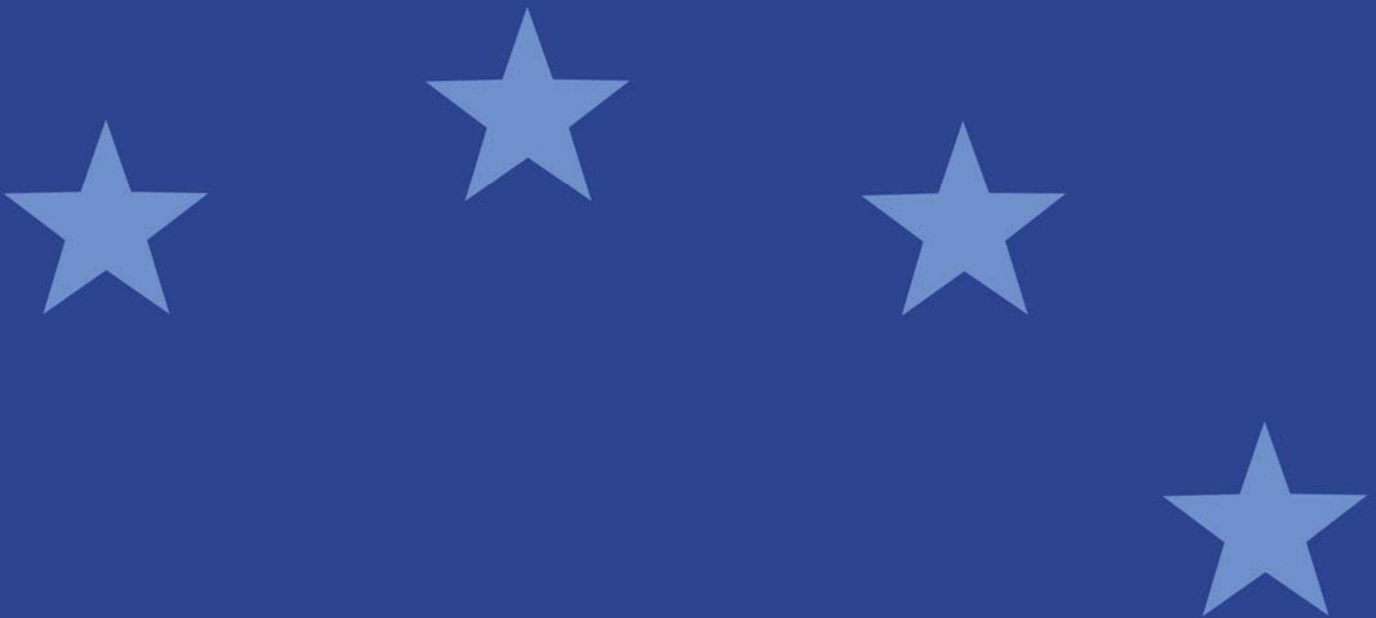
Opinion

Draft Regulatory Technical Standards on transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives under MiFIR



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Glossary

CA	Competent Authority
COFIA	Classes of financial instruments approach
ESMA	European Securities and Markets Authority
IBIA	Instrument by Instrument approach
LIS	Large in scale
MiFID	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and the Council
MiFID II	Markets in Financial Instruments Directive and amending Directive 2002/92/EC and Directive 2011/61/EU – Directive 2014/65/EU of the European Parliament and of the Council
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2016 on markets in financial instruments and amending Regulation (EU) No 648/2012
RTS	Regulatory Technical Standards
SI	Systematic Internaliser
SSTI	Size specific to the instrument

1 Legal Basis

1. In accordance with Article 1(8), Article 9(5), Article 11(4), Article 21(5) and Article 22(4) of 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 (MiFIR), the European Securities and Markets Authority (ESMA) shall develop draft regulatory technical standards (RTS) to specify transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives.

