiency, resilience and integrity of financial markets notably by achieving greater transparency for non-equity instruments, this objective does not appear to have been achieved. Based on the above assessment, ESMA considered in the CP that more real time post-trade transparency information should be made available across asset classes to enhance competition among market participants, reduce asymmetries of information and deliver high quality information for market users leading to more efficient markets overall. However, ESMA also noted that such benefit would only be delivered through more uniform rules further supporting the creation of a real EU single market.

148. As a first step, ESMA recommended, similarly to the proposal for pre-trade transparency, to delete the concept of SSTI for the deferral regime. As for the pre-trade SSTI, ESMA suggested compensating for the deletion of the SSTI deferral by lowering the post-trade LIS threshold, possibly to different levels depending on the asset class. Such a proposal would require a change of the Level 1 text (for the deletion of SSTI deferral) and of the Level 2 text (e.g. for the recalibration of the post-trade LIS threshold).

General approach for LIS and illiquid deferral

149. In the CP, ESMA proposed three different options aimed at simplifying the post-trade transparency regime, which are described below:

a. Option 1: Volume masking for transactions in illiquid instruments and for large transactions;

b. Option 2: Volume masking only for large transactions;

c. Option 3: Volume masking for large trades for two days and extended volume masking for very large trades.

FIGURE 9 - OPTIONS FOR SUPPLEMENTARY DEFERRALS

	Real-time	T+2 deferral	Supplementary deferral	National discretion
Status quo	Below SSTI, below LIS for liquid instruments	Above SSTI, above LIS for liquid instruments and for all illiquid instruments	From 4 weeks to indefinite deferral	4 different options at national level
Option 1	All except volume masking only for LIS and illiquid instruments		Publication of all details after 2 weeks	
Option 2	All except volume masking only for LIS		Publication of all details after 2 weeks	
Option 3	All except volume masking only for LIS	Publication of all details for LIS	Publication of all details for very-large LIS after 4 weeks	

150. ESMA asked stakeholders whether they agree with the assessment of the level of post-trade transparency and the need of a more streamlined and uniform post-trade regime with no options at the discretion of the different jurisdictions. ESMA also sought stakeholders' views on the proposed amendments to the current post trade regime, notably with regard to the deletion of the SSTI deferral, possibly coupled with a lower post-trade LIS threshold and to the three main options considered for supplementary deferrals.

<u>General approach for data quality and consolidated tape provider (CTP)</u>

151. In the CP, ESMA concluded that (i) (delayed) post-trade information is difficult to find and/or its access is frequently subject to restrictions; (ii) the value of most post-trade information is limited and often outdated due to data quality issues and the use of long deferrals, in particular the 4-week one (iii) the usability of data is further limited by the fragmented reporting environment with currently more than 279 trading venues and APAs operating which in turn, among other reasons, hinder the emergence of a CTP due to the high costs of implementing the different rules necessary for a proper aggregation of data under the different post-trade transparency regimes across jurisdictions.

152. In order to address the above issues, ESMA proposed to (i) follow up, in close cooperation with CAs, on the compliance of trading venues and APAs with the obligation to provide market data free of charge 15 minutes after publication (ii) simplify the deferral regime (iii) to focus on enforcement of the current provisions by CAs and issuing further supervisory guidance in some areas.

3.2.1.2 Feedback to the consultation

<u>Overall assessment</u>

153. A large majority of respondents agreed with ESMA's assessment that the overall level of real-time post-trade transparency appears to be very limited and considered that MiFID II had not delivered meaningful post-trade transparency for non-equity instruments.

154. In contrast, a smaller group of respondents stressed the breadth of financial classes and types of instruments under the MiFIR post-trade transparency regime and the significant increase of post-trade data prompted by the new post-trade transparency requirements. Those stakeholders considered the overall level of real-time post-trade transparency as decent. Some of them noted that the real issue does not arise from the current deferral regime but rather from access to fragmented market data across trading venues and APAs.

155. Although respondents had different views on the overall level of post-trade transparency, almost all respondents agreed with the views expressed by ESMA on the need of a more streamlined and uniform post-trade regime across jurisdictions. The national discretion enshrined in the current regime was considered by most respondents as a source of an unlevel playing field and as an unnecessary complication. Some stakeholders insisted on the need for a more uniform regime to be properly calibrated so that the market can continue to function efficiently.

SSTI deferral

156. Stakeholders had split views on the proposal to delete the SSTI deferral, with a slight majority supporting the proposal.

157. Many of the respondents that did not support the proposal brought forward arguments similar to those made with regard to the SSTI pre-trade transparency waiver. Those respondents argued that it was still premature to make any significant changes to the post-trade transparency regime. In addition, as more instruments may be considered liquid in the future, they considered that the use of the SSTI deferral could become more relevant and any changes to the regime could therefore be detrimental to liquidity.

158. Respondents agreeing with ESMA's proposal stressed that the current regime is overly complex and the deletion of the SSTI threshold/deferral would have the positive effect of simplifying the regime. Those respondents had split views as to whether the deletion of the SSTI deferral should be combined with a lower post-trade LIS threshold.

LIS and illiquid deferral

159. Overall, respondents were supportive of a one-step approach for deferrals which would consist in 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) instead of the two-steps approach for LIS and very large transactions (Option 3).

160. Concerning the choice between Option 1 or 2, views were split with a number of respondents being against any changes or suggesting a more ambitious regime. A slight

majority of respondents was in favour of Option 2, i.e. of removing the illiquid deferral and of requiring real-time post-trade transparency for transactions in illiquid instruments.

Data quality and consolidated tape provider (CTP)

161. Most respondents supported the measures proposed by ESMA. Furthermore, some stakeholders raised concerns that the limited quality of post-trade data could also be linked to the lack of enforcement.

162. In order to improve the level of post-trade transparency respondents made the following suggestions:

- provide further guidance on the use of the Financial Instruments Reference Data System (FIRDS) and the Financial Instruments Transparency System (FITRS) and publish liquidity results also using the asset class and sub-asset class classification;

- provide further guidance on whether the SI regime should only apply to TOTV instruments or to uTOTV instruments;

- require APAs to systematically publish data amendments (there is often no tagging of a cancellation of or amendment to the original report even though tags are available in Table 3 of Annex II of RTS 2) and simplify the deferral regimes that further exacerbate the difficulties of APAs reporting;

- introduce a Level 1 change prohibiting charging for data even prior to 15 minutes. (consistently with the US regime for derivatives);

- require the reporting of more than one identifier (apart from the ISIN), as ISINs are not always suitable for OTC instruments;

- investigate the problem of inconsistent assignments of CFI codes and ensure more consistency with the ESMA CFI validation document. In order to solve this, respondents recommended that ESMA liaises with ANNA/NNAs on this aspect;

- many participants stressed the importance to have a 'golden source' of data, listing all the instruments in scope of transaction reporting and post-trade transparency and recommended that FIRDS subject to improvement of data reliability and quality might be the right database).

3.2.1.3 ESMA’s assessment and recommendations

Overall assessment

163. ESMA noted that, the majority of respondents agreed with its assessment and that MiFID II/MiFIR have to date not fully delivered on the objective of enhancing the efficiency, resilience and integrity of financial markets, notably by achieving greater transparency for non-equity instruments. Feedback received confirmed that more real time post-trade transparency information should be made available across asset classes to enhance

competition among market participants, reduce asymmetries of information and deliver high quality information for market users. ESMA also notes that many market participants support a focus on more stringent obligations on post-trade transparency rather than the pre-trade transparency side.

164. ESMA also takes note of the very broad support expressed by stakeholders in favour of a more streamlined and uniform post-trade regime that no longer includes options left at the discretion of the different NCAs.

165. In the CP, ESMA had highlighted that a post-trade transparency regime providing more real-time information would bring the EU system closer to the system in the US for swaps, where the large majority of transactions are reported in real-time and only very few transactions are eligible for a very short deferral of, in most cases, 15-30 minutes (block trades). Block trades in swaps in the US are published with the volume capped, i.e. no information on the transaction size other than that the transaction was of block size.

166. During the consultation period, ESMA has been made aware that the CFTC is currently considering adjusting its transparency regime. The CFTC intends to maintain the principle of publishing the large majority of transactions in real-time, but has sought feedback from stakeholders for limiting the number of transactions that may be considered block trades while at the same time providing for a longer deferral period for block trades of 48 hours.

167. While the CFTC has not taken a final decision on the way forward, ESMA considers nevertheless that since the principle of real-time transparency for the large majority of transactions will persist in the US, ensuring more real-time post-trade transparency in the EU would result in a better alignment of the two systems.

168. Based on the above, ESMA suggests amending the MiFIR post-trade transparency regime for non-equity instruments as set out below.

<u>SSTI deferral</u>

169. Considering the feedback received from stakeholders and in line with the proposal for pre-trade transparency, ESMA proposes to delete the concept of SSTI for the deferral regime in Level 1.

170. In ESMA's view, the deletion of the SSTI deferral will create a simpler post-trade transparency regime resulting in more transparency, ensuring a level playing field as well as more clarity for market participants. As a consequence, ESMA also proposes to delete the SSTI package deferral as provided for in RTS 2.

171. To ensure that the deletion of the SSTI concept for the deferral regime delivers on the expected benefits with regard to improved transparency, and taking into account that the LIS deferral is likely to be increasingly used after the deletion of the SSTI deferral, ESMA also proposes to adequately lower the post-trade LIS thresholds, if appropriate, through an amendment of RTS 2. If such proposal was adopted, ESMA would further engage with

stakeholders to determine appropriate revised post-trade LIS thresholds, possibly with different levels depending on the asset class.

172. In conclusion, these proposals would require the amendment of Level 1 and eventually Level 2.

LIS and illiquid deferral

173. As post trade transparency, on the one hand, should be increased for the sake of investors, it should, on the other hand, be limited to protect liquidity providers. Finding the right level of transparency thus always requires a balanced approach.

174. Despite some market participants supporting the elimination of any deferral for illiquid instruments and the objective of increasing the level of transparency overall, ESMA considers it important that liquidity providers in thin markets are adequately protected.

175. Therefore, ESMA proposes to base a new deferral regime on volume masking for both illiquid instruments and LIS transactions. Consequently, ESMA's proposal (Option 1 from the CP) (i) provides for publication of post-trade information for transactions above the LIS threshold and in illiquid instruments as close to real time as possible with the volume being masked and (ii) requires the publication of the volume of those transactions after a certain period of time, following the execution of the transaction, such as two calendar weeks.

176. This proposal would require the amendment of Level 1 and Level 2 provisions.

Sovereign bonds

177. ESMA is also aware given wider developments in the current Covid-19 crisis that a customised transparency regime for the trading of sovereign bonds in the secondary markets may still be warranted. ESMA stands ready to assist in calibrating such regime.

Data quality and consolidated tape provider (CTP)

178. ESMA takes note of the suggestions made and will address them through the continuous work on data quality of the FIRDS and FITRS systems, the follow-up work on the cost of market data and OTC data quality that started after the publication of the MiFID Report on the price of market data and the consolidated tape for equity instruments[14], the revision of RTS 2 and potentially future guidance on trade reporting.

[14] MiFID II/MiFIR Review Report No. 1 on the development in prices for pre- and post-trade data and on the consolidated tape for equity instruments ref. ESMA70-156-1606 (link)

3.2.2 Temporary suspension of transparency

3.2.2.1 General approach and legal framework

179. Articles 9(4), 11(2) and 21(4) of MiFIR provide the possibility to temporarily suspend the pre- and post-trade transparency requirements for non-equity instruments where the liquidity of a class of financial instruments falls below a certain threshold. To date these provisions have not been used by CAs, including during the recent episodes of high volatility of EU markets during the Covid-19 crisis.

180. The provisions in RTS 2 further specifying the parameters and methods for a temporary suspension, take into account that a temporary suspension should only be considered where there has been a significant drop in liquidity compared to a sufficiently long reference period to avoid a temporary suspension due to, for instance, seasonal effects. Moreover, the approach reflects that the liquidity profile of illiquid instruments may be more volatile than that of liquid instruments and therefore provided for a more restrictive threshold for suspending the transparency provisions for illiquid instruments.

181. ESMA considers that co-legislators may have introduced this provision as an ‘emergency brake’ to address potential detrimental effects of the transparency provisions. However, ESMA considers that the concept of a temporary suspension of the transparency provisions as currently set out in MiFIR raises a number of questions.

182. Firstly, it is not clear why such a supplementary tool is needed. In case of events that might significantly damage investors’ interests or the orderly functioning of the market, trading venues and CAs can already suspend instruments from trading. It is unclear in which circumstances CAs may want to use the possibility to temporarily suspend only the transparency obligation while not suspending the instrument from trading.

183. Secondly, most non-equity instruments are currently considered as not having a liquid market and are therefore subject to less stringent transparency provisions. It is unclear what currently the purpose of suspending the transparency of illiquid instruments would be, since for these instruments the transparency requirements are already largely disapplied. However, ESMA appreciates that this situation may evolve should there be more liquid instruments in the future.

184. Thirdly, the possibility to temporarily suspend the transparency obligations is limited to the jurisdiction of the CA using this option and there is no EU-wide mechanism, despite the fact that calculations are supposed to be performed at EU level. For instance, should one CA decide to temporarily suspend the transparency obligations for sovereign bonds, such suspension would be limited to the sovereign bonds traded on the trading venues established in that jurisdiction for which the competent authority is responsible. In other words, unless there is a coordinated action by CAs, despite an EU-wide drop in liquidity of sovereign bonds, the transparency obligations would continue applying in all other jurisdictions, thereby distorting the level playing field.

185. Finally, in order to exercise such an option, CAs are expected to perform the calculations using trading activity recorded at EU level and all CAs are facing the challenge to collect this data.

186. In view of the issues described above and taking into account that, to date, no CA suspended the transparency obligations, ESMA suggested in the CP to remove the possibility to temporarily suspend the transparency obligations from the Level 1 text.

187. ESMA also recommended that, should there be demand for maintaining this provision, a mechanism should be introduced to ensure that where the thresholds are met, the temporary suspension is applied across the Union.

3.2.2.2 Feedback to the consultation

188. Only a minority of respondents to the consultation agreed with ESMA's proposal, whereas a large majority of respondents opposed it - citing several reasons including that it may be too early to draw any conclusions at this point in time, and that it could be necessary to have this backstop in the future for extreme market conditions. Moreover, respondents highlighted that that the regime is still currently at the beginning of the phase-in and the uncertainty on how the future regime might look like following the MiFID review, which may call for keeping the possibility of a temporary suspension.

189. Respondents supporting ESMA's proposal noted that it is unclear whether the backstop is necessary, and some said that a temporary suspension is not practical. One respondent envisaged specific changes to the current regime, emphasizing the need for more timely reaction, more granularity and lower thresholds for stressed scenarios.

190. Not all respondents commented on the EU-wide mechanism, but of those who did, there was a slight majority in favour of such a mechanism. The group against the EU-wide mechanism would rather keep the responsibility with the individual CAs as this would allow for a more responsive mechanism in their view.

3.2.2.3 ESMA's assessment and recommendations

191. Taking into account the feedback from stakeholders, ESMA would accept maintaining the provisions in MiFIR to temporarily suspend transparency.

192. Nevertheless, for reasons of consistency and efficiency, ESMA recommends amending the regime to install an EU mechanism. Such a process would include conferring power upon ESMA to take a decision with respect to the suspension of transparency. This approach would ensure coordination between EU Member States and would safeguard an application of the suspension across the EU.

193. This proposal would require a change of the Level 1 and 2 provisions.

3.2.3 The concept of traded on a trading venue (TOTV)

3.2.3.1 General approach and legal framework

194. Several provisions in MiFID II / MiFIR rely on the concept of “traded on trading venue” (TOTV) and in particular the pre- and post-trade transparency requirements for trading venues and investment firms (including SIs) trading OTC, the obligations to report transaction data and the requirement to submit reference data. More specifically, the TOTV concept is used in the following provisions:

- Articles 3, 6, 8, 10, 11, 14, 18, 20 and 21 imposing pre-trade and post-trade transparency requirements on market operators and investment firms operating a trading venue as well as investment firms (including systematic internalisers) operating OTC;

- Articles 23 and 32 setting out trading obligations for shares and derivatives; and

- Articles 26 and 27 imposing transaction reporting and reference data obligations on investment firms and operators of trading venues.

195. As highlighted in the CP, there is no definition of TOTV in MiFID II/MiFIR. While this concept appears self-explanatory with respect to centrally issued and fully standardised financial instruments like shares or bonds, its application is less straightforward regarding OTC derivatives.

