EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Director General

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Mr Steven Maijoor
Chairman
European Securities and Markets Authority - ESMA
103, rue de Grenelle
F-75345 Paris

Dear Mr Maijoor, Dear Steven,

On 28 September 2015, ESMA submitted to the Commission the draft regulatory technical standard (draft RTS) on transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives pursuant to Article 9 and Article 11 of Regulation (EU) No 600/2014 (MiFIR).

The draft RTS submitted by ESMA lays down the criteria for when bonds, structured finance products, emission allowances and derivatives are considered to be liquid and sets out the parameters and methods for the calculation of those thresholds above which waivers or deferrals may be granted.

On behalf of Commissioner Hill, I would like to inform you of that DG FISMA will recommend that the Commission endorses the draft RTS on transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives once the amendments described below are introduced.

Overall, we are supportive of general approach that ESMA taken to this standard. However, in the areas set out below we would like ESMA to take a more cautious approach to the calibration of the regime in the initial years, gradually building towards ESMA's proposed calibrations once the data reporting system is effectively up and running and the effects can be properly assessed. Such an approach is also reflective of the concerns raised by the European Parliament's ECON Committee and some members of the Council.

With regard to the determination of liquidity for all classes of bond markets we are concerned that two trades per day in a given bond (ISIN) might not be reflective of continuous buying and selling interest and that such a standard might identify too many bonds as liquid instruments.

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According to Article 2(1)(17) MiFIR a market for a financial instrument or a class of financial instruments can only be considered a liquid market when there are ready and willing buyers and sellers on a continuous basis. We are doubtful whether two daily trades reflects the prevalence of ready and willing buyers and sellers on a continuous basis. This concern is particularly relevant given that ESMA's draft RTS works on the assumption that 10 or 15 trades constitutes a liquid market with respect to all other non-equity asset classes apart from bonds.

Therefore, DG FISMA would only recommend that the Commission endorses the draft RTS if a more cautious approach were followed and the threshold for a liquid market for bonds were more closely aligned with the daily trading thresholds that are currently foreseen for other non-equity instruments.

In order to achieve this alignment, the RTS should work with several successive thresholds pertaining to the number of daily trades that indicate the existence of a liquid bond market. In this respect, the RTS should determine the existence of a liquid market for bonds according to a declining schedule of daily trades, to be phased in over a four year period:

- Year 1: 15 daily trades (estimated coverage: 1.100 bonds or "ISINs");
- Year 2: 10 daily trades (estimated coverage: 1500 ISINs);
- Year 3: 7 daily trades (estimated coverage: 1900 ISINs),
- Year 4: 2 daily trades (estimated coverage: 2600 ISINs).

In order to verify whether this approach correctly determines the existence of a liquid market, the RTS should include provisions according to which ESMA would be obliged to make annual assessments of liquidity levels in all classes of bond markets covered by the pre-trade transparency obligations. These assessments should be made on a set of predefined criteria, such as verification that the above mentioned ISIN coverage ratios are indeed the ones that emerge officially reported data under MiFID II becomes available. The regular assessments would also need to look into the trading volumes that can be attributed to the ISINs covered by the transparency obligations. The move to a subsequent daily trading threshold requires that trading volumes with respect to those ISIN covered by the transparency obligations have not declined. ESMA would need, therefore, to assess data on trading volumes and the number of trades on an annual basis.

According to Article 9(1)(b) MiFIR competent authorities shall be able to waive the obligation for market operators and investment firms operating a trading venue to make public the information referred to in Article 8(1) MiFIR for actionable indications of interest in request-for-quote and voice trading systems that are above a size specific to the financial instrument. Waivers under this provision can only be granted once the obligations in Article 8(1) MiFIR would expose liquidity providers to undue risk.

Given that the electronic infrastructure to collect trading data for the asset classes in the RTS is not yet operational we have doubts whether currently available evidence supports the proposed calibration of the thresholds denoting the size specific to the financial instrument (SSTI). This raises doubt as to whether the proposed SSTI thresholds applicable to all classes of bonds and other asset classes would comply with Article 9(1)(b) MiFIR as they might expose liquidity providers to undue risk.

In order to remedy this concern we propose a more cautious approach in two area:

- In relation to the calculation of the SSTI thresholds that are applicable to bonds we suggest that the current percentile calibration, generally the 60th percentile currently contained in the draft RTS, are set materially lower - generally at the 30th percentile. Moving to the 30th percentile would be accompanied with an annual increase to the 40th (year 2), 50th (year 3) and then 60th (year 4) percentile.

- In relation to the SSTI thresholds that apply to derivatives and other non-equity asset classes, we would also suggest that references to the 60th percentile currently contained in the draft RTS are set at the 30th percentile. Moving to the 30th percentile would be accompanied with an annual increase to the 40th (year 2), 50th (year 3) and then 60th (year 4) percentile. To ensure that such an approach still results in an increase in the level of transparency compared with what may be required today, all current cash floors stay in place during the phase-in period.

The move to a subsequent range of percentiles requires that liquidity providers can continue operations without encountering undue risk. ESMA would need, therefore, to regularly assess the operations of liquidity providers in the non-equity asset classes covered in the RTS to ensure that such increases do not pose undue risks to liquidity providers

I would like therefore to inform you that DG FISMA will recommend that the Commission endorses the draft regulatory technical standard submitted by ESMA on transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives once the once the above mentioned concerns are adequately taken into account and the necessary modifications are made.

I am very grateful for the work that has been undertaken by ESMA and its members to deliver the MiFID II level II package of measures. This is a substantial package that has been delivered professionally and to a high standard. The standards that have been submitted, if endorsed by the co-legislators, will contribute to better functioning markets in the EU with a high level of investor protection.

Yours sincerely,

Olivier Guersent