2 Background and Procedure

2. On 28 September 2015, ESMA submitted draft RTS to specify transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives as draft RTS 2 to the European Commission (the Commission) pursuant to Article 15(1) of Regulation No (EU) 1095/2010 (the ESMA Regulation) and Articles 1(8), 9(5), 11(4), 21(5) and 22(4) of MIFIR.

3. In a letter of 14 March 2016, DG FISMA informally indicated to ESMA its intention to endorse draft RTS 2 subject to a number of changes.

4. On 20 April 2016, the Commission informed ESMA of its intention to endorse draft RTS 2 subject to a number of changes in accordance with Article 10(1) of the ESMA Regulation. In particular, the Commission requested the following changes:

   i. The introduction of a phased approach for the liquidity assessment of bonds, gradually decreasing the average daily number of transactions in a bond needed for determining a market as liquid.

   ii. The introduction of a phased approach for the determination of the pre-trade size specific to the instrument (SSTI) threshold for non-equity financial instruments, gradually increasing the trade percentile for determining the threshold.

   iii. The introduction of an annual ESMA assessment and an annual amendment of the RTS triggering the move to a subsequent phase for the liquidity assessment of bonds and the increase of the trade percentile for determining the pre-trade SSTI threshold.

5. ESMA notes that the letter from the Commission was received in excess of the three month period foreseen in Article 10(1) of the ESMA Regulation.

6. Pursuant to Article 10(1) of the ESMA Regulation, this notification from the European Commission triggers a period of six weeks during which ESMA may amend its draft RTS on the basis of the European Commission's proposed amendments and resubmit it in the form of a formal opinion. ESMA shall send a copy of its formal opinion to the European Parliament and to the Council.

7. In the interest of avoiding further delays to the MiFID II implementation process ESMA has started working on this opinion immediately after receiving the letter of 14 March 2016. Therefore it has been able to submit this opinion ahead of the expiry of the six week deadline following the formal notification of 20 April 2016.

8. ESMA points out that any changes to RTS 2 have been made on the basis of the draft text submitted by ESMA on 28 September 2015 which ESMA considers as the relevant reference point in the absence of any opposite indication by the Commission.

9. It is for the Board of Supervisors to adopt such formal opinion in accordance with Article 44(1) of the ESMA Regulation.

3 Executive Summary

10. ESMA agrees to the phased approach for the liquidity criterion ‘average daily number of trades’ for determining the liquidity status of bonds and for the trade percentile for determining the pre-trade size specific to the instruments for certain non-equity classes. While ESMA remains of the opinion that the transparency requirements as proposed in the September 2015 RTS package were already calibrated in a cautious manner, based on an in-depth data analysis and following two public consultations, the phased approach may add an additional layer of security in the face of a lack of a high-quality data set available to ESMA or market participants and may contribute to the smooth implementation of MiFID II/MiFIR.

11. ESMA proposes some targeted adjustments to ensure the smooth applicability of the phased approach without undue side effects. This concerns in particular the temporary increase of the issuance size of corporate bonds and covered bonds for the first liquidity assessment of newly issued corporate bonds and covered bonds and the introduction of threshold floors for the pre-trade SSTI for bonds to ensure a meaningful level of transparency.

12. ESMA opposes the Commission’s proposed approach for implementing the phase-in. ESMA considers that only inserting the first stage of the phase-in in the RTS and requiring ESMA to propose annually amendments of the draft RTS in order to adjust the thresholds to the next level based on an assessment of the operation of the applicable thresholds is overly burdensome, lacks legal certainty and will result in a significantly longer phase-in than the anticipated four years. In addition, and more importantly, the proposed approach raises the question whether it would provide for meaningful transparency and, in this respect, satisfy the objective to strengthen transparency as stated in recital 1 of MiFIR. The RTS would only include the transparency requirements of the first phase, which do not go substantially beyond current transparency practices in bond markets.

13. ESMA suggests instead opting for an automatic phase-in, with annual transition to the next stage included in the RTS, which would be accompanied by a monitoring of the impact of the pre-trade transparency regime.