196. ESMA has therefore considered it useful to further specify the concept of TOTV for OTC-derivatives in an Opinion[15] in order to delineate OTC derivatives that are within the scope of MiFIR and therefore subject to the transparency and transaction reporting requirements from those OTC derivatives that are not considered TOTV and as a consequence outside the scope of those requirements.

197. As explained in the CP, the ESMA’s Opinion is based on a narrow interpretation of the concept of TOTV. Only OTC derivatives sharing the same reference data details as derivatives traded on a trading venue are considered TOTV and, hence, subject to the MiFIR transparency and transaction reporting requirements.

198. The ESMA Opinion further clarifies that the notion of “same reference data details” should be understood as the OTC-derivatives sharing the same values as the ones reported to the Financial Instruments Reference Data System (FIRDS) in accordance with the fields of Regulation (EU) 2017/585 (RTS 23) for derivatives admitted to trading or traded on a trading venue, except for fields 5 to 12 (the trading venue and issuer-related fields). Hence, OTC-derivatives not sharing the same reference data as instruments reported to FIRDS, for instance the ISIN, would not be considered TOTV.

[15] ESMA Opinion OTC derivatives traded on a trading venue (ESMA70-156-117), 22 May 2017, accessible at: https://www.esma.europa.eu/sites/default/files/library/esma70-156-117_mifir_opinion_on_totv.pdf

199. ESMA opted for this narrow interpretation since, at the time, it was perceived as the best approach to ensure consistent interpretation of the TOTV concept across the different provisions of MiFIR and to contribute to supervisory convergence in the Union. It was also considered as the most pragmatic way to get the MiFIR transparency and transaction reporting regimes up and running, given the reduced IT complexity of this approach.

200. ESMA feared that this narrow interpretation would reduce the scope of OTC-derivatives considered to be TOTV. Therefore, ESMA committed to monitor market developments to ensure that this interpretation of TOTV does not undermine market transparency and efficiency, does not result in information asymmetries between market participants and does not create incentives to move trading to the OTC space as this would run counter to the legislative goals expressed in MiFID II/MiFIR.

201. Following the issuance of the Opinion, ESMA received mixed feedback from stakeholders. While some stakeholders embraced the interpretation as being pragmatic and providing legal certainty, other stakeholders expressed strong concerns that the interpretation was difficult to apply in practice and too narrow exempting de facto too many OTC-derivatives from the scope.

202. In the CP, ESMA highlighted the large gap between the number of ISINs created with ANNA DSB and number of ISINs reported to FIRDS. This gap is particularly pronounced for equity, commodity and credit derivatives, where less than 10% of ISINs created are ultimately reported to FIRDS. Regarding FX derivatives and interest rate swaps, about a quarter of ISINs generated are ultimately reported to FIRDS.

203. While ESMA acknowledged that there are different factors beyond the narrow interpretation of the TOTV concept that could explain that created ISINs are ultimately not reported to FIRDS, those figures may confirm the concerns expressed by various stakeholders that only a very limited proportion of OTC-derivative trading is currently subject to transparency and reference data reporting. With respect to transaction reporting , it should be noted that the proportion is higher especially in the area of OTC equity derivatives due to the fact that financial instruments where the underlying is a TOTV financial instrument or an index or a basket composed of TOTV financial instruments are reportable in accordance with Article 26(2)(b) and (c) of MiFIR.

204. In the CP, ESMA therefore considered it necessary to raise questions regarding the TOTV concept and more specifically about how to ensure that, in line with the general objective pursued by MiFIR, a larger share of OTC derivative trading is brought into the scope of transparency and transaction reporting.

3.2.3.2 Feedback to the consultation

205. In the CP, ESMA asked for feedback on the following points:

a. whether the concept of TOTV should remained aligned for both transparency and transaction reporting;

b. whether market participants agree that the level of transparency in OTC derivatives remains low and, if so, what possible alternative approach they would support to broaden the scope of OTC derivatives subject to transparency and transaction reporting.

206. Regarding the alignment of the TOTV concept (and hence scope of application) for transparency and transaction reporting, a very large majority of respondents supported maintaining the TOTV concept aligned for both purposes. They considered that misalignment would introduce unnecessary complexity leading to increased compliance costs for market participants and more data quality issues.

207. Those that disagreed with the alignment were mainly concerned about uTOTV instruments (and not pure TOTV instruments), i.e. financial instruments where the underlying is a TOTV financial instrument or an index or a basket composed of TOTV financial instruments (see Article 26(2)(b) and (c) of MiFIR). They considered that ESMA should not propose to apply post-trade transparency to those instruments. More generally, those respondents considered that transaction reporting should be broader in scope than post-trade transparency.

208. Respondents more generally stressed that post-trade reports remain highly resource intensive and invited ESMA to reflect on whether more synergies and simplification could be found between the various reporting obligations. For instance, some suggested to merge the MiFIR transaction reporting with EMIR reporting. They noted that the added complexity of the various reporting regimes is a source of errors and generally leads to poor data quality. In this respect, ESMA invites to refer to the considerations made in section 12 of the CP on the MiFIR review report on the obligations to report transactions and reference data (ref. ESMA-74-362-773), which covers the interaction of this obligation with the reporting obligation under EMIR.

209. Regarding the narrow interpretation of TOTV and its impact on the scope of application of transparency and transaction reporting, responses received showed a clear split of views between trading venues and proprietary traders on the one hand and banks and SIs on the other hand. The former generally agreed with the ESMA assessment that the TOTV definition is very narrow while the latter, who would be directly impacted by a broader interpretation of the TOTV concept, disagreed with it.

210. Similarly, regarding the possible ways forward suggested by ESMA in the CP, views were split between respondents supporting the status quo (Option 1) and respondents supporting to remove the TOTV concept for derivatives and apply transparency and transaction reporting to all OTC trades (Option 3).

211. Respondents supporting the status quo stressed that market participants already had to go through resourceful and costly developments to comply with the current reporting requirements and that it is not the right time to change or further expand those. Some suggested that ESMA should rather focus on ensuring high quality reporting and the development of a consolidated tape.

212. On substance, they considered that expanding the scope of transparency would not serve any valid purpose. In their views, investment firms trading OTC offer customised products to their clients with unique characteristics. Requiring transparency measures to apply to those instruments would not help price discovery or set a benchmark for clients trading those non-TOTV products.

213. Respondents in favour of Option 3 noted that it would (i) establish a comprehensive transparency regime for OTC transactions, (ii) level the playing field between trading venues and SIs, (iii) increase consistency with other jurisdictions (the US in particular), and (iv) reduce operational and compliance costs. In their view, most participants active in the OTC space trade not only non-TOTV instruments but also TOTV derivatives and, therefore, have the capacities to easily cope with an extended scope of application of post-trade transparency. Lastly, the deferrals contained in the MiFIR transparency regime provide an adequate protection to OTC market participants leaving them sufficient time to hedge their position before transactions would be made public. On the contrary, those supporting Option 1 considered that Option 3 would bring non-standardised products into the scope of transparency while those are bespoke by nature and therefore not suitable for such disclosure.

214. Option 2 only received limited support during the consultation, many respondents highlighting (i) the additional complexity this would introduce, (ii) the possibility for market participants and SIs to design products avoiding post-trade transparency, and (iii) the difficulty to define criteria that will be used to identify standardised derivatives (that should be subject to post-trade transparency). Some highlighted that the proposal to request trading venues to publish information regarding standardised products traded on their platforms might also not allow automation of TOTV checks which is deemed a necessary precondition for investment firms subject to reporting obligations.

215. Beyond the options described in the CP, some respondents suggested alternative approaches to broaden the scope of transparency and transaction reporting.

216. Some respondents suggested expanding the scope of the derivative trading obligation (DTO), allowing for fewer exemptions from the clearing obligation (CO), and maintaining robust equivalence between global trading jurisdictions. Especially in the context of the LIBOR transition, the DTO should be expanded to capture alternative risk-free rates (RFR, e.g. SOFR, EuroSTR, SONIA) which would help achieving the goals of regulators and policymakers alike in making RFR-based swaps more transparent.

217. Some noted that, beyond the options proposed by ESMA in the CP, the scope of OTC transactions subject to transparency could be increased by targeted amendments to the ISIN allocation criteria (e.g. referring to the tenor of swaps instead of their maturity date) and the reporting time to FIRDS.

218. Lastly, one respondent suggested, as an alternative option, that OTC derivative transactions involving an investment firm that is an SI in the relevant sub-asset class are presumed to be subject to post-trade transparency. These transactions would be subject to post-trade transparency with the SI fulfilling the reporting obligations.

3.2.3.3 ESMA's assessment and recommendations

219. Regarding first the alignment of the TOTV concept for both transparency and transaction reporting purposes, responses showed strong support for maintaining the consistent application of the concept across MiFIR provisions. ESMA agrees with this feedback and therefore recommends maintaining the same TOTV concept across all MiFIR provisions.

220. Regarding the interpretation of the TOTV concept, responses received during the consultation shed light on the broad range of views among market participants.

221. On the one hand, ESMA continues to believe that the exclusion from the scope of transparency and transaction reporting of standardised OTC derivative contracts and transactions is not satisfactory from a policy perspective. This was not the intention of the co-legislators and MiFIR was on the contrary meant to bring to light trading in instruments that used to be outside the scope of transparency.

222. In addition, the limited scope of application of the transparency obligations might disincentivise moving trading in standardised OTC derivative contracts to exchanges or electronic trading platforms as recommended already more than 10 years ago by the parties to the G20 Pittsburgh summit.

223. ESMA therefore continues to have concerns about the status quo approach (Option 1). While it is true that some further progress can be made regarding the quality of reporting, ESMA considers that this can be done in parallel to a revision of the TOTV concept.

224. On the other hand, ESMA acknowledges that the two other options proposed in the CP also present drawbacks. Option 2 appears complex to implement both for ESMA (who will have to define the criteria to be used for the TOTV test) and for market participants (who will have to check the status of all instruments at all times). ESMA also agrees that Option 3, while being conceptually simple, would significantly broaden the scope of OTC-derivatives and bring also bespoke derivative contracts into scope. Imposing transparency on those non-standardised derivatives might not only represent an unnecessary burden for reporting entities but it might, more generally, introduce reporting noise for other participants rather than meaningful transparency. Therefore, at this stage, ESMA does not consider Option 3 as an appropriate solution and would discard it from its further deliberations.

225. ESMA is therefore contemplating alternative approaches such as the one based on incorporating derivative contracts traded by SIs into the scope of the MiFIR transparency and transaction reporting obligations. The scope of SIs, as well as, the transactions that would be covered by this extension need to be further clarified, in particular in line with the scope of SI which may encompass non-TOTV instruments. ESMA intends to consult on these aspects in the consultation paper on the MiFIR review report on the obligations to report transactions and reference data (ref. ESMA-74-362-773), which outlines possible ways of how this alternative approach could apply in practice.

226. While the above aspects will need to be further defined following the outcome of the consultation, ESMA's preliminary view is that an alternative approach based on an extension of the scope to instruments traded by SIs presents several benefits:

a. It would increase the scope of public and regulatory transparency without bringing pure bespoke OTC transactions into the scope;

b. Preliminary findings (based, for instance, on ANNA DSB figures regarding the number of created ISINs) indicate that the SI market share in OTC derivatives is not negligible and bringing their activity into the scope would therefore represent a significant increase of public and regulatory transparency;

c. The approach relies on SIs who are supposed to have already systems in place to report both transactions and reference data and therefore do not seem to imply major system updates for market participants; and

d. The approach also would not imply significant adjustments of the ESMA system.

227. At the same time, ESMA recognises that this approach might act as a deterrent for investment firms opting in as SIs and, ultimately lead to a reduction of the number of firms operating as such with impact on the general level of transparency.

228. In addition, ESMA also acknowledges that the TOTV concept is at the root of key MiFIR provisions and any amendment to this concept should therefore be thoroughly considered and consulted upon. It therefore appears reasonable to gather more input from market participants on this new approach and ESMA intends to consult on this alternative approach in the consultation paper on the MiFIR review report on the obligations to report transactions and reference data (ref. ESMA-74-362-773).

229. ESMA intends to formulate its final proposal on the way forward for TOTV in the final report on transaction reporting taking notably the alternative approach but also Options 1 and 2 described in this paper into account.

3.3 Trading obligation derivatives

3.3.1 Article 28 of MiFIR

3.3.1.1 General approach and legal framework

230. Pursuant to Article 28(1) of MiFIR, financial counterparties and certain non-financial counterparties, as defined in EMIR and specified in the RTS determining the classes of derivatives subject to the CO, are required to trade derivatives subject to the DTO on regulated markets, MTFs, OTFs or third-country trading venues following an equivalence decision by the Commission under Article 28(4) of MiFIR.

Equivalence decisions

231. According to Article 28(4) of MiFIR, "The legal and supervisory framework of a third country is considered to have equivalent effect where that framework fulfils all the following conditions:

• trading venues in that third country are subject to authorisation and to effective supervision and enforcement on an ongoing basis;

• trading venues have clear and transparent rules regarding admission of financial instruments to trading so that such financial instruments are capable of being traded in a fair, orderly and efficient manner, and are freely negotiable;

• issuers of financial instruments are subject to periodic and ongoing information requirements ensuring a high level of investor protection;

• it ensures market transparency and integrity via rules addressing market abuse in the form of insider dealing and market manipulation."

232. Currently two equivalence decisions have been adopted by the Commission. The first relates to the CFTC-authorised designated contract markets (DCMs) and swap execution facilities (SEFs) in the US and the other one to Singapore approved exchanges and recognised market operators.

Circumvention provisions

233. Article 28(2) of MiFIR introduces provisions aiming at preventing the circumvention of the DTO via third-country entities. Pursuant to Article 28(2) of MiFIR, the DTO should apply (i) to transactions of counterparties subject to the DTO with third-country financial entities that would be subject to the CO if they were established in the Union; and (ii) to third-country entities that would be subject to the DTO if they were established in the Union provided that the contract has a direct, substantial and foreseeable effect within the Union or where such obligation is necessary or appropriate to prevent the evasion of the DTO.

234. The types of contracts which have a direct, substantial and foreseeable impact in the Union and the cases where the DTO is necessary or appropriate are further specified in Commission Delegated Regulation 2017/57924[16] (RTS 5). The RTS closely follows the approach chosen for a parallel provision in Article 4(1)(a)(iv) and (v) of EMIR, which is further specified in Commission Delegated Regulation (EU) No 285/2014[17].

Trading of derivatives subject to the DTO on a non-exclusive and non-discriminatory basis

235. Article 28(3) of MiFIR states that the derivatives subject to the trading obligation should be traded or admitted to trading on a trading venue on a non-exclusive and non-discriminatory basis.

Link to the Clearing Obligation

236. The DTO is closely linked to the CO under EMIR since according to Articles 28(1) and 32(1) of MiFIR. The application of the CO is ordinarily the precondition for the DTO and triggers the need to assess whether the class of derivatives should also be subject to the DTO.

237. To date, ESMA analysed several classes of interest rate, credit, equity and foreign exchange OTC derivatives and proposed some of them for the CO. The CO currently applies to some OTC interest rate derivatives denominated in EUR, GBP, JPY, USD, NOK, PLN, and SEK; and certain CDS on European corporate indices.

238. ESMA also assessed some equity derivatives as well as non-deliverable FX forwards but did not propose to include these classes of derivatives in the scope of the CO. In order to reduce systemic risk, the set of classes subject to the CO may evolve and ESMA will continue analysing the different classes of derivatives to assess whether they are suitable for the CO.

239. Following the amendment of EMIR (EMIR Refit)[18], the scope of counterparties subject to the CO (Article 4a) has been amended. ESMA already conducted a review about the alignment of MiFIR with the changes introduced by EMIR Refit in January 2020 and recommended a full alignment between the CO and the DTO provisions on the scope of counterparties.[19]

240. In the CP, it was noted that ESMA had not been made aware of any issues concerning the different provisions in Article 28 of MiFIR. ESMA therefore did not consider making

[16] Commission Delegated Regulation (EU) 2017/579 of 13 June 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 the direct, substantial and foreseeable effect of derivative contracts within the Union and the prevention of the evasion of rules and obligations, OJ L 87, 31.3.2017, p. 189; https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0579

[17] Commission Delegated Regulation (EU) No 285/2014 of 13 February 2014 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations, OJ L 85, 21.3.2014, p. 1, https://eurlex.europa.eu/eli/reg_del/2014/285/oj

[18] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02012R0648-20190617&from=EN

[19] https://www.esma.europa.eu/sites/default/files/library/esma70-156-2076_emir_final_report_on_alignment_clearing_and_trading_obligations.pdf

any changes, other than those amendments necessary to align the MiFIR provisions with EMIR Refit changes. ESMA asked in the CP whether stakeholders had any remarks in respect of this assessment of Article 28 of MiFIR.

3.3.1.2 Feedback to the consultation

241. Of the respondents providing feedback to this question, about half either broadly agreed with ESMA's assessment of Article 28 of MiFIR or noted agreement with the need to adjust the DTO regime to align it with the changes introduced by EMIR Refit.

242. Some respondents outlined explicitly a couple of areas where the alignment of the DTO and CO regimes should be improved, including suppressing the DTO for small financial counterparties (SFC) and non-financial counterparties (NFC), suspending automatically the DTO when the CO is suspended, and more dynamic references to 'transactions' that are caught by the CO and DTO.

243. Regarding the equivalence regime, a couple of respondents proposed to amend Article 28(4) to ensure that central aspects of the MiFID II framework are considered as part of equivalence decisions. These include ensuring third-country trading venues (a) provide market participants with non-discriminatory access and (b) apply comparable transparency requirements to derivatives subject to the DTO as in MiFIR.

244. Some respondents made remarks on the application of the DTO to alternative risk-free rates, on banning the practice of post-trade name give ups, and on incentives to move look-alike derivatives contracts traded "EMIR" OTC to 'pure OTC' to avoid central clearing.

245. Stakeholders also took the opportunity to provide remarks in the context of Brexit, on the current uncertainty surrounding the granting of equivalence to UK trading venues and on possible conflicting EU and UK derivative trading obligations. These respondents highlighted that in the absence of equivalence following Brexit, UK branches of EU firms will be subject to conflicting rules as regard DTO (EU and UK rules). Some respondents considered positive equivalence decisions in respect of the UK as important and considering the potential conflicting rules called to remove third-country branches of EU firms from the scope of the DTO.

3.3.1.3 ESMA's assessment and recommendations

246. Considering, the support to align the MiFIR provisions for the DTO with the EMIR Refit changes for the CO, ESMA proposes a full alignment between the CO and the DTO provisions. Most, if not all, of the additional suggestions on further improving the alignment of the DTO and CO regimes were addressed in the earlier review done by ESMA. ESMA also sees merit in more dynamic references between EMIR and MiFIR.

247. ESMA appreciates the remarks that were made by respondents on the need to change other provisions in the current DTO regime. ESMA has carefully reflected on them and notes that some of the remarks do not contain targeted amendments of the specific provisions of Article 28 of MiFIR.

248. The one targeted amendment concerns the conditions for equivalence under Article 28(4) of MiFIR. ESMA is of the view that for the purpose of determining eligibility as a trading venue for derivatives subject to the trading obligation, the proposed additional criteria would be beneficial.

249. ESMA therefore proposes to amend Article 28(4) of MiFIR to ensure third-country trading venues (a) provide market participants with non-discriminatory access and (b) apply comparable transparency requirements to derivatives subject to the DTO as in MiFIR.

250. Concerning the group of comments related to the application of the DTO to derivatives based on alternative risk-free rates, ESMA notes that any extension of the DTO to such derivative contracts would require changes of the relevant Level 2 requirements and is dependent on applicable liquidity calculations. ESMA will look into the necessity of any such changes in due course.

251. Concerning the issue of post-trade name give-up, it should be noted that ESMA has been made aware of possible issues around this practice. ESMA is still reflecting if and how to tackle these issues.

252. ESMA takes note of the remarks made by respondents in the context of Brexit but has to highlight that equivalence decisions are not within the remit of ESMA.

253. ESMA is aware of the numerous challenges that the end of the transitional period creates for market participants and will try to address them to the best of its abilities taking into consideration the current legislative framework.

254. In conclusion, the above proposals require changes to Level 1 and eventually Level 2.

3.3.2 Article 32 of MiFIR

3.3.2.1 General approach and legal framework

255. Article 32(1) of MiFIR sets out the procedure to determine the classes of derivatives that are subject to the DTO and requires ESMA to draft RTS specifying the classes of derivatives subject to the DTO and the dates from which the DTO takes effect for different categories of counterparties as defined in the RTS specifying the CO. A precondition for a class of derivatives (or a subset) to be considered subject to the DTO is that it should first be declared subject to the CO.

256. Article 32(2) of MiFIR specifies two further conditions for a class of derivatives subject to the CO to be considered for the DTO: (i) the class of derivatives (or a subset) must be admitted to trading or traded on at least one trading venue as referred to in Article 28(1) of MiFIR (Article 32(2)(a), ‘the venue test’), and (ii) there must be sufficient third-party buying and selling interest in the class of derivatives (or a sub-set) so that it is sufficiently liquid to trade only on the venues referred to in Article 28(1) (Article 32(2)(b), ‘the liquidity test’).

257. In order to determine the relevance and the availability of the parameters provided by Level 1 and to assess the effects of MiFID II/MiFIR on the classes subject to the DTO, ESMA carried out a data analysis, covering interest rate derivatives and credit derivatives subject to the DTO. Detailed results of this analysis can be found in the CP.

258. ESMA concluded that the parameters had proven relevant and that the holistic approach chosen by ESMA was taking the criteria set out in Article 32 and RTS 4 appropriately into account. While at the time of the assessment, not all criteria were fully built into the approach, ESMA considers that they are nevertheless relevant and likely to be applied for future assessments. In the CP, ESMA therefore noted that it does not consider it necessary to amend the provisions at Level 1 and Level 2.

259. Nonetheless, stakeholders were asked to share their views on the criteria and whether they think these are sufficient and appropriate for assessing the liquidity of derivatives. ESMA also asked whether it would be necessary to include further criteria.

<u>Extension of the DTO to derivatives not cleared or not made available for trading</u>

260. Article 32(4) of MiFIR empowers ESMA to identify and notify to the Commission the classes of derivatives or individual derivative contracts that should be subject to the DTO but for which no CCP has yet received authorisation under Article 14 or 15 of EMIR, or which are not admitted to trading or traded on a trading venue. Following the notification from ESMA, the Commission may publish a call for development of proposals for imposing the DTO on those derivatives.

261. To date, ESMA has not recommended to make classes of derivatives, which are not cleared or not made available for trading, subject to the DTO on the basis of the procedure in Article 32(4) of MiFIR.

262. ESMA therefore sought feedback from stakeholders whether ESMA should make use of the provision in Article 32(4) of MiFIR for asset classes currently not subject to the trading obligation.

3.3.2.2 Feedback to the consultation

263. Almost all respondents to this question considered the current criteria used to assess the liquidity of derivatives sufficient and appropriate and did not deem it necessary to include any additional criteria. Answers show there is also almost unanimity on the idea that ESMA should not make use of the provision in Article 32(4) of MiFIR.

264. A minority of respondents found it necessary to amend the methodology or criteria, commenting that it should be decided on a case-by-case basis whether a (non-cleared product) trade is conducted OTC or on-venue, that unless proven illiquid the default status of all OTC derivatives should be that they are subject to the DTO, and that a more customised approach should be applied.

265. A practical recommendation directed at ESMA was to assess the impact of the DTO using the data submitted to FITRS related to the trading activity under MiFID II instead of voluntary data collection exercises.

266. Finally, a few respondents highlighted that in the context of Brexit, the liquidity of instruments currently in-scope for DTO and more generally the scope of DTO should be reassessed knowing the changes that Brexit could introduce (especially regarding GBP and USD IRS).

3.3.2.3 ESMA's assessment and recommendations

267. Vis-à-vis the question on Article 32(4) of MiFIR, ESMA takes note of the agreement among respondents not to make use of this provision.

268. ESMA also takes note of the broad agreement amongst stakeholders in relation to the currently applicable criteria to assess the liquidity of derivatives and would hence not propose any Level 1 changes. ESMA also considers that this approach has been consistent with other jurisdictions. While maintaining the current approach in terms of assessment criteria, ESMA intends to further analyse the recommendation to use FITRS for the purpose of the DTO to include market-wide activity data and avoid the use of ad-hoc data collections. In parallel, ESMA would also investigate whether to require more granular reporting for derivatives captured under the DTO, as this would be beneficial for ESMA to assess their precise liquidity. In line with this, in the context of a future review of RTS 2 it might be considered to include additional reference data in RTS 2.

269. As regard the comments on the potential Brexit impact, ESMA will continue to monitor closely how liquidity develops post-Brexit and whether markets will be sufficiently liquid to allow EU market participants to execute transactions in derivatives subject to the trading obligation on eligible trading venues.

270. This proposal would require a change of the Level 2 provisions.

3.3.3 Suspension of the trading obligation

3.3.3.1 General approach and legal framework

271. Pursuant to Article 32(5) of MiFIR, ESMA should submit to the Commission a draft RTS in order to amend, suspend or revoke an existing RTS whenever the trading obligation of a class or a subset thereof is modified following a change in the criteria set out above. The Commission may afterwards adopt these RTS.

272. Therefore, the process for a suspension of a trading obligation does not allow for a shortened procedure to be applicable in case of an emergency linked to market changes that would require a timely suspension of the DTO. The process for submitting technical standards requires first ESMA to conduct a public consultation and then the Commission to endorse the draft RTS submitted within 3 months.

273. ESMA believes that under certain circumstances a swift suspension of the DTO could be needed to preserve the stability of financial markets in line with what has been agreed for the closely associated CO for derivatives in the EMIR Refit.

274. Under EMIR refit, the suspensions of the DTO and the CO can be requested at the same time, become effective at the same time and be extended at the same time, for the same period. However, EMIR Refit does not introduce a standalone mechanism to suspend the DTO, without suspending the CO. ESMA considers that there may be circumstances where the CO may not be suspended but which nevertheless require a swift suspension of the DTO. For instance, that could be the case where a class of derivatives becomes unsuitable for mandatory trading on a trading venue or where there has been a material change to one of those criteria in respect of a particular class of derivatives (e.g. sudden change of liquidity due to major market events). Moreover, such a tool may also be necessary for derivatives subject to the DTO following the procedure under Article 32(4) of MiFIR.

275. In the CP, ESMA therefore recommended establishing a self-standing possibility to suspend the DTO. Such process would closely mirror the process set out in EMIR Refit for the suspension of the CO. According to this process, ESMA would be able to submit a request to the Commission to suspend the DTO where one of following conditions is met:

a. the class of derivative is no longer suitable for the DTO on the basis of the criteria referred to in paragraphs 2 and 3 of Article 32;

b. a trading venue is likely to cease trading that specific class of derivative and no other trading venue is making available to trade that class of derivatives without interruption;

c. the suspension of the DTO for a specific class of derivative or for a specific type of counterparty is necessary to avoid or address a serious threat to the orderly functioning of financial markets in the Union and that suspension is proportionate to that aim.

276. Based on the reasons and evidence provided by ESMA, the Commission should, without undue delay either suspend the DTO for the specific class of derivative or for the specific type of counterparties or reject the requested suspension and provide ESMA with a detailed reasoning for its decision. The Commission’s decision to suspend the DTO would be published in the Official Journal of the European Union, on the Commission’s website and in the public register referred to in Article 34 of MiFIR.

277. A swift suspension of the DTO should be valid for a period of three months from the date of the publication of that suspension in the Official Journal of the European Union. The suspension could be extended for additional periods of three months, with the total period of suspension not exceeding twelve months.

3.3.3.2 Feedback to the consultation

278. All respondents, which represented a variety of stakeholders, agreed with the proposal to have a process in place to swiftly suspend the DTO, although a couple of respondents stressed that if required by the circumstances, the suspension should not be "swift" but "immediate".

279. Some respondents stressed the need for the suspension of the trading obligation to be based on pre-defined mechanisms and pre-defined criteria to give as much guidance as possible to market participants. Such criteria should preferably be subject to public consultation.

3.3.3.3 ESMA's assessment and recommendations

280. ESMA took note of the broad support expressed by stakeholders in favour of a procedure to allow for the swift suspension of the DTO.

281. ESMA also took note of the suggestions made by some stakeholders to have additional pre-defined mechanisms and criteria for the suspension of the DTO so that market participants can better anticipate when such suspension may take place. However, ESMA considers that the procedure for the DTO suspension should retain some flexibility to deal with potential market developments and exercise judgement as to the need to suspend the DTO. A pre-set quantitative drop in liquidity in a class of instruments would for instance not allow for such flexibility.

282. Finally, ESMA appreciates that the suspension of the DTO would be an impactful decision for market participants but notes that a prior public consultation would contradict the need for swift action supported by all stakeholders.

283. Considering the need for a suspension of the DTO to become effective quickly, if not immediately as stressed by one stakeholder, ESMA gave further thoughts to the procedure for the suspension of the DTO suggested in the CP, which currently closely mirrors the process set out in EMIR Refit for the suspension of the CO.

284. ESMA however notes some differences between the CO and the DTO that should be considered when setting out a process for the suspension of the DTO. The suspension of the DTO would notably not raise the same financial stability issue as the suspension of the CO. In addition, while the CO, and its potential suspension, applies per class of derivatives, the DTO applies at a more granular level and the suspension could therefore possibly only involve a subclass of derivatives, with here again a lower impact than a CO suspension.

285. ESMA therefore proposes to introduce in Level 1 a shorter procedure for the self-standing suspension of the DTO capable of ensuring a timely reaction to market developments. In addition, for this procedure to serve its purpose, ESMA notes that the tests to be met for the suspension should not be overly demanding. For the reasons explained above, ESMA would for instance not consider proportionate to have to

demonstrate that the suspension of the DTO for a subclass of derivatives "is necessary to avoid or address a serious threat to the orderly functioning of the financial markets in the Union", as for the suspension of the CO.

286. In conclusion, these proposals require a Level 1 change.

3.3.4 Other issues concerning the derivatives trading obligation

3.3.4.1 General approach and legal framework

287. ESMA wanted to provide the opportunity in the CP for market participants to indicate whether they see any other issues with the application of the DTO. As mentioned in the CP, one point that could be raised is the application of the DTO to branches and whether the application should be aligned with that of the share trading obligation.

3.3.4.2 Feedback to the consultation

288. Respondents provided different suggestions and comments in relation to the DTO, many of which echoed the remarks which were made in response to the earlier question Q20 in the CP on the assessment of Article 28 of MiFIR. For instance, also here many respondents highlighted issues related to Brexit and equivalence decisions, notably on the issue of conflicting trading obligations post-Brexit.

289. In addition to similar comments received to Q20 on MiFIR/EMIR alignment, benchmarks and post-trade name give up, respondents suggested to improve the regime by way of monitoring the impact of the DTO on clients in relation to the phasing in of category 3 clients. A couple of respondents proposed reconsidering LIS thresholds for DTO instruments as the pre-trade LIS threshold permits a significant percentage of overall market activity to be pre-arranged, which undermines the objectives of the DTO. It was suggested to use the post-trade threshold instead.

290. Lastly, a couple of other participants suggested that discrepancies between the MiFIR transparency regime and the trading obligation should be aligned to the best extent possible. According to these respondents, this could be achieved through a) defining which asset classes are generally appropriate for trading on trading venues (i.e. trading eligible under the MiFIR trading obligation); and b) trading venues to assess the application of pre- and/or post- trade transparency exemptions in order to mitigate any adverse effects, and consequently to apply for waivers and deferrals with competent authorities.

3.3.4.3 ESMA's assessment and recommendations

291. For the points on the post-trade name give up, further MiFIR-EMIR alignment, and the application of the DTO for risk-free benchmarks we refer to ESMA's assessment and recommendations under the assessment of Article 28 of MiFIR earlier in the report. ESMA would reiterate however that equivalence decisions are not within the remit of ESMA.

292. ESMA is sympathetic to the idea of monitoring the impact of the DTO on clients, but also notes that the results of such assessment might not be of use as the current review processes of MiFID II/MiFIR offer no flexibility to define the types of counterparties subject to the DTO, considering that these types are specified under EMIR. ESMA therefore will not perform such assessment at this point in time.

293. Regarding the suggestion to reconsider pre-arranged trading for DTO instruments by way of using the post-trade LIS threshold, ESMA considers that such an approach might be inconsistent. Nevertheless, the idea of increasing LIS thresholds for derivatives subject to the DTO could be considered in a future RTS 2 review.

294. As stated in section 3.3.1.2 of the report, ESMA takes note of the remarks made by respondents in the context of Brexit but has to highlight that equivalence decisions are not within the remit of ESMA.

295. ESMA is also aware of the numerous challenges that the end of the transitional period creates for market participants and will try to address them to the best of its abilities taking into consideration the current legislative framework.