14. Under this approach, ESMA would, during the phased implementation of the transparency provisions, assess annually the impact of those provisions on bond market liquidity and on the activity of liquidity providers. In case significant negative impacts are identified, ESMA would propose an amendment to the RTS. ESMA considers that this approach ensures the cautious implementation of the transparency regime while avoiding the drawbacks of the process proposed by the Commission.

15. Finally, ESMA proposes a number of technical drafting changes to Annexes I-IV of draft RTS 2 that are needed for the development of the data reporting system and to ensure consistency of draft RTS 2, RTS 1 and RTS 23. ESMA notes that the ongoing negotiations on an amendment of the Level 1 text may require adjustments to the provisions on package transactions in draft RTS 2.

4 ESMA Opinion

4.1 Liquidity assessment for bonds

16. MiFIR introduces transparency requirements for bonds, structured finance products, emission allowances and derivatives with powers for competent authorities (CAs) to waive the obligation for market operators and investment firms operating a trading venue to make public pre-trade information for non-equity instruments for which there is not a liquid market. Furthermore, transactions in non-equity instruments for which there is not a liquid market may also benefit from deferred publication.

17. ESMA's draft RTS 2 proposes to assess the liquidity of bonds on a quarterly basis using an instrument by instrument approach (IBIA). Each individual bond would be declared liquid if the following three quantitative liquidity criteria are met on a cumulative basis:

    i. Average daily notional amount traded ≥ EUR 100,000;

    ii. Average daily number of trades ≥ 2

    iii. Percentage of days traded over the period considered ≥ 80%

18. ESMA notes that the Commission is overall supportive of this methodology but requests two changes:

    i. the introduction of a more cautious approach for the liquidity assessment of bonds by introducing a phased approach starting with a less demanding schedule of trades per day and gradually moving to the daily trades proposed by ESMA in the draft RTS 2 submitted on 28 September 2015;

    ii. the introduction of an annual assessment of the operation of the applicable liquidity thresholds, taking into account the evolution of trading volumes and other relevant factors and where appropriate an amendment to the RTS adjusting the threshold to the next level.

4.1.1 Daily number of trades and phase-in

19. The Commission requests a more cautious approach for determining whether a bond has a liquid market and raises concerns that the criterion of two trades per day may not reflect the prevalence of ready and willing buyers and sellers on a continuous basis. Furthermore, the Commission stresses that the liquidity assessment for bonds is more stringent than for derivatives where in most classes 10 or 15 trades constitute a liquid market. Finally, the Commission notes the differences in liquidity conditions across asset classes and points in particular to a decrease in the liquidity of corporate bonds from 2010 to 2015.

20. ESMA appreciates that the criterion of an average number of daily trades of at least two when considered on an individual basis may raise concerns. However, it should be noted that ESMA's proposal suggests the use of three cumulative criteria to determine the liquidity status of a bond and is therefore a more demanding test than requiring that only one criterion should be met. In particular, the criterion that requires the bond to be traded on more than 80% of trading days avoids wrongly qualifying bonds as liquid when simply looking at the criterion 'average daily number of trades' which in isolation may inadvertently capture bonds having only episodic liquidity. In ESMA's view, and in accordance with Article 2(1)(17)(a), the concept of "prevalence of ready and willing buyers and sellers on a continuous basis" is adequately reflected by the cumulative application of all the criteria in the liquidity test.

21. ESMA also points to the differences in the liquidity assessments for bonds and derivatives. The liquidity assessment for most derivatives will be carried out on a class basis (COFIA) whereas IBIA will be used for bonds. The higher number of daily trades for determining a liquid market for derivatives is therefore linked to the fact that more than one instrument will be covered per sub-class, whereas the liquidity assessment for bonds will be carried out at a per ISIN level. Any attempt at assessing how strict ESMA's methodology is by comparing per ISIN figures for bonds to the per sub-class level for derivatives is therefore inadequate.