296. In response to the feedback on the alignment of the transparency and DTO regimes, ESMA considers that there could be merit in ensuring consistency between the liquidity status for transparency purposes and the DTO assessment. For a future RTS 2 review it might be considered to amend the RTS to reflect that any derivative subject to the DTO (or CO) would per definition be liquid for transparency purposes.

297. The above proposals would require a change of the Level 2 provisions.

3.3.5 Article 34 of MiFIR

3.3.5.1 General approach and legal framework

298. Pursuant to Article 34 of MiFIR, ESMA should publish and maintain on its website a register specifying the derivatives subject to the DTO, the venues where they are admitted to trading or traded, and the dates from which the obligation takes effect.

299. Accordingly, the ESMA register includes three sections to mirror the above three requirements.

300. As of today, the DTO applies to 8 classes of OTC fixed to float single currency interest rate swaps denominated in EUR, USD, GBP on Libor and Euribor with main tenors (3M, 6M). The DTO applies also to two classes of index credit default swaps on Itraxx Europe Main and crossover indices with a maturity of 5 years.

301. As mentioned in the CP, ESMA currently considers the presence of a register as still valid and does not recommend any change in this respect. In the CP, ESMA asked stakeholders whether they had any views on the functioning of the register.

3.3.5.2 Feedback to the consultation

302. Market participants also consider the register as useful and as a tool that should be maintained. Just one respondent proposed to merge the register with FIRDS so that all data can the gathered in the same place.

3.3.5.3 ESMA's assessment and recommendations

303. In view of the broad support on maintaining the register as it is, ESMA does not propose any change in relation to the register.

4 Level 2 review

4.1 Annual RTS 2 review: phase-in approach for bonds and derivatives

304. 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.

305. 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). ESMA's assessment 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.

306. 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.

307. While the conclusions and proposals regarding the MiFIR review are presented in this report, the ESMA assessment of the concerned RTS 2 provisions has been published in a separate report published in July 2020[20].

308. In this report, ESMA proposed to the Commission to: (i) move to stage 2 for the average daily number of trades threshold used for the quarterly liquidity assessment of bonds; (ii) move to stage 2 for the pre-trade size specific to the instrument threshold for bonds; both proposals mean to improve the currently limited transparency in the bond market; and (iii) not to move to stage 2 for the pre-trade size specific to the instrument threshold for the other non-equity instruments.

309. In the CP, ESMA also seized the occasion to raise a more general question on the liquidity determination method used for bonds (Q25 in the CP). Since it did not refer directly to the annual review mandated to ESMA under Article 17 of RTS 2, ESMA has not reported on the feedback received in the RTS 2 annual report published in July 2020. The feedback and ESMA's assessment are therefore presented in section 3.1.4 of this report.

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[20] MiFID II/MiFIR Annual Report under Commission Delegated Regulation (EU) 2017/583 (RTS 2), ref. ESMA70-156-2682 (link)

4.2 RTS 2 review for commodity derivatives

4.2.1 Background

310. Having received feedback from various stakeholders related to the specificities of the commodity derivative markets and how they should be taken into consideration in RTS 2, ESMA took the opportunity of this review report to address those concerns.

311. After the publication of the transitional transparency calculations, stakeholders argued that revisions would be necessary in relation to (1) the methodology to determine whether a commodity derivative contract has a liquid market; and (2) the level of the pre-trade LIS threshold for liquid commodity derivatives contracts.

312. Those two elements are relevant in the context of the waivers from pre-trade transparency as they determine the contracts which are eligible to benefit from the illiquid waiver under Article 9(1)(c) of MiFIR, and the LIS waiver under Article 9(1)(a) of MiFIR.

313. The changes proposed in the CP were without prejudice to the proposals raised by ESMA on reviewing the Level 1 text. ESMA is working under the assumption that any review of RTS 2 can be performed and implemented ahead of any change of the Level 1.

4.2.2 Segmentation Criteria

4.2.2.1 General approach and legal framework

314. The liquidity determination depends on the choice of so-called “segmentation criteria”, which are different in number and nature for each sub-asset class. The segmentation criteria define the way in which the contracts are aggregated into smaller subsets called “sub-classes”. The liquidity determination is then performed at the sub-class level. All contracts in the same sub-class have the same liquidity determination (liquid or illiquid) and the same threshold values (pre- and post-trade LIS and SSTI).

315. The segmentation criteria might currently lead to very granular classes in some cases, and rather broad classes in other cases (with the potential result of mixing unrelated contracts in the same class).

316. This effect had already been identified for certain energy derivatives, where insufficient guidance was provided in relation to the population of a particular segmentation criterion (“Delivery/Cash settlement location”, which is based on Field 14 of Table 2 of Annex IV of RTS 2). This led to inconsistent reporting and the resulting aggregation of multiple and unrelated contracts in the same class.

317. To address those concerns, ESMA formulated three proposals in the CP.

318. First, ESMA suggested that the segmentation criteria “delivery/cash settlement location” should apply to all commodity derivatives contracts where the geographical

delivery location is relevant, rather than being limited to the sub-set currently set in RTS 2 (i.e. currently, the field is only applicable to the energy types oil, oil distillates, oil light ends, electricity and inter-energy while it is not applicable to the energy types natural gas, coal and renewable energy, nor to metals and agricultural contracts). Indeed, it would appear reasonable that this segmentation criterion is used consistently for all commodity derivatives, and in particular for gas contracts which function in a similar way as electricity contracts.

319. Second, in relation to the way in which the field should be populated, ESMA suggested that when a standard already exists (such as the EIC Y code for electricity and gas contracts[21]), this standard should be used. To that effect, the standard where available should be specified in the legislation (Field 14 of Table 2 of Annex IV of RTS 2).

320. When such standard does not exist, ESMA and NCAs should work closely with trading venues to determine an efficient and consistent way to populate this field, which could then be implemented via Level 3 measures or reporting instructions. This approach would prove relatively flexible, as it could be modified in the future depending on possible market developments. ESMA and NCA could also determine that in specific cases, the field should be left blank, which would result in the segmentation criterion not playing a role.

321. In addition, ESMA noted in the CP that the segmentation criterion “settlement type” (cash, physical or other) is currently used only for the sub-asset class “Energy commodity swaps” while it could be argued that the same segmentation criterion should also apply to “Energy commodity futures/forwards” and “Energy commodity options”. Indeed, this is an important feature of energy contracts and is defined in the contract specifications. Hence ESMA suggested the addition of the segmentation criterion “settlement type” to the sub-asset classes “Energy commodity futures/forwards” and “Energy commodity options”.

322. The proposals made in the CP related to segmentation criteria are summarised below:

- Proposal SC1: apply the segmentation criterion “delivery/cash settlement location” to all commodity derivatives;
- Proposal SC2: define in RTS 2, to the extent possible, the standards to report the field “delivery/cash settlement location” (e.g. EIC Y code for electricity and gas contracts);
- Proposal SC3: apply the segmentation criterion “settlement type” to all energy sub-asset classes;

323. All proposals require a change to RTS 2. ESMA requested feedback on those proposals in the CP under Question 30.

[21] The EIC C Y code for electricity and gas contracts corresponds to the delivery point of the market area. As per the EIC reference manual available on the entso-e website, “the EIC code of type Y is used to identify a domain which can be considered as a delimited area that is uniquely identified for a specific purpose and where energy consumption, production or trade may be determined. It can be a geographical or market area, such as control areas, balance groups, bidding zones, balancing areas, etc.” The list of relevant EIC Y codes for each standard contract is maintained and published by ACER on the REMIT Portal at this link

4.2.2.2 Feedback to the consultation

General feedback in relation to the segmentation criteria

324. Many respondents consider that the segmentation criteria for commodity derivatives are insufficiently granular, which led to several derivatives contracts being incorrectly classified as liquid and receiving inadequate LIS thresholds.

325. One stakeholder suggested that the liquidity framework in general should not rely on the reference data provided under RTS 23, and instead solely rely on the reference data provided under RTS 2. According to this market participant, the absence of a legal link between RTS 2 and the sub-categories of RTS 23 has led to inconsistencies and confusion in the market.

326. Some respondents discussed the possibility of adding the trading venue as a segmentation criterion and had split views on the matter. Those supporting the addition of the trading venue as a segmentation criterion consider that a contract should not be deemed liquid on Venue X solely on the ground that it is liquid on Venue Y. In their view, this methodology prevents exchanges from launching a new contract that is already liquid on another venue.

327. On the other end, one trading venue argued that products listed on several venues, with the same underlying, should be treated equally with respect to pre-trade transparency. In their view, departing from the current approach and adding the trading venue as a segmentation criterion could create opportunities to circumvent the pre-trade transparency obligations.

Feedback in relation to the settlement location (SC1 and SC2)

328. Stakeholders strongly supported the two proposals related to the segmentation criterion "settlement location" (SC1 and SC2). One APA mentioned that they experienced difficulties sourcing the field 'settlement location' because the information is not made available by all trading venues. As a result, they supported the effort to standardise the field and make this data point more readily available to market participants.

329. While supporting the proposals SC1 and SC2, stakeholders asked ESMA to be mindful of the following elements:

- the existence of a standard to define the settlement location is straightforward in the case of electricity and gas (EIC Y codes), but not necessarily in the case of other types of derivatives. In case no standard is available, the guidance should be to leave the field empty. Otherwise there is a risk that each venue will set its own standard, which would result in the creation of ad-hoc sub-classes;

- mandating the field 'settlement location' to new sub asset-classes would result in significant IT developments and costs. Therefore, ESMA should adjust the timeline adequately and changes should only be forward-looking, without historical changes.

330. The proposal to apply the segmentation criterion “settlement type” to all energy sub-asset classes (SC3) was not supported by respondents. They claimed that the introduction of a new field would result in a change to the file structure, which would be costly in terms of IT adaptation. Besides, they considered that adapting the existing segmentation criteria as proposed under SC1 and SC2 should be sufficient at this stage.

4.2.2.3 ESMA’s assessment and recommendations

331. Taking into account the feedback received, ESMA considers that any revision of RTS 2 should include the proposals to extend the segmentation criterion “settlement location” to all commodity derivatives (SC1) and to define requirements or guidance to populate the corresponding reference data (SC2).

332. ESMA further agrees with the suggestions that (1) when no standard is available for the settlement location, that field should be left blank in order to avoid the creation of ad-hoc sub-classes; and (2) the changes to the reference data should only be forward-looking, without the need to correct past reference data.

333. ESMA accepts the negative comments made regarding the proposal to extend the segmentation criterion “settlement type” to all energy sub-asset classes (SC 3) and hence will not take this proposal forward.

334. In relation to the proposal to add the trading venue as a segmentation criterion, ESMA considers that the intention of the regulation was always to aggregate available liquidity across all trading venues and that doing otherwise could create opportunities to circumvent the pre-trade transparency obligations. Therefore, ESMA does not consider that this proposal is appropriate.

4.2.3 Determination of liquid classes

4.2.3.1 General approach and legal framework

335. Once the sub-classes are established on the basis of the segmentation criteria, RTS 2 (Annex III, Table 7.1) sets out that commodity derivatives contracts belonging to a specific sub-class are deemed to have a liquid market when (1) the average daily notional amount (ADNA) is greater than EUR 10M; and (2) the average daily number of trades (ADNTE) is greater than 10.

336. ESMA notes that, whilst the parameters for the ADNA and ADNTE could in principle be set at different levels for different sub-asset classes (e.g. the one for “Metal commodity swaps” could be different than the one for “Energy commodity futures/forwards”), they are currently set in RTS 2 at the same level for all sub-asset classes. As a result, the flexibility embedded in the system as it currently exists might not have been used so far in the most efficient manner.

337. The CP also discussed the possibility to use metrics different than the ADNA and ADNTE to assess liquidity. In relation to the ADNA, the current methodology based on notional amounts in EUR has the merit of being easy to calculate and being denominated in the same unit across all instruments. It has however been criticised because notional amounts are influenced by prices and possibly currency fluctuations.

338. In addition, the ADNA fails to make a proper distinction between (1) a market with on average few trades of large sizes (potentially illiquid); and (2) a market with on average numerous trades of small sizes (potentially liquid). Those two markets could have the exact same average daily notional amounts while exhibiting different liquidity profiles. In this respect, the use of standard trade size denominated in a unit that is native to the underlying commodity (e.g. MW, barrels, tons) would allow for a more accurate reflection of market liquidity.

339. Whilst acknowledging the merits of using alternative quantitative liquidity criteria, ESMA noted in the CP that this would be a substantial departure from the current methodology. First, this would create significant changes for market participants relatively shortly after the implementation of MiFID II. Second, this would have a major impact on ESMA's IT systems (which have only recently been developed and are still under evolution based on the current state of the legislation) with the associated costs on reporting entities, NCAs and ESMA.

340. In the CP, ESMA requested stakeholders to provide their views on the current liquidity assessment of commodity derivatives (Q29).

4.2.3.2 Feedback to the consultation

General feedback on the liquidity assessment of commodity derivatives

341. Many respondents underlined that the current liquidity determination is not appropriate for commodity derivatives and in particular for energy derivatives. In their view, the current framework has led to the following unintended consequences: (1) new and illiquid contracts being incorrectly classified as liquid, hence becoming subject to transparency requirements which are appropriate for developed markets; (2) small members whose capabilities are limited to trading smaller sizes on a pre-negotiated basis (e.g. block trades) are prevented from doing so, and have to conclude their transactions either OTC, or on a central limit order book with a risk of sub-optimal execution (due to low liquidity).

342. In their view, this has led to reduced liquidity for market participants generally, but particularly for commodity producers and consumers who often utilise futures for physical commodity hedging purposes. Many stressed that commodity derivatives are often illiquid; therefore, the possibility to pre-negotiate the transactions away from trading venue (for subsequent on-venue execution and CCP clearing) represents a vital option to achieve a good execution outcome.

343. They often advocated that trading venues had incorporated the specific features of commodity markets via the existence of block thresholds (block trades[22]). In their view, the LIS thresholds are currently set at values which are disproportionate compared to the pre-MiFID Block sizes, which prevents the market from functioning in an efficient manner.

Liquidity metrics

344. Most respondents shared the view that the metrics currently employed in RTS 2 for the liquidity determination (ADNA and ADNTE) were not appropriate to capture the liquidity profile of commodity derivatives.

Average Daily Notional Amount (ADNA)

345. First, the use of ADNA does not allow to make a distinction between (1) a market with on average few trades of large sizes (potentially illiquid); and (2) a market with on average numerous trades of small sizes (potentially liquid). Those two markets could have the exact same average daily notional amounts while exhibiting different liquidity profiles.

346. Second, the use of notional amounts implies that factors such as prices and currency fluctuations are taken into account for the liquidity determination. Yet, respondents unanimously claimed that such factors were unrelated to the liquidity status and only resulted in adding significant noise to the liquidity determination.

347. Hence the consensus was that liquidity should be determined, not in terms of notional amounts, but in terms of standard size measured in a base quantity unit that is native to the instrument (e.g. MW, barrels, tons), thus eliminating the influence of price and currency.

Average Daily Number of Trades (ADNTE)

348. Respondents agreed that the use of the trade frequency was a reasonable metric to assess liquidity, as this reflected the ability to find a counterparty in a relatively short period of time. They however suggested that the current parameter for the ADNTE was inappropriately calibrated.

349. All reported that the current level of ADNTE was too high: some suggested ESMA to further consult the industry on the appropriate calibration, while others made concrete proposals.

350. Specifically, instead of the current value of 10 trades per day (which corresponds to 1 trade every 48 minutes, assuming an 8-hour trading session), they proposed to set the value at 100 trades per day (which corresponds to 1 trade every 5 minutes).

[22] A block trade is a transaction negotiated privately, which size (generally in lots) exceeds a specific threshold set by the exchange (so called “Block threshold” or “Block sizes”). Block trades are subsequently submitted to the exchange for registration and clearing.

351. Several respondents further proposed to use the median daily number of trades, instead of the average, as this metric flattens the impact of extreme values hence takes better into account the discrepancies in trade count within a day, over the historical period.

4.2.3.3 ESMA's assessment and recommendations

352. The proposals and conclusions related to the liquidity determination and the level of the pre-trade LIS thresholds are closely linked. They are formulated together in section 4.2.4.3 below.

4.2.4 Level of pre-trade LIS thresholds for commodity derivatives

4.2.4.1 General approach and legal framework

353. After the publication of the results of the transitional transparency calculations, stakeholders complained that the pre-trade LIS thresholds were too high for the "least liquid" contracts having a liquid market and tended to be higher for less liquid than for very liquid contracts.