22. ESMA shares the assessment that liquidity conditions differ across asset classes. These differences have been duly taken into account when calibrating the transparency regime. This is reflected, for instance, in the choice for IBIA for bonds as compared to COFIA for most derivatives, or the different methodological approach proposed for the most liquid equity derivatives sub-asset classes as compared to less liquid classes such as exotic derivatives. [1]

23. As concerns the Commission's observation of declining liquidity in corporate bond markets, the overall picture is less clear. While it is correct that the corporate bond turnover ratio has declined over the last years, in some segments of the bond markets

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[1] Concerning the Commission's observation that draft RTS 2 requires 15 daily trades for equity derivative swaps and portfolio swaps despite the fact that equity derivatives are generally assumed to be more liquid than fixed income instruments, ESMA points to the different methodologies used within the various equity derivatives sub-asset classes reflecting the different degree of liquidity. For those equity derivatives which are traded frequently (and mostly on-venue) ESMA proposes to declare ex ante the whole sub-class as liquid (e.g. sub-classes of stock (index) options and futures/forwards) whereas for less liquid sub-asset classes (e.g. portfolio swaps) a COFIA determination based on a minimum average daily number of trades of 15 would be carried out on a sub-class level.

trading volume has increased.[2] Recent studies point to a bifurcation of liquidity of bond markets with stable liquidity for benchmark sovereign bonds and deteriorating liquidity in those markets segments which have been historically less deep.[3] It should also be noted that these liquidity trends are driven by several factors, such as technological progress, monetary policy changes and changes in the market structure away from a dealer-oriented principle-based model and towards an agency-based model.[4]

24. The liquidity assessment proposed by ESMA automatically takes changes in market liquidity into account. The quarterly determination of the liquidity status of a bond based on IBIA will ensure that market developments are taken into account with only a very short time lag. Hence, in a scenario where trading activity in one bond (or across the bond market overall) declines, it is more probable that this bond (or bonds across the bond market) will not pass the liquidity thresholds proposed in draft RTS 2 and may therefore be waived from pre-trade transparency.

25. Given the uncertainty of the market impact of the transparency provisions and in view of the lack of a comprehensive and consistent data set for calibrating the transparency requirements, the Commission suggests a phased-in application of the liquidity assessment for bonds, i.e. the use of a declining schedule of daily trades, to be phased in over a four year period for determining the existence of a liquid market:

    i. Year 1: 15 daily trades;

    ii. Year 2: 10 daily trades;

    iii. Year 3: 7 daily trades;

    iv. Year 4: 2 daily trades.

26. ESMA wishes to emphasise that it has always been in favour of a more cautious phased-in approach, pointing at the experience in the US, and bearing in mind that MiFIR applies from one day to the next to an extremely wide range of asset classes which is unprecedented in any regulatory framework across the globe.

27. ESMA understands that the phase-in would only affect the liquidity criterion 'average daily number of trades' whereas the two other liquidity criteria ('average daily notional amount' and 'Percentage of days traded over the period considered') would remain in place and the thresholds would remain unchanged during the phase-in.

28. Table 1 and

29. Table 2 (cf. pages 11 and 12 below) provide an overview of the expected coverage ratio during the phase-in period using the liquidity criteria 'Percentage of days traded over the period considered' and 'Average daily notional amount' as specified in draft RTS 2 but allowing for a decreasing schedule for the criterion 'average daily number of trades'

[2] See IOSCO (2016): Securities market risk outlook 2016 (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD527.pdf)
[3] See Committee on the Global Financial System (2016): Fixed Income market liquidity, CGFS papers, No. 55, January 2016 (http://www.bis.org/publ/cgfs55.pdf)
[4] See IOSCO (2016).

ranging from 15 to 2. The results are based on transaction reporting data covering a sample period 1 June 2013 to 31 May 2014.

30. While these numbers serve well as a rough indicator, they should be interpreted in a cautious manner as the data is derived from transaction reporting which is designed to serve market integrity purposes rather than statistical analysis. In particular, stakeholders raised concerns that transaction reporting builds on post-allocated trade data which may result in underestimating the actual size of trades and overestimating the number of transactions.

31. ESMA has done its utmost to clean the transaction reporting data for it to provide an accurate picture of trading in the Union but it appreciates that it is not a perfect data source just like any analysis by stakeholders is not based on a data source which provides a comprehensive and a 100% accurate picture. Given that a better data set will only become available with the advent of MiFID II this provides another good reason to err on the side of caution when MiFID II becomes applicable and potentially become more ambitious later on.

32. Starting with a significantly higher average daily number of trades criterion of 15 trades/day results in a significantly lower coverage ratio (about 1,100 ISIN out of a total sample of 54,395 ISINs or 2% of ISINs) compared to the ISIN coverage using the criterion as proposed in the ESMA's draft RTS 2 (about 2600 ISINs out of 54,395 ISINs or 5% of ISINs).

33. Looking at the coverage ratio in terms of trading in liquid bonds, using an average daily number of trades criterion of 15 results in a lower number of trades initially covered. Initially, 79% of trades are expected to be executed in liquid instruments, moving to a coverage ratio of 88% at the end of the phase-in once the average daily number of trades criterion reaches 2.

34. Looking at the effects of the phase-in for different types of bonds based on the ESMA data, it can be observed in Tables 1 and 2 that the phase-in would, in particular, affect corporate bonds, covered bonds and other public bonds which would start with a significant lower coverage ratio both in terms of percentage of liquid ISINs and in terms of percentage of trades in liquid instruments. The coverage ratio for sovereign bonds on the other hand would be more stable, already covering a significant proportion in terms of ISINs and percentage of trades at the start of the phase-in.

35. However, as already mentioned these figures need to be interpreted with caution and are subject to a degree of uncertainty. Data provided by other stakeholders shows a significantly smaller coverage ratio, in particular, during the first stage of the phase-in. Thus, only a marginal segment of the market may be subject to the trade transparency provisions at the initial stages of the phase in.

36. Data provided by TRAX reveals a different picture with only a very small coverage ratio of about 300 bonds on an annual basis (the data includes only corporate and sovereign bonds) at the start of the phase-in (based on 15 trades/day). As can be seen from Table 3, under the 15 trades/day criterion 97% of all bonds subject to transparency would be sovereign bonds. Moving to 10 trades/day and 7 trades/day would slightly decrease this

ratio to about 90%, but only the move to 2 trades/day would allow for a transparency covering all types of bonds.

37. However, it should be noted that the ESMA data and the TRAX data are different in terms of reference period used, type of bonds covered and that the TRAX data only looks at the liquidity criterion 'average daily number of trades' and does not include the two other liquidity criteria (overestimating hence the number of liquid bonds). The TRAX data also does not capture trading by retails investors.

38. As a conclusion, ESMA agrees that, in view of the uncertainty on the impact of the transparency requirements on bond trading and given the data deficiencies, a phased-in implementation of the liquidity assessment would be beneficial.

39. ESMA has therefore introduced a phase-in for the liquidity assessments for bonds in draft RTS 2 by adding the staged approach to the liquidity criterion 'average daily number of trades'. The ESMA proposal assumes a one year delay in the application of MiFID II/MiFIR as it was proposed by the Commission in its proposal amending MiFIR and MiFID II of 9 February 2016 and therefore starts on 3 January 2018 only.[5] ESMA suggests to use the following declining schedule of trades:

Stage	'Average daily number of trades'	Application period
1	15	3 January 2018 – 15 May 2019
2	10	16 May 2019 – 15 May 2020
3	7	16 May 2020 – 15 May 2021
4	2	From 16 May 2021

40. It should also be noted that the introduction of a phase-in would have implications on the determination of the liquidity status of newly issued bonds. Under the approach proposed by ESMA, the liquidity status of newly issued bonds would be initially determined using COFIA on the basis of a minimum issuance size. Bonds above a certain class-specific issuance size would be determined as liquid until the first quarterly determination of the liquidity status, whereas bonds below that issuance size would be declared as not having a liquid market.