354. Using the transitional transparency calculations data, ESMA analysed in the CP the relation between the pre-trade LIS thresholds and the liquidity of the classes, as measured by the ADNTE, for various classes deemed to have a liquid market. The data confirmed that high values of LIS thresholds were observed for the classes where the ADNTE was the lowest, while for classes with the highest ADNTE, the LIS values were lower, and in many cases equal to the floor[23].

355. This observation appears at odds with the expected policy outcome, which would rather be that the LIS threshold is higher for the most liquid contracts. ESMA further analysed in the CP the distribution of the trades pertaining to specific liquid classes, to understand the reason behind the current relation between the LIS threshold and the ADNTE and came to the following conclusions:

— For "less liquid" classes

356. There are only a few small trades and liquidity clusters around specific trade sizes. There are some "jumps" in the distribution. The rounding methodology defined in Article 13(12) of RTS 2[24] can have a large impact on the level of the LIS threshold, depending on where those jumps occur in the distribution of trades.

[23] To recall, as per Article 13(2)(b)(ii) of RTS 2, the pre-trade LIS threshold for commodity derivatives is the highest of (1) the 70% percentile; and (2) the threshold floor (which is currently set at 500,000 EUR for all commodity derivatives).
[24] To determine the 70th percentile according to the rounding methodology defined in Article 13(12) of RTS 2, trades are grouped according to their volume (in EUR) into the following bins: size bin = 100,000 until 1M, size bin = 500,000 until 10M; size bin = 5M until 100M, size bin = 25M after.

357. The large bin size[25] (EUR 500,000 as defined in accordance with the rounding methodology) leads to a significant difference between the threshold supposed to be retained (70th percentile) and the one retained in practice. For these classes, a more granular rounding methodology (hence a smaller bin size) would lead to a more accurate determination of the 70th percentile, and to a lower LIS threshold.

— For "very liquid" classes

358. The distributions exhibit a lot of small trades and more than 70% of the trades generally occur within the first bin [0 – 100,000]. For those classes, the size of the first bin (EUR 100,000 as defined in accordance with the rounding methodology) leads to a significant difference between the threshold supposed to be retained (70th percentile) and the one retained in practice. Hence a more granular rounding methodology for the first bin would lead to a more accurate determination of the 70th percentile.

359. This effect is however superseded by the effect of the floor: since the 70th percentile generally corresponds to the first bin (100,000 EUR) which is lower than the pre-trade LIS floor, the floor is used in most cases. This means that for those classes, the level of the pre-trade LIS threshold corresponds to a large trade percentile. Please refer to Box 1 below for further explanations on the methodology to calculate the LIS threshold.

BOX 1: METHODOLOGY TO DETERMINE THE PRE-TRADE LIS THRESHOLD

The methodology used to determine the pre-trade LIS threshold for commodity derivatives is defined in Article 13(2)(a)(v) of RTS 2 for classes not having a liquid market, and in Article 13(2)(b)(ii) of RTS 2 for classes having a liquid market.

For commodity derivatives not having a liquid market, the pre-trade LIS threshold follows a static determination: the pre-trade LIS threshold is equal to a value defined in Table 7.3 of Annex III of RTS 2. Currently, this value is equal to 500,000 EUR for all commodity sub-asset classes.

For commodity derivatives having a liquid market, the threshold shall be the greater of (1) the trade size below which falls the percentage of the transactions corresponding to a defined trade percentile; and (2) the threshold floor. The parameters to be retained for the thresholds floor and the trade percentile are defined in Table 7.2 of Annex III of RTS 2. Currently, those parameters are equal to 70th for the trade percentile, and 500,000 EUR for the threshold floor, for all commodity sub-asset classes.

[25] To determine percentiles, trades are grouped according to their volume in so-called "bins". The sizes of those bins are defined according to the rounding methodology set in Article 13(12) of RTS 2: size bin = 100,000 until 1M, size bin = 500,000 until 10M; size bin = 5M until 100M, size bin = 25M after.

$$PreTrade\ LIS(commo) = \max(threshold\ floor, trade\ percentile) = \max\ (EUR\ 500{,}000, 70^{th} percentile)$$

The 70th percentile represents the trade size (in EUR) below which 70% of the transactions fall. If this value is smaller than the floor (EUR 500,000), the LIS threshold is set at the level of the floor. In this case, the LIS threshold will correspond to a trade percentile higher than the 70th. Example: for a theoretical class, 70% of the transactions are lower than 100,000 EUR and 90% of the transactions are lower than 500,000 EUR. Then the 70th percentile is equal to 100,000 EUR, and the LIS threshold is equal to the floor (500,000 EUR) which corresponds to the 90th percentile.

360. Overall, it appears that the current methodology based on percentiles and threshold floors leads by construction to higher thresholds for less liquid classes, which was not the initial intention of the regulation.

361. In the CP, ESMA noted that this counterintuitive effect could be mitigated by recalibrating the parameters, i.e. the level of the percentile, the level of the pre-trade LIS threshold floor and/or the rounding of the thresholds for values greater than EUR 100,000 (referred to in Article 13(12) of RTS 2). This would require a change to RTS 2 but could be implemented at a reasonable cost.

362. ESMA asked stakeholders to provide a general evaluation of the current calibration of the pre-trade LIS threshold in Question 31 of the CP.

4.2.4.2 Feedback to the consultation

363. Market participants welcomed the analysis of the CP which evidenced the counterintuitive effects arising from the current percentile approach. Respondents generally confirmed that the current methodology based on percentiles and threshold floors led by construction to high thresholds for the least liquid classes, and to low LIS thresholds for the most liquid classes. The results of this approach would imply that instruments with a low liquidity can support higher LIS levels that highly liquid instruments – when in fact the opposite is true.

364. This outcome is due to the differences in the liquidity distribution, between liquid and illiquid contracts, and several market participants have provided numerical examples and graphs to illustrate this effect:

- instruments with high liquidity profiles exhibit very high liquidity in small sizes. For those instruments, the 70th percentile would typically be equal to a very low trade size;
- for instruments with low liquidity profiles, the trade size is driven by metrics which are specific to the instruments and tends to cluster around specific multiple (e.g. 10

lots, 25 lots, 50 lots). For those instruments, the 70th percentile would typically be equal to a high trade size.

365. As a result, most market participants suggested to use a scaled approach based on variations in distribution i.e. to use a methodology which would appropriately take into account the existence of different shapes in the distribution of liquid versus illiquid contracts. However, they have not been specific as to which approach could be used.

366. Finally, they argued that the minimum threshold (floor) of 500,000EUR is too high and should be decreased significantly.

Way forward

367. Market participants are aware that the proposals they are supporting (changing the methodology to determine liquid instruments and changing the methodology to set the LIS thresholds) represent very significant changes from a legal and operational point of view. Therefore, they suggested that a two-step approach might be the most efficient way forward:

- Step 1: the current methodology is maintained, but the parameters are recalibrated to eliminate the most problematic effects of the current functioning (i.e. the very high LIS thresholds for the least liquid instruments);

- Step 2: the current methodology is reshaped entirely on the basis of the proposals developed above (e.g. use of different metrics to determine whether an instrument has a liquid market, liquidity determined in a base quantity unit that is native to the instrument, percentile approach replaced by a scaled approach based on variations in the liquidity distribution).

368. One market participant supported the status quo (no change to the methodology nor to the parameters) and one market participant supported a change to the parameters but not to the methodology (i.e. supported Step 1 only).

369. With regards to the recalibration proposed under Step 1, there were 2 proposals: (1) a minority of respondents suggested that ESMA makes a proposal for (and further consults on) a new calibration on the basis of the results of the 2020 liquidity calculations (based on 2019 data); (2) a majority of respondents provided the new calibration set out below.

Proposed re-calibration

	IL waiver (Table 7.1, Annex III, RTS 2)		LIS waiver (Table 7.2, Annex III, RTS 2)	
	Average daily number of trades	Average daily notional amount (ADNA)	LIS percentile	LIS, notional value of a trade
Current value	10	10,000,000	70	500,000
Proposal	100	100,000,000	30	50,000

	IL waiver (Table 13.1, Annex III, RTS 2)		LIS (Table 13.2, Annex III, RTS 2)	
	Average daily number of trades	Average daily amount (ADA)	LIS percentile	LIS, notional value per trade
Current value	5	150,000 tons of CO_2 equivalent	70	EUA as underlying 50,000 tons / other underlying: 25,000 tons
Proposal	100	150,000	30	50,000/25,000

4.2.4.3 ESMA's assessment and recommendations

370. In relation to the liquidity assessment of commodity derivatives, ESMA overall agrees with the feedback received, pointing to the limits of the current quantitative criteria (ADNA, ADNTE). In particular, ESMA sees merits in exploring metrics different than notional amounts, to avoid the noise introduced by the influence of prices and exchange rate conversions.

371. As pointed out by several market participants, this could be achieved by assessing liquidity in terms of standard size measured in a base quantity unit that is native to the instrument (e.g. MW, barrels, tons).

372. In relation to the LIS thresholds, ESMA considers that there is sufficient evidence to conclude that the current methodology based on percentiles and threshold floors leads by construction to high thresholds for the least liquid classes, which contradicts the original objective. As a result, the use of a scaled approach based on variations in distribution should be considered.

373. In relation to the recalibration suggested by many respondents, ESMA notes that the proposed changes depart significantly from the current values (ADNTE and ADNA multiplied by 10, percentile changed from 70th to 30th, threshold floor divided by 10). This would inevitably lead to (i) a decrease in the number of liquid sub-classes; and (ii) lower LIS thresholds for liquid sub-classes. While the overall impact will clearly be a reduction of the level of pre-trade transparency in commodity derivatives markets, the scale of that impact is difficult to assess at this stage and would need to be calculated on the basis of quantitative data. At the same time, ESMA recognises the specificities of commodities market.

374. Overall, ESMA notes that both steps suggested by stakeholders (i.e. changing the parameters and/or changing the methodology) would require changes to RTS 2, hence requiring in both cases a public consultation.

375. As a result, ESMA will develop concrete proposals on the basis of all the suggestions which have been explained in this report and set them out in a separate consultation paper on the review of RTS 2, which ESMA intends to publish in due course. Those proposals should be based on ad-hoc and recent quantitative data. ESMA will hence reach out to the relevant market participants towards the end of 2020, in order to gather appropriate data that will be key in the development of those proposals.

5 Annexes

5.1 Annex I

Opinion of the Securities and Markets Stakeholder Group

The Securities and Markets Stakeholder Group did not opine on the ESMA CP.

5.2 Annex II

Feedback on the consultation paper

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?

376. Stakeholders responding to this question had mixed views. About half of the respondents, in particular trading venues but also some representatives of the buy side and proprietary traders, were supportive of extending the pre-trade transparency regime to tackle the deficiencies highlighted by ESMA in the CP. The other half of respondents, in particular from the sell side, did not see the need to extend or amend the pre-trade transparency regime and rather recommended to focus on improving the post-trade transparency regime and improving data quality.

377. Respondents not supporting increased pre-trade transparency highlighted that the costs of information leakages in consequence of more pre-trade transparency are expected to be higher than the benefits of such a change, in particular in view of the trading protocols used in non-equity markets, such as voice trading and RFQ systems. Many respondents considered that quotes are often tailor-made and that making public the information on such quotes would not have a major impact on improving the level of transparency. In addition, respondents stressed that the pre-trade transparency regime had only been in place for a short time and that it would be premature to conclude that it did not deliver. For these reasons, stakeholders expressing views against increased pre-trade transparency suggested to focus on establishing a consolidated tape for equity instruments and bonds and reviewing the framework for deferrals from post-trade transparency.

378. Nevertheless, respondents against increased pre-trade transparency made a number of suggestions to amend the Level 1 and 2 text, such as simplifying the quoting obligations for SIs by deleting Article 18(6) and (7) of MiFIR and levelling the playing field between venues and SIs and OTC trading by requiring trading venues to only report the market side of a transaction and not the client side (i.e. individual allocations).

379. Respondents in favour of increased pre-trade transparency in non-equity markets argued that it would increase price competition and allow new liquidity providers to enter markets. This group viewed non-equity markets as too opaque and considered that the fragmented market structure impairs client access to best execution and denies clients the ability to effectively compare and evaluate the quality of prices. Furthermore, this group of respondents considered that many non-equity instruments are liquid, and that the illiquid waiver should be either removed or amended to increase pre-trade transparency.

380. Respondents in favour of increased pre-trade transparency made a number of proposals for amendments of the Level 1 and 2 texts, such as: (i) requiring all trades in bonds and securitised derivatives below 100,000 EUR to be concluded on lit trading venues; (ii) reducing the number of available waivers, in particular eliminating the SSTI

waiver and restricting the use of the LIS and illiquid waivers (e.g. no illiquid waiver for listed derivatives since market making obligations are in place for such instruments); (iii) moving more trading in bonds and derivatives from OTC to trading venues by expanding the number of liquid bonds or moving all trades below-LIS to trading venues and SIs.

381. A number of respondents from both groups were supportive of revising the liquidity assessment and the LIS and the SSTI thresholds applicable to commodity derivatives in RTS 2. Furthermore, some respondents suggested to extend the hedging exemption under Article 8(1) of MiFIR to a broader range of market participants and financial instruments.

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?

382. The majority of respondents were of the view that the pre-trade transparency regime needs to be simplified and made more coherent for the market and supported ESMA's proposal to remove the SSTI waiver and to lower the LIS threshold. About one third of respondents did not consider that the simplification of the pre-trade transparency waivers would contribute to the improvement of the level of pre-trade transparency available and considered that the current legal framework is sufficient for this purpose.

383. In addition to ESMA's proposals, respondents in favour of simplification made further proposals to streamline the waiver regime, such as

- removing the illiquid waiver;
- accelerating the move to stage 4 of the phase-in regime for the bond liquidity determination;
- reviewing the methodology for calibrating waiver thresholds, recalibrating the liquidity assessments to better reflect differences in trading volumes across asset classes (e.g. increase LIS-thresholds for listed derivatives), including the addition of qualitative criteria (e.g. derivatives subject to the EMIR clearing obligation (CO) should always be considered to have a liquid market). Recalibrating the methodology for determining the liquidity status and the SSTI and LIS-thresholds was also supported by a number of respondents not in favour of simplifying the waiver regime;
- removing the TOTV concept: Currently most OTC trading (including SI trading) in derivatives is not subject to pre- and post-trade transparency due to the narrow TOTV interpretation. Some respondents suggest eliminating the concept of TOTV to significantly reduce the regulatory complexity and operational costs for market participants and increase transparency.

384. Incorporating trading volume into the methodology used for determining the pre-trade SSTI methodology and LIS thresholds in order to ensure that a minimum amount of total trading activity is subject to pre-trade transparency (e.g. 50% of trading activity in the relevant sub-class). Respondents suggesting this approach considered that relying solely on trade count leads to overly broad waivers.

385. Furthermore, some respondents while in general in favour of simplification, made some proposals that would in their view further contribute to better pre-trade transparency, such as:

a. Introducing some flexibility to lower minimum thresholds in highly volatile market conditions, in order to facilitate the hedging;

b. extending the hedging exemption in Article 8(1) of MiFIR to cover all market participants;

c. introducing a negotiated trade waiver for non-equity instruments and, in particular, commodity derivatives.

386. The latter two points were also supported by some stakeholders not in favour of a simplification of the regime.

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?

387. Feedback from respondents was split on the proposal to delete the SSTI waiver.

388. Many respondents that were against ESMA's proposal, in particular sell-side firms and MTFs, argued that the pre-trade transparency regime is still in its infancy and that it is too soon for any significant changes. As a way forward, these respondents considered that until the industry moves to the next stage of the SSTI pre-trade thresholds it would be premature to make any changes to the legal framework. Respondents further pointed out the need for waivers to protect liquidity providers from being exposed to unduly risks.

389. Other respondents were of the view that the removal of the SSTI waiver could incentivize more OTC trading which would be against the objectives of MiFID II/MiFIR. Furthermore, respondents also argued that, as liquidity thresholds will be adjusted (hence reducing the universe of instruments benefitting from the illiquid waiver), the SSTI waiver will become increasingly important.

390. Many buy-side firms were against the proposal and of the view that, until a full-fledged consolidated tape for all instruments is in place, no changes should be made to the waiver regime. Furthermore, these respondents suggested that in order to improve transparency,

trading venues should not offer more than four order types since currently trading venues are offering too many order types that are not for the benefit of end-investors. Finally, some sell-side firms noted the importance of the SSTI concept for the SI regime.

391. As regards to those agreeing with ESMA's proposal to delete the SSTI waiver, the vast majority were of the view that it should be accompanied by lowering of the LIS threshold. Respondents agreed that the transparency regime would be significantly streamlined by combining the SSTI and LIS waivers into one clear size-based waiver from pre-trade transparency requirements.

392. Respondents also urged to remove the SSTI concept across MiFIR, i.e. also for the SI-quoting obligation and to replace it by a reference to (a high percentage of) the LIS threshold. One respondent suggested applying the same pre-trade transparency thresholds for all trading systems and SIs. This would provide for a more level playing field and could be considered alongside a revised LIS threshold.

393. A number of respondents noted that an idea for fixed income related derivatives, for example, would be to re-evaluate applicable trade-percentiles and volume-percentiles for specific sub-asset classes including a potential switch from trade-percentiles to volume-percentages where appropriate.

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.

394. Views on the two options were split, with a majority of respondents (representing the buy- and sell-side) in favour of option 1, i.e. to keep the concept of SSTI for the SI-quoting obligation. It should be noted that many stakeholders supporting of option 1 stressed their opposition of deleting the SSTI waiver. A few respondents in favour of option 1 suggested replacing the SSTI threshold currently determined on the basis of percentiles by a fixed threshold at the same level as the current applicable SSTI threshold).

395. Option 2 also received significant support, in particular from trading venues, but also from a number of buy-side participants. Stakeholders in favour of option 2 stressed the need to align the pre-trade transparency requirements for SIs and trading venues. Most stakeholders in favour of option 2 recommended that the threshold for the SI-quoting obligations should be a high percentage of the LIS-threshold.

396. A few respondents considered that there was no need for a special regime for SIs in the first place.

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.

397. A large majority of respondents representing a variety of stakeholders, including trading venues, energy traders, large sell side firms, did not support the proposal to turn the hedging exemption into a negotiated trade waiver. The argument made is that this would increase paperwork and procedural obligations, thereby outweighing any potential benefit that the waiver approach may bring.

398. Most respondents supporting retaining the hedging exemption however suggested to extend the benefit of the hedging exemption to financial counterparties so that all participants can manage risks arising from activity in the physical market. Extension of the exemption to financial counterparties would also allow for crucial trades in nascent and illiquid contracts to be executed on venue for clearing purposes.

399. Although supportive of retaining and extending the hedging exemption, some respondents also supported introducing a new negotiated trade waiver under Article 9 of MiFIR for commodity derivatives or more broadly for non-equity instruments.

400. The respondents supporting the proposal for the sake of clarity and legal certainty included some banking federations and trade associations, as well as one trading venue. They had split views as to whether the waiver should cover all derivatives (Option 1) or be limited to commodity derivatives (Option 2).

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.

401. The majority of respondents opposed the proposal for ESMA to issue an opinion on new trading protocols using different arguments. Amongst opponents to the proposal two groups can be identified.

402. The larger group stressed that the current definitions of trading systems and their respective transparency requirements, as set out in Annex 1 of RTS 2, are sufficient to cover all systems used to trade.

403. In addition, this group noted that: (i) the creation of a burdensome and time-consuming approval process, could be an obstacle to innovation; (ii) the case-by-case approach could lead to a fragmented and patchy regulatory treatment of the trading systems; and (iii) ESMA would have to develop an opinion on systems never assessed before and without proper involvement of market participants.

404. With respect to ESMA's role in the process, it was also stressed that NCAs are supervising trading venues and better placed to oversee and monitor the functioning of trading systems in the respective jurisdictions.

405. The second group of respondents, while agreeing that the current catalogue of trading systems in Annex 1 of RTS 2 does not fully capture all available trading systems and results in several system being classified as hybrid systems, did not support the envisaged ESMA opinion on new trading protocols as proposed in the CP.

406. The possible alternatives they suggested included: (i) better clarifying the existing definition of trading system; (ii) extending the definition of trading systems in order to cover variations of the current system types, which may share the same characteristics but are also innovative; and (iii) using ESMA's opinions as a complementary solution, only for new trading systems which are in no way variations of the definitions listed in Annex 1 and completely innovative.

Q7: Do you agree with the proposal for the definition of hybrid systems? 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.

407. A majority of the respondents to the consultation agreed with ESMA's proposal to further clarify the definition of hybrid systems. Respondents indicated that hybrid systems should not be used as a catch all category and should not facilitate the avoidance of transparency. Where a hybrid system simply covers a combination of other systems, that system should meet the pre-trade transparency obligations applicable to each relevant component part of the overall trading system.

408. Several respondents recommended to cover hybrid system variations by extended definitions and address real innovations through ESMA opinions. One respondent noted that ESMA should focus its attention on trading systems that provide a substantively different price determination process than those specified in the current Annex. The Annex could even merge the existing criteria into a simpler platform-agnostic table that looks at the outcome of the price determination process. Another respondent noted that the definitions of Annex 1 should be amended in such a way that they cover variations of the initial system types, which might share main characteristics but are also partly innovative (such as "RFQ variations", covering RFQ systems which, for example, start with an RFQ and switch to an auction after the initial requester's trading interest has been satisfied).

409. One respondent stated suggested clarifying that both continuous order book and quote-driven trading systems which have market making agreements in place should not be subject to the pre-trade transparency requirements.

410. Two respondents noted that it would be more appropriate to review this definition not in isolation but in the broader context of a systematic and comprehensive review of all trading systems.

411. A couple of respondents emphasised that any further guidance should ensure that the categories of trading systems reflect actual practices while not being too prescriptive and leaving room for trading venues to determine the best fit. Guidance should also entail a proportional approach so that barriers to entry and innovation are minimised.

412. Those disagreeing with the proposal argued that the current definitions and their respective transparency requirements, are sufficient. Other respondents considered that adjustments should be made by introducing new categories of trading systems, leaving the hybrid category untouched in order not to unduly hinder innovation and not to jeopardize the existence of established market models which currently fall into this category. Some respondents, noted that the way forward proposed by ESMA would constrain innovation and limit the evolution of bond market trading practices.

413. Lastly, some respondents to the consultation paper noted that regarding trading systems in a broader sense, a far bigger problem for pre-trade transparency exists with regard to other firms operating unregulated trading systems and protocols (so called software or middleware providers).

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

414. The great majority of respondents agreed with the proposal to require SIs to make available data free of charge 15 minutes after publication, as this would remove asymmetries across markets.

415. They noted that, under the current regime, SIs can use delayed, free of cost pre-trade data from trading venues to determine their prices whereas trading venues are not able to access SIs pre-trade information free of charge.

416. According to this group of respondents, in addition to further level the playing field between SIs and trading venues, the solution would also improve the overall access to pre-trade transparency for all investors, facilitating investment decisions.

417. Few respondents belonging to this group also pointed out that to ensure a level playing field with trading venues, an extension to SIs of the ESMA Q&A on MiFID II/transparency topics (Q&A 9a) would be necessary.

418. Other respondents would only support the proposal, provided that: (i) it is limited to TOTV products and (ii) trading venues do not charge the SIs when providing and publishing quotes.

419. Only a minority of respondents discouraged ESMA from making any change to pre-trade transparency requirements. They stressed the importance of conducting a full cost-benefit analysis including establishing the real demand for such a change, the costs of building the require systems and any other undue risk, before proceeding with the proposal. They also noted that the current delayed data regime has proved to be costly to implement and with very little interest from market participants.

420. Some respondents against the proposal also argued that trading venues and SIs have different characteristics which justify the application of different sets of rules. Furthermore, they pointed out that Article 18 of MiFIR already specifies which quotes an SI must make

available, at which point in time and under what conditions, taking duly into account that SIs are bilateral business models.

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

421. Most respondents considered that developing technical standards would be of benefit to the industry, provided the template only incorporates a minimal number of relevant fields to ensure only essential information is disclosed. The template should not be overly prescriptive given the different specificities of all the non-equity asset classes that would be in scope and be developed in cooperation with relevant market stakeholders.

422. Several respondents pointed out that the template should be based on existing data standards, for example using fields that have already been defined under MiFID post-trade transparency or transaction reporting obligations. The standardisation in pre-trade transparency should be reached through:

- the use of ISINs for derivatives;

- the use of UTIs;

- the creation of a Consolidated Tape, as the first level of pre-trade transparency rely on high-quality post-trade data.

423. Moreover, the proposed standardisation of pre-trade information should be applicable to all types of execution venues, including SIs.

424. Other respondents were of the view that it would be operationally complex to implement the ESMA proposal and the objective of achieving a greater level of pre-trade transparency on financial markets would not be met by further standardising the pre-trade information. They argued that each transaction involving a non-equity instrument has its own characteristics, linked to the nature of the instrument and to other factors, which means that the price set for one transaction is not transposable to another. Therefore, standardisation of the pre-trade transparency information would be useless to ensure a comparability of the information provided to clients and investors.

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

425. A large majority of the respondents generally agreed with ESMA's assessment that the overall level of real-time post-trade transparency remains very limited. Those respondents believed that MiFID II has not delivered meaningful post-trade transparency for non-equity asset classes.

426. These respondents provided different suggestions to improve the regime such as shortening the deferral periods significantly and harmonising the use of deferrals across Member States.

427. By contrast, a smaller group of stakeholders expressed a different view, mentioning that the MiFID II/MiFIR post-trade transparency regime is the largest regime of its type globally, in terms of the number of financial classes and types of instruments within scope. Similarly, those respondents noted that the requirements introduced by MiFIR have prompted a significant increase of post-trade data and that the overall level of real-time post-trade transparency is a reasonably decent one.

428. However, all respondents agreed with ESMA's statement about the need of a more streamlined and uniform post-trade regime across jurisdictions. The current regime provides national discretion which may cause unlevel playing field issues. In any case, this should be well calibrated and well timed in order to allow the market to continue to function efficiently. One respondent would support the above-mentioned simplification provided it does not expose liquidity providers/SIs to undue risks. Another respondent mentioned that any simplification and harmonisation of the post trade regime should not create additional implementation costs for the concerned entities (e.g. IT costs).

429. Lastly, one response stated that the main issue with the transparency regime is not the incoherence of deferral regimes, but rather the access to data, pointing out that the focus should be on setting up a consolidated tape. Related to this, another respondent considered that although MiFID II/MiFIR has increased post-trade quality data, information is not easily accessible to the market as post-trade information is fragmented across the different venues and APAs.

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

430. Respondents had split views with regards to the proposal to delete the SSTI concept in the post-trade transparency regime with a very slight majority in favour of the proposal.

431. Many of the respondents that did not support the proposal brought forward arguments similar to those made with regards to the pre-trade transparency regime. Those respondents argued that it is still premature to make any significant changes to the post-transparency regime. In addition, as more instruments will be considered liquid, the use of the SSTI will be increasingly important and any changes to the regime would be detrimental to liquidity.

432. Those respondents were of the view that there should be a more careful analysis of the regime and the post trade data currently available. Some respondents also mentioned the consolidated tape as a tool that can improve post-trade transparency without the need to change the deferral regime.

433. Respondents who agreed with ESMA's proposal stressed that the current regime is overly complex and the SSTI threshold deletion would have the positive effect of simplifying the regime. Those respondents supporting were split between those that agreed with lowering the LIS threshold together with the deletion of the SSTI threshold and those that did not. One common comment from these respondents was that the same changes should apply to the SI regime.

434. Most respondents agreed with having a single deferral threshold per asset class.

435. Regardless of their views on the proposal, some respondents expressed doubts as to the quality of the data used by ESMA. The suggestion was made that ESMA should consider referencing commercial data available from third-party sources to provide a benchmark against the MiFID II data ESMA receives. This would allow ESMA to validate the quality of the data ESMA receives and ensure more accurate annual LIS/SSTI and liquidity calculations.

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

436. Views were split between option 1, 2 and 3 and those market participants in favour of no changes (mainly sell side) or in favour of a more transparent regime (mostly trading venues) with deferrals lasting no longer than T+2.

437. Of those in favour of option 1, some respondents recommended that the option should be amended to allow for the publication of price information only after 2 days and full publication after two weeks. One stakeholder supported option 1 only for bonds, and suggested option 2 or 3 for derivatives.

438. Most respondents in favour of option 2 or 3 expressed a slight preference for option 3. One stakeholder suggested that providing real-time transparency for illiquid instruments would be of particular value. Some stakeholders in favour of option 2 or 3 suggested that option 1 could be acceptable if the share of liquid instruments was higher (e.g. all derivatives subject to the EMIR clearing obligation should be considered having a liquid market).

439. Out of those respondents not supporting any of the options presented, two groups can be identified.

440. A first group of stakeholders (composed mainly of the sell-side) considered it important to maintain the current regime to avoid negative liquidity impacts, avoid disclosing positions and allow market makers to unwind their positions. These respondents considered that ESMA should focus on calibrating the current system, improving data quality and establishing a CTP rather than changing the regime at such an early stage. They also stressed that many transactions are already published after 2 days and that the

comparison with the US TRACE system is not appropriate (i.e. smaller scope of instruments, gradual build-up, full transparency only after 6 months, only aggregated information for sovereign bonds, more developed capital markets in the US). Some of these stakeholders suggested though to harmonise the regime EU-wide to avoid having different deferral systems in place (i.e. T+2, plus 4-week volume omission in the whole EU). A few MTFs also cautioned against reforming the deferral system.

441. A second group of stakeholders (mainly trading venues) were supportive of a simplified regime but suggested alternative proposals. In particular, they recommended shorter deferral periods (i.e. T+1 or T+2).

442. Respondents pointed to differences in the US regime (TRACE for bonds and regime for SEFs) and asked for clarification to which regime ESMA was referring to. Stakeholders had also different perceptions of the effects of TRACE. In the view of some stakeholders it resulted in market participants no longer willing to trade high volumes, whereas other did not agree with this assessment and praised the positive effects of more transparency.

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?

443. The large majority of respondents reiterated their response provided to Q12.

444. The majority of respondents expressed a preference for a one-step approach but had different views on the appropriate length of the deferral ranging from 5-15 minutes to several weeks. The two-step approach was only supported by few stakeholders.

445. Most stakeholders from the sell-side were against any of the options presented and highlighted that a two-step approach as suggested under option 3 would increase further complexity.

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?

446. From the responses obtained, the majority of respondents would support the measures proposed by ESMA. However, some respondents considered that the current issues are not related to poor enforcement or that changes in the level 1 text are not needed. In addition, two participants did not support broadening the scope of post-trade transparency to derivatives. One respondent argued that an analysis of the application of the current

regime should be carried out once the liquidity status of FX derivatives is re-assessed. Those against the proposal did not see a need for changes to be implemented.

447. The majority of participants made detailed proposals in their responses. Among the suggestions for improving the level of post-trade transparency, it was mentioned that:

- Further guidance from ESMA is needed (covering interaction with and use of FIRDS and FITRS or whether the SI regime should only apply to uTOTV instruments).

- Many respondents highlighted the problem of inconsistent CFI codes, as they do not match the instrument listing. In order to solve this, respondents recommended that ESMA liaises with ANNA/NNAs on this aspect.

- In addition, many participants stressed the importance to have a 'golden source' of data, listing all the instruments in scope of transaction reporting and post-trade transparency (which could be FIRDS if the reliability and data quality of this database are improved).

- It was also proposed that SIs should be able to contractually agree with other SIs on which entity is in charge of reporting.

- Some suggested a Level 1 change prohibiting charging for data even prior to 15 minutes (consistently with the US regime).

- Some recommended that the ESMA's FIRDS and FITRS databases incorporate asset class and sub-asset class classification in their extractable liquidity determination lists and that these lists are made available for public consumption.

- Other considered that APAs should be required to systematically publish data amendments (there is often no tagging of a cancellation of or amendment to the original report) and that deferral regimes should be simplified.

- Lastly, for some respondents, reporting should require more than one identifier (apart from the ISIN), as ISINs are not fit for purpose for OTC instruments reporting.

448. The following proposals were less mentioned but still considered:

- A respondent proposed not requiring users to have a license to access post-trade transparency data. This respondent also considered that the guidance clarifying that "Where a redistributor/third party charges for added-value services created from such data, trading venues, APAs and CTPs may impose fees or other similar restrictions to this redistributor/third party." should be reviewed. It potentially restricts any commercial use of the data which is made available free of charge since "added-value services" could be understood broadly and include activities such as making investment decisions on the back of the data, where that company is charging a management fee.

- One respondent recommended ESMA to promote harmonisation when discrepancies exist in Member States' transpositions. In addition, the respondent proposed more supervision at the EU level.

- Other respondents stressed that the use of the flag 'pending' or how to fill the 'price', 'quantity' and 'notional amount' fields should be clarified. Others flagged that the use of an ISO standard or the FIX typology is not always used and should be closely supervised.

- Some more generally asked ESMA to investigate some APAs blocking automated machine access or not following RTS 2 specification (so aggregated feed cannot be created across TVs and APAs).

449. In conclusion, the majority of responses did show general support for the way forward proposed. Other alternatives made concerned more practical aspects of transparency (e.g. inconsistencies in CFI instrument codes, use and reliably of FITRS and FIRDS data sources) or to the access to current data (e.g. making more post-trade data free of charge or removing existing arrangements preventing access to data). Views on promoting more enforcement were split: some believing that this is necessary, while others considering that the lack of transparency is not a lack of enforcement problem.

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

450. Respondents expressed different views of what would be the optimal transparency regime to help with the potential creation of a CTP. Few stakeholders mentioned that the regime should be: (i) comprehensive; (ii) real time; and (iii) low-cost. The main reason for this is that in any other cases the CTP will not have access to a sufficient amount of useful data to provide a valuable service to market participants. At the same time, one stakeholder considered that there should be no regulatory requirements placed on the CTP.

451. One respondent mentioned that the two main issues that should be addressed are (i) the low quality of data and (ii) the lack of a unified post-trade deferral regime. One respondent expressed similar concerns pointing out that a uniform and harmonised deferral regime across the EU would help with the quality of a bond consolidated tape. In addition, one stakeholder identified other issues that have prevented the emergence of a CTP, e.g. the lack of data standardisation, the lack of clarity about whether CTPs can provide additional services in addition to a consolidated tape, etc...

452. More generally, if some were of the view that the current regime should serve as a basis for the creation of a CTP others considered that the creation of a CTP is independent to any type of transparency regime. in the latter case, the question should rather be the

other way round as it would be the consolidated tape that will facilitate and push for data standardisation, data quality improvement, better understanding of market activity and liquidity and therefore allow for an appropriate calibration of the transparency regime.

453. Other respondents provided further suggestions. One suggested that the number of options available in the post-transparency regime should be reduced. Another respondent clarified that, rather than the transparency regime itself, the pre-condition for a consolidated tape for derivatives is high quality of data on a reasonable commercial basis.

454. As a general remark, respondents supported the creation of a post-trade CTP. However, a smaller group of stakeholders did not express support for the creation of a CTP stressing that there is no actual need for establishing one for any asset classes. One of those entities recommended the creation of a ‘Tape of Record’ as a viable alternative which would be a significantly less complex and costly to set-up, while providing a comprehensive database to the benefit of the entire industry. Finally, a couple of respondents were not in favour of the introduction of a consolidated tape for non-equity since this will increase market data costs and be of little value.

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

455. Responses received showed a clear split of views between trading venues and investment firms. The former agreed with the ESMA assessment that the TOTV definition is very narrow while the latter, who would be directly impacted by a broader interpretation of the TOTV concept, disagreed with it.

456. More specifically, within the respondents that agreed with ESMA’s assessment that the TOTV definition is very narrow in its current form, some concurred with ESMA’s assessment but believed it needs to be expanded as it does not explain why there should be 20 million ISINs created in OTC products for which there has been no turnover data reported to FIRDS, given that DSB charges for the creation of an ISIN. Such respondents think it would be more useful if supervisors had reconciled the data reported under RTS 22 with that reported under RTS 2.

457. To improve transparency, the respondents also suggested expanding the scope of the DTO, allowing for fewer exemptions from clearing, and maintaining robust equivalence between global trading jurisdictions. Especially in the context of the LIBOR transition, the DTO should be expanded to capture alternative risk-free rates (SOFR, EuroSTR, SONIA) which would help achieving the goal of regulators and policymakers alike in making RFR-based swaps more transparent.

458. Respondents that did not consider that the non-TOTV concept is too narrowly interpreted disagreed that more derivatives should be subject to transparency requirements because it would not serve any valid purpose. The main arguments against ESMA’s assessment were as follows:

- investment firms offer custom products to their clients with unique characteristics. Requiring transparency measures to apply to those instruments would not help price discovery or set a benchmark for clients trading those non-TOTV products. Furthermore, these instruments are not traded on-venue, and therefore, cannot be required to be made transparent simply for the sake of levelling the playing field between on-venue and off-venue trading.

- making such non-TOTV instruments transparent would not (i) help any price discovery or identification of available liquidity either on- or off-venue for any existing or potential new market participants (because such products are custom, unique and therefore not comparable), nor (ii) help the development of those custom products and client solutions by liquidity providers if this transparency results in increased risks for them (more difficulty to hedge notably), nor (iii) help clients trading those non-TOTV / custom products, because such products are unique and therefore not comparable nor (iv) level the -playing field with trading venues, as such instruments are not available on venue and would never need to be.

- the creation of ISINs for non-TOTV instruments, which will be traded only once, will only complexify the reporting framework as an ISIN would need to be created with an external provider (ANNA DSB), reported to FIRDS, used in the transaction reporting of both counterparties to the transaction implying an exchange of that ISIN between counterparties and its integration in their respective systems, after execution.

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.

459. A very large majority of respondents supported maintaining the TOTV concept aligned for both transparency and transaction reporting. They considered that not aligning the two would introduce unnecessary complexity leading to increased compliance costs for market participants (those costs being already very high) and more data quality issues. Some stressed that, if alignment remains preferable, it also calls for additional caution to be exercised when amending the TOTV concept since a change made to address one policy need (e.g. increase transparency) could have unintended consequences for another.

460. Those that disagreed with the alignment were mainly concerned about uTOTV instruments (and not pure TOTV instruments). They considered that ESMA should not propose to apply post-trade transparency to those instruments. More generally, those respondents considered that transaction reporting should be broader in scope than post-trade transparency.

461. One respondent considered that transaction reporting and transparency provisions could be different, not necessarily in terms of the instruments or transactions, but rather in terms of the entities responsible for the reporting. The respondent invited ESMA to consider a market structure where transactions are not negotiated on multilateral platforms but formally executed by the financial market intermediary. In this case, the trading venue should be responsible for publishing details of transactions while the counterparties or the financial intermediary would remain responsible for the transaction reporting.

462. Respondents more generally stressed that post-trade reports remain highly resource intensive and invited ESMA to reflect on whether more synergies and simplification could be found between the various different reporting obligations. For instance, some suggested to merge the MiFIR transaction reporting with EMIR reporting. They noted that the added complexity of the various reporting is generating many errors and generally participate to poor data quality.

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.

463. Respondents were quite evenly split between those supporting option 1 and those supporting option 3 (removing the TOTV concept bringing, as a consequence, all OTC transactions, within the scope of MiFIR post-trade transparency obligations). There was however a slight majority for option 1.

464. Those supporting option 1 (status quo) stressed that market participants already had to go through resourceful and costly developments to comply with the current reporting requirements and that it is maybe not the right time to change or further expand those. Some suggested that ESMA should rather focus on ensuring high quality reporting and the development of a tape.

465. Those supporting option 3 noted that it would (i) establish a comprehensive transparency regime for OTC transactions, (ii) level the playing field between trading venues and SIs, (iii) increase consistency with other jurisdictions (US in particular), (iv) reduce the operational and compliance costs. In their view, most participants active in the OTC space trade not only non-TOTV instruments but also TOTV derivatives and therefore have the capacities to easily cope with an extended scope of application of post-trade transparency. Lastly, the deferrals contained in the MiFIR transparency regime provides for adequate protection to OTC market participants leaving them sufficient time to hedge their position before transactions would be made public. On the contrary, those supporting option 1 considered that option 3 would bring non-standardised products into the scope of transparency while those are bespoke by nature and therefore not suitable for such disclosure.

466. Option 2 only received limited support during the consultation, with many respondents highlighting (i) the additional complexity this would introduce, (ii) the possibility for market participants and SIs to design products avoiding post-trade transparency, and (iii) the difficulty to define criteria that will be used to identify standardised derivatives (that should be subject to post-trade transparency). Some highlighted that the proposal to request trading venues to be published information regarding standardised products traded on their platforms would also not allow automation of TOTV check which is yet a necessary arrangement for investment firms subject to MiFIR reporting obligations.

467. Some noted that, beyond the options proposed by ESMA in the CP, the scope of OTC transactions subject to transparency could be increased by targeted amendments to the

ISIN allocation criteria (e.g. referring to the tenor of swaps instead of their maturity date) and the reporting time to FIRDS.

468. Lastly, one respondent suggested, as an alternative option, that OTC derivatives transactions involving a firm that is a systematic internaliser in the relevant sub-asset class are presumed to be subject to post-trade transparency. There would be no TOTV test for these transactions which would be automatically subject to post-trade transparency, with the systematic internaliser fulfilling the reporting obligation.

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

469. Only some respondents agreed with ESMA's proposal to remove the possibility to temporarily suspend transparency provisions. These respondents argued that maintaining transparency during all market conditions is necessary for investor confidence, liquidity, and efficient market functioning.

470. A very large majority of respondents however did not support the removal invoking several reasons. Some did not consider the fact that it has not been used as sufficient reason to delete the safeguard. It may be too early to draw conclusions at this point in time, and it can be doubted whether the provision of a temporary suspension of transparency obligations was designed with frequent use in mind. Others noted that the possibility provides a backstop for extreme market conditions. Such conditions were recently witnessed during the volatile events of Q1 2020. It could be necessary to have this backstop in the future and hence it should not be deleted. Other current provisions, such as the suspension of trading, might not have an equivalent effect. Moreover, some noted that we are only in the first of the four stages tightening the transparency regime, with the final stage resulting in a significantly greater number of bonds becoming liquid. Finally, the changes that come from this consultation, given they are unknown at this stage, may increase the need to retain the possibility to temporarily suspend transparency provisions.

471. Some noted that a temporary suspension is not practical. There were some respondents who stated that it was unclear whether it is a necessary requirement to retain.

472. A couple of respondents noted that if this provision is maintained, they agree with introducing an EU-wide mechanism to ensure consistency. One respondent emphasised that a regime applicable at EU level still needs to have sufficient regulatory flexibility to ensure the continued functioning of financial markets. However, three respondents were against changing to an EU wide mechanism and were in favour of keeping the responsibility with the individual NCAs as this would allow for a more responsive mechanism.

473. One respondent envisaged specific changes to the current regime, emphasising a need for more timely reaction (make it feasible to detect in real time the unexpected and significant decrease in liquidity and enable NCAs to proceed with urgency), more

granularity (to avoid that a significant decline in liquidity affecting a specific “niche” of financial instruments belonging to a wider class risks goes undetected) and lower thresholds for stressed scenarios (requiring a percentage decline higher than 60% and 80% for instruments which have, respectively, a liquid and an illiquid market risks being excessively challenging).

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

474. Approximately half of the respondents either broadly agreed with ESMA’s assessment of Article 28 of MiFIR or noted in particular agreement as regards the need to adjust the DTO regime to align it with the changes introduced by EMIR Refit.

475. It was stressed a couple of times by respondents representing the trading venue side 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 conducted by ESMA. One respondent from the trading venue side argued for expanding the scope of the DTO, allowing for fewer exemptions from clearing, and maintaining robust equivalence between global trading jurisdictions. For instance in the context of the LIBOR transition, the DTO could be expanded to capture alternative risk-free-rates. It was noted that while exemptions may well have good intentions they create a division and a possibly even greater hurdle for market participants to benefit from automation of trades, improved quality of execution, and greater returns for their end investors. The latter was in line with the remarks of another trading venue, i.e. that it seems questionable whether exempting these market participants will eventually serve to their advantage as they will most likely remain strongly bilaterally exposed to a potential default of large market participants and overall will increase their dependence on these.

476. One respondent representing the buy-side asked for the complete removal of the DTO, and that otherwise the regime should be improved in terms of (i) aligning trading and clearing regimes and scopes, (ii) ensuring equivalence with the UK’s and US’ regime applicable to derivatives, (iii) suppressing the DTO for SFC and NFC, to ensure alignment with EMIR Refit, and (iv) suspending automatically the DTO when the CO is suspended.

477. Two respondents reacted that in order to make the EMIR-MiFIR alignment future proof, it would be preferable to refer to ‘transactions’ that are caught by the CO and DTO, rather than to ‘counterparties’.

478. Another respondent noted that it should be ensured that regulators have a clear mechanism to quickly and effectively suspend the DTO; and clarify that the introduction of benchmarks fallback clauses under BMR Article 28(2) does not trigger the application of a DTO, and to clarify that trades resulting from post-trade risk reduction activities should not be subject to the DTO and CO.

479. Two respondents from the trading venue side noted the following remark. While derivatives traded on a RM are subject to an obligation to centrally clear, look-alike contracts traded (EMIR) OTC 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. According to these respondents, there would be 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.

480. A couple of respondents proposed to amend Article 28(4) to ensure that central aspects of the MiFID II framework are considered as part of equivalence decisions. These include ensuring third-country trading venues (a) provide market participants with non-discriminatory access and (b) apply comparable transparency requirements to derivatives subject to the DTO.

481. In the context of Brexit, two buy-side respondents asked for the removing third country branches of EU firms from the scope of application of the EU DTO considering the uncertainty surrounding the granting of equivalence to UK trading venues (the preferred option) and possible conflicting EU and UK trading obligations. One respondent noted that the implementation of Article 28(2) MiFIR should be carefully monitored in order to avoid that its application to EU branches operating in non-EU countries undermine their competitiveness in favour of local intermediaries. Another respondent noted that in addition to restricting the scope of the DTO, adopting a strictly territorial application of the DTO or avoiding conflicting rules under Article 33 of MiFIR could be considered by the EU and the UK. In general, several respondents emphasised the importance of the Commission (shortly) adopting equivalence decisions regarding UK trading venues.

482. It was noted by one respondent that ESMA should consider explicitly banning the practice of post-trade name give up as it limits liquidity and best execution for certain instruments which are subject to the clearing obligation.

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.

483. Almost all respondents considered the current criteria used to assess the liquidity of derivatives sufficient and appropriate and did not deem it necessary to include any further criteria.

484. Answers show there is also almost unanimity on the idea that ESMA should not make use of the provision in Article 32(4) MIFIR. In this respect, a few respondents reported to have not identified any asset class which should be subject to the DTO in the absence of CCPs offering clearing of such products, and one that the instruments in questions are either not standardized or liquid enough to be subject to the DTO. One respondent also reported to believe that the use of the provisions under Article 32(4) MIFIR with respect to non-standard date derivatives or off-the-runs could detrimentally impact the liquidity of those instruments.

485. A matter that was pointed to by more than one respondent is that in the context of Brexit, the liquidity of instrument currently in-scope for DTO and more generally the scope of DTO should be reassessed knowing the changes that Brexit could introduce (especially regarding GBP and USD IRS).

486. The answers which slightly differed from those just reported brought forward different ideas.

487. For example, one respondent expressed the idea that for non-cleared products, market participants should be able to decide on a case-by-case basis whether they want to conduct a trade OTC or on-venue (should a venue be prepared to execute a non-cleared trade).

488. Another respondent supported the idea that all OTC derivatives should be subject to the trading obligation, unless they can be proven to be illiquid, and that it is the illiquidity that should need to be proven.

489. One respondent expressed the view a more customized approach to assess which instrument is liquid or not liquid should be applied.

490. A recommendation made to ESMA was to assess the impact of the DTO using transaction reports published under MiFID II instead of voluntary data collection exercises. It was argued that this is critical for policy assessments to take into account all the market-wide trading activity across all relevant trading venues, rather than few trading venues.

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.

491. All respondents, which represented a variety of stakeholders, generally agreed with the proposal to have a procedure in place to swiftly suspend the trading obligation for derivatives, although a couple of respondents stressed that if so required by the circumstances, the suspension should not be “swift” but “immediate”.

492. Two stakeholders noted that the suspension of the trading obligation should be based on pre-defined mechanisms and pre-defined criteria to give as much guidance as possible to market participants.

493. One respondent further stressed that the suspension of the DTO should be a last resort option and subject to objective market metrics that are both easily observable by all participants and defined by ESMA and presented to the market for comment. Another respondent supported public consultation on the DTO suspension if circumstances allow and otherwise ensure that the various viewpoints are considered by policy makers before making such important decision.

494. A couple of respondents noted that whilst a suspension of the CO should also lead to a suspension of the DTO, a suspension of the DTO, however, would not need to necessarily lead to a suspension of the CO.

495. One fund management association supported deleting the DTO and considered ESMA's proposal as a second best, suggesting extending the suspension period beyond 12 months.

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

496. Respondents provided different suggestions and comments in relation to the DTO and its application with respect to branches as well as on whether this should be aligned with the STO.

497. Most of the issues highlighted by respondents are related to Brexit. In particular, several stakeholders mentioned that without an equivalence decision, the EU DTO will prevent UK branches of EU firms to continue trading on UK derivatives venue. On this, it was stressed that should equivalence not be granted to UK trading venues, the trading obligation should not apply anymore to transactions carried out by third countries branches of EU firms in order to avoid applying two conflicting trading obligations to these branches so they can remain competitive. Consequently, those respondents suggested to amend the provisions of Article 28(2) of MiFIR accordingly.

498. In addition, a couple of other participants suggested that discrepancies between the MiFIR transparency regime and the trading obligation should be aligned to the best extent possible. According to the same respondents, this can be achieved through: a) defining which asset classes are generally appropriate for trading on trading venues (i.e. trading eligible under the MiFIR trading obligation); and b) trading venues to assess the application of pre- and/or post- trade transparency exemptions in order to mitigate any adverse effects, and consequently to apply for waivers and deferrals with competent authorities.

499. Furthermore, a couple of respondents made the following suggestions to improve the regime: i) monitoring the impact of the DTO on clients; ii) prohibiting post-trade name give-up; and iii) reconsidering pre-arranged trading.

500. Moreover, one buy-side association asked ESMA to remove the DTO. The same respondent added that, should the DTO be maintained, the following four aspects of the existing regime should be improved: (i) aligning trading and clearing regimes and scopes, (ii) ensuring equivalence with the UK's and US' regime applicable to derivatives or applying it only on EU securities, (iii) suppressing the DTO for SFC and NFC, to ensure alignment with EMIR Refit, and (iv) suspending automatically the DTO when the CO is suspended.

501. Respondents raised also a point related to BMR. There seems to be a consensus on the fact that the introduction of fallback clauses in legacy contracts should not trigger a DTO. Those entities asked ESMA to clarify this (by an hoc-amendment in MiFIR), that i) the substitution of interest rate benchmarks and ii) the introduction of fallbacks pursuant to BMR should not trigger the application of the DTO.

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

502. Market participants agreed on considering the register as useful and as a tool that should be maintained. Just one respondent proposed to merge the register with FIRDS so that all data can the gathered in the same place.

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.

503. Respondents expressed a broad variety of views. Overall though, a majority of respondents appeared to be in favour of improving the current methodology rather than undertaking a comprehensive overhaul. Trading venues appeared more concerned about the low number of bonds qualifying as liquid while, for banks, this low number is justified considering the specific market structures and trading pattern of those instruments.

504. One area for improvements often mentioned is the quality of data. While respondents welcomed the progress made by all parties, some stressed that many transactions appear to be not or only partially reported with impacts on the overall number of bonds considered liquid. Many respondents suggested ESMA to associate market participants more closely to help identifying issues and misreporting. For instance, some respondents invited ESMA to share its data (and not only the results) with market participants to allow them to better understand the calculations performed and more easily spot possible anomalies. Other suggested to perform those checks through the ESMA's Data Advisory Group (DAG). Lastly, several respondents reported discrepancies between the calculations published on the different ESMA sources (i.e. website, Register web interface and FITRS XML).

505. Some respondents noted that all bonds do not have similar liquidity patterns and recommended to apply different tests to the different categories of bonds. Some suggested to differentiate here between the different bond types (e.g. sovereign bonds, corporate bonds, private placement, emerging markets, high yield, etc…) while others would rather use ratings as a differentiating criterion (e.g. Investment Grade vs non-investment grade bonds). Some respondents also suggested to exclude bonds that never trade for the ESMA analysis. Finally, some considered that different thresholds could be used depending on the life stage of the bond (e.g. the longer the time to maturity / from issuance, the tighter the thresholds).

506. Many members stressed that liquidity of bonds is very cyclical which explained the change of liquid status of numerous bonds. For them, the calculation frequency currently used (quarterly assessment) does not fit well with the liquidity pattern of most bonds. By way of example, the first ESMA assessment based on issuance size can remain valid for up to 5.5 months while in practice the most active trading period typically only lasts three weeks after issuance. Some members therefore recommended to renew the ESMA calculations more frequently, i.e. on monthly basis (in particular after issuance and over the last month of the bond's life).

507. No specific comments were made regarding the criteria currently used and the concerns raised seems to concern the applicable thresholds rather than the criteria themselves. Some members however invited ESMA to also take into account transactions below EUR 100,000 when performing the liquidity calculations (note from ESMA: those transactions are actually taken into account for the liquidity test but excluding for the purpose of SSTI and LIS computations).

508. Those that considered that the thresholds should be revisited invited ESMA to do this based on available data to ensure that the new thresholds are better aligned with the general objective of MiFIR. Others considered that, considering the current context (e.g. Covid-19 crisis, Brexit), thresholds should be maintained, and any revision postponed to a later date.

509. Lastly, some respondents suggested to simply abandon the concept of liquidity for bonds and to only calibrate transparency based on the size of transactions.

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

510. The feedback to this question is provided in the MiFID II/MiFIR Annual Report under Commission Delegated Regulation (EU) 2017/583 (RTS 2) (link).

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.

511. The feedback to this question is provided in the MiFID II/MiFIR Annual Report under Commission Delegated Regulation (EU) 2017/583 (RTS 2) (link).

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.

512. The feedback to this question is provided in the MiFID II/MiFIR Annual Report under Commission Delegated Regulation (EU) 2017/583 (RTS 2) (link).

Q29: What is your view on the current calibration of the ADNA and ADNTE 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.

General feedback on the liquidity determination for commodity derivatives

513. A majority of respondents underlined that the current calculation methodology, in general, is not appropriate for non-equity instruments and in particular for energy derivatives. In their view, the current framework has led to the following unintended consequences: (1) new and illiquid contracts being incorrectly classified as liquid, hence becoming subject to transparency requirements which are appropriate for developed markets; (2) small members whose capabilities are limited to trading smaller sizes on a pre-negotiated basis (e.g. block trades) are prevented from doing so, and have to conclude their transactions either OTC, or on a central limit order book with a risk of sub-optimal execution (due to low liquidity).

514. In their view, this has led to reduced liquidity for market participants generally, but particularly for commodity producers and consumers who often utilise futures for physical commodity hedging purposes.

515. Several markets participants highlighted the specific characteristics of commodity markets, which in their view would justify a different regime for those instruments. They stressed in particular that commodity derivatives are often illiquid; therefore, the possibility to pre-negotiate the transactions away from trading venue (for subsequent on-venue execution and CCP clearing) represents a vital option to achieve a good execution outcome.

516. They further indicated that commodities market participants utilize a broad range of contract types (in terms of location, delivery type, duration and size), which are used to hedge risks related to the production or consumption of an underlying physical commodity. This requires the identification of a counterparty, without bearing the risk of market movements or of disclosing sensitive information.

517. They often advocated that trading venues had incorporated those specific features and needs via the existence of block thresholds (block trades[26]). In their view, the LIS thresholds are currently set at values which are disproportionate compared to the pre-MiFID Block sizes, which prevents the market from functioning in an efficient manner. For example, they cited the highly liquid ICE Futures Europe Gasoil Futures contract, where the LIS threshold is equal to 10 lots compared to the 100 lots pre-MiFIR block threshold. In contrast, in less liquid products such as Rotterdam Coal Options, only trades above 50 lots would be considered LIS as compared to the 5 lots pre-MiFIR block threshold.

Liquidity determination

518. All respondents appear to agree on the idea that the metrics currently employed in RTS 2 for the liquidity determination (ADNA and ADNTE) are not appropriate to capture the liquidity profile of commodity derivatives.

[26] A block trade is a transaction negotiated privately, which size (generally in lots) exceeds a specific threshold set by the exchange (so called “Block threshold” or “Block sizes”). Block trades are subsequently submitted to the exchange for registration and clearing.

ADNA

519. First, as also acknowledged in para. 331 of the CP, the use of ADNA does not allow to make a distinction between (1) a market with on average few trades of large sizes (potentially illiquid); and (2) a market with on average numerous trades of small sizes (potentially liquid). Those two markets could have the exact same average daily notional amounts while exhibiting different liquidity profiles.

520. Second, the use of notional amounts implies that factors such as prices and currency fluctuations enter into account in the liquidity determination. Yet, respondents unanimously claim that such factors are unrelated to the liquidity status and only result in adding significant noise to the liquidity determination. They mention for example that:

- price movements occurring in the same direction as changes in liquidity exaggerate the liquidity changes;
- price movements which occur in the opposite direction mute the change in liquidity;
- price movements without a change in liquidity make liquidity appear more volatile than it actually is.

521. Hence the consensus is that liquidity should be determined, not in terms of notional amounts, but in terms of standard size measured in a base quantity unit that is native to the instrument (e.g. MW, barrels, tons), thus eliminating the influence of price and currency.

ADNTE

522. Respondents agreed that the use of the trade frequency is a reasonable metric to assess liquidity, as this reflects the ability to find a counterparty in a relatively short period of time. They however suggested that the current parameter for the ADNTE was inappropriately calibrated.

523. All reported that the current level of ADNTE was too high: some suggested ESMA to further consult the industry on the appropriate calibration, while others made concrete proposals.

524. Specifically, instead of the current value of 10 trades per day (which corresponds to 1 trade every 48 minutes, assuming an 8-hour trading session), they proposed to set the value at 100 trades per day (which corresponds to 1 trade every 5 minutes).

525. Several further proposed to use the median daily number of trades, instead of the average, as this metric flattens the impact of extreme values hence takes better into account the discrepancies in trade count within a day, over the historical period.

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?

General feedback in relation to the segmentation criteria

526. Many respondents expressed the idea that in general the segmentation criteria for commodity derivatives are insufficiently granular, which led in their view to several derivatives contracts being incorrectly classified as liquid and receiving inadequate LIS thresholds. They have pointed out in particular the case of oil commodity derivatives, where contracts with the same underlying but delivered to different delivery points, have been aggregated in the same sub-classes. This would have resulted in discriminatory treatment for the less liquid contracts.

527. One stakeholder suggested that the liquidity framework in general should not rely on the reference data provided under RTS 23, and instead solely rely on the reference data provided under RTS 2. According to this market participant, the absence of a legal link between RTS 2 and the sub-categories of RTS 23 has led to inconsistency and confusion in the market.

528. Some respondents discussed the possibly of adding the trading venue as a segmentation criterion and had split views on the matter. Those supporting the addition of the trading venue as a segmentation criterion consider that a contract should not be deemed liquid on Venue X solely on the ground that it is liquid on Venue Y. In their view, this methodology (which is the existing one) prevents exchanges from launching a new contract (or a new type of contract, depending on the granularity used for the liquidity assessment) that is already liquid on another venue. On the other end, one trading venue argued that products listed on several venues, with the same underlying, should be treated equally with respect to pre-trade transparency. In their view, departing from the current approach and adding the trading venue as a segmentation criterion could create opportunities to circumvent the pre-trade transparency obligations.

Feedback in relation to the specific proposals in the CP

Delivery location (SC1 and SC2)

529. Stakeholders expressed strong support in favour of the two proposals related to the segmentation criteria "settlement location" (SC1 and SC2). One APA mentioned that they experienced difficulties sourcing the field settlement location because the information is not made available by all trading venues. As a result, they supported the effort to standardise the field and make this data point more readily available to market participants.

530. While supporting the proposals SC1 and SC2, stakeholders asked ESMA to be mindful of the following elements:

- the existence of a standard to define the settlement location is straightforward in the case of electricity and gas (EIC Y Codes), but not necessarily in the case of other types of derivatives. In case no standard is available, the guidance should be to leave the field empty. Indeed, otherwise there is a risk that each venue will set its own standard, which would result in the creation of ad-hoc sub-classes;

- mandating the field settlement location to new sub asset-classes would result in significant IT developments and costs. Therefore, ESMA should adjust the timeline adequately and changes should only be forward-looking, without historical changes

Settlement type (SC3)

531. There was limited feedback received with respect to the proposal to apply the segmentation criterion “settlement type” to all energy sub-asset classes (SC3). Besides, those who provided feedback did not support the proposal. They claimed that the introduction of a new field would result in a change to the file structure, which would be costly in terms of IT adaptation. They consider that adapting the existing segmentation criteria (as proposed under SC1 and SC2) should be sufficient at this stage.

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.

532. Market participants welcomed the analysis of the CP which evidenced the counterintuitive effects arising from the current percentile approach. Respondents generally confirmed that the current methodology based on percentiles and threshold floors leads by construction to high thresholds for the least liquid classes, and to low LIS thresholds for the most liquid classes. The results of this approach would imply that instruments with a low liquidity can support higher LIS levels that highly liquid instruments – when in fact the opposite is true.

533. This outcome is due to the differences in the liquidity distribution, between liquid and illiquid contracts, and several market participants have provided numerical examples and graphs to illustrate this effect. The quantitative analysis provided by stakeholders confirms ESMA’s findings as presented in the CP:

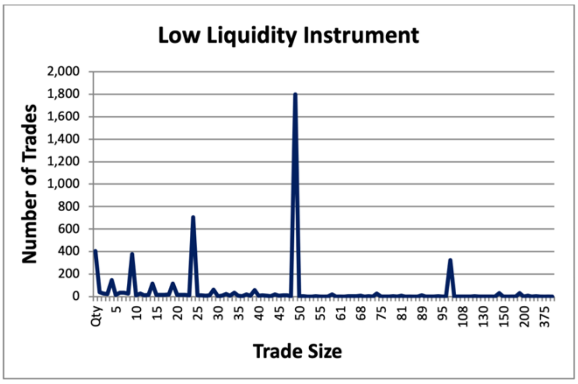
- instruments with high liquidity profiles exhibit very high liquidity in small sizes. For those instruments, the 70th percentile would typically be equal to a very low trade size (e.g. 1 lot as illustrated in Figure 1);

- for instruments with low liquidity profiles, the trade size is driven by metrics which are specific to the instruments and tends to cluster around specific multiple (e.g. 10 lots, 25 lots, 50 lots). For those instruments, the 70th percentile would typically be equal to a high trade size (e.g. 50 lots as illustrated in Figure 2).

Figure 1: Distribution of trade quantities in a highly liquid instrument

Source: ICE, 2018.

Figure 2: Distribution of trade quantities in a low liquidity instrument



534. As a result, most market participants suggested to use a scaled approach based on variations in distribution i.e. to use a methodology which would appropriately take into account the existence of different shapes in the distribution of liquid versus illiquid contracts. They have not been more specific as to which approach exactly could be used.

535. Finally, they argued that the minimum threshold (floor) of 500,000EUR is too high and should be decreased significantly.

<u>Way forward</u>

536. Market participants are aware that the proposals they are supporting (changing the methodology to determine liquid instruments and changing the methodology to set the LIS thresholds) represent very significant changes from a legal and operational point of view. Therefore, they suggested that a two-step approach might be the most efficient way forward:

- Step 1: the current methodology is maintained, but the parameters are recalibrated to eliminate the most problematic effects of the current functioning (i.e. the very high LIS thresholds for the least liquid instruments);

- Step 2: the current methodology is reshaped entirely on the basis of the proposals developed above (e.g. use of different metrics to determine whether an instrument has a liquid market, liquidity determined in a base quantity unit that is native to the instrument, percentile approach replaced by a scaled approach based on variations in the liquidity distribution)

537. One market participant supported the status quo (no change to the methodology nor to the parameters) and one market participant supported a change to the parameters but not to the methodology (i.e. supported Step 1 only).

538. With regards to the recalibration proposed under Step 1, there were 2 proposals: (1) a minority of respondents suggested that ESMA makes a proposal for (and further consults

on) a new calibration on the basis of the results of the liquidity calculations that are expected to be published in the summer 2020 (based on 2019 data); (2) a majority of respondents provided a new calibration set out below – and they all proposed the same.

	IL waiver (Table 7.1, Annex III, RTS 2)		LIS waiver (Table 7.2, Annex III, RTS 2)	
	Average daily number of trades	Average daily notional amount (ADNA)	LIS percentile	LIS, notional value of a trade
Current value	10	10,000,000	70	500,000
Proposal	**100**	**100,000,000**	**30**	**50,000**

	IL waiver (Table 13.1, Annex III, RTS 2)		LIS (Table 13.2, Annex III, RTS 2)	
	Average daily number of trades	Average daily amount (ADA)	LIS percentile	LIS, notional value per trade
Current value	5	**150,000** tons of CO_2 equivalent	70	EUA as underlying **50,000** tons / other underlying: **25,000** tons
Proposal	**100**	**150,000**	**30**	**50,000/25,000**