41. The issuance sizes to be applied for the first liquidity assessment had been calibrated in light of the liquidity criteria used for the IBIA approach, in particular, the criterion of an 'average number of daily trades' of at least 2. This calibration had been chosen since the trading frequency of a bond is positively correlated with the issuance size of a bond. That

[5] However, given that there is to date no legal certainty on the final application date of MiFID II/MiFIR, ESMA did not delay the dates provided in the annexed draft RTS. ESMA assumes that once an agreement on the delay of application of MiFID II/MiFIR has been reached those dates will be amended accordingly.

means, *ceteris paribus*, the higher the issuance size of a bond, the higher the average trading frequency of the bond and the more liquid the bond. Hence, this approach aims at minimising potential cliff effects when moving from the initial determination of the liquidity status of a newly issued bond based on issuance sizes to the quarterly liquidity assessment on basis of the three liquidity criteria.

42. Based on the data presented in table 1 and 2 as well as in table 3, in particular the coverage ratio of corporate bonds and covered bonds under IBIA would be significantly smaller at the initial stages of the phase-in, whereas the first liquidity assessment of newly issued corporate bonds and covered bonds would remain subject to the same issuance size throughout the four stages of the phase-in. Without a change in the issuance size for the first liquidity assessment of newly issued bonds, there is therefore a risk of a significant cliff effect for corporate bonds and covered bonds during the first two stages of the phase-in where a significant amount of newly issued corporate bonds would be initially declared liquid based on their issuance size, but would change their liquidity status at the first quarterly IBIA assessment.

43. To avoid such an outcome ESMA considers it appropriate to temporarily raise the issuance size for newly issued corporate bonds and covered bonds for the initial liquidity determination.

44. Therefore, and although this has not been suggested by the Commission in its letters, ESMA recommends increasing the issuance thresholds used to determine whether newly issued corporate bonds and covered bonds have a liquid market during the first two stages of the phased-in approach from EUR 500 million to EUR 1 billion, that is until the first quarterly determination of the liquidity status of bonds based on transactions executed in the first quarter 2020. Hence, the first determination of the liquidity status of corporate bonds and covered bonds issued until 31 December 2019 should be based on an issuance size of EUR 1 billion. For corporate bonds and covered bonds issued thereafter the applicable issuance size for the determination of the initial liquidity status would be EUR 500 million.

Type of bond	Issuance size in EUR	Issuance date
Corporate bond	1,000,000,000	Until 31 December 2019
	500,000,000	After 31 December 2019
Covered bond	1,000,000,000	Until 31 December 2019
	500,000,000	After 31 December 2019

TABLE 1: NUMBER OF LIQUID BONDS UNDER A DECREASING SCHEDULE OF AVERAGE DAILY NUMBER OF TRADES

Average daily number of trades	15			10			7			2		
	liquid	**illiquid**	**total**	**liquid**	**illiquid**	**total**	**liquid**	**illiquid**	**total**	**liquid**	**illiquid**	**total**
Sovereign bonds	488	3,704	4,192	532	3,660	4,192	588	3,604	4,192	745	3,447	4,192
Other public bonds	11	1,357	1,368	21	1,347	1,368	34	1,334	1,368	52	1,316	1,368
Corporate bonds	549	40,327	40,876	854	40,022	40,876	1,142	39,374	40,876	1,645	39,231	40,876
Convertible bonds	6	167	173	7	166	173	7	166	173	7	166	173
Covered bonds	55	7,731	7,786	83	7,703	7,786	128	7,658	7,786	223	7,563	7,786
Total number of bonds in the sample	**1,109**	**53,286**	**54,395**	**1,497**	**52,898**	**54,395**	**1,899**	**52,496**	**54,395**	**2,672**	**51,723**	**54,395**

TABLE 2: PERCENTAGE OF BONDS (ISINS) AND PERCENTAGE OF TRADES UNDER A DECREASING SCHEDULE OF AVERAGE DAILY NUMBER OF TRADES

	% of ISINs		% of trades		% of ISINs		% of trades		% of ISINs		% of trades		% of ISINs		% of trades	
Average daily number of trades	**15**				**10**				**7**				**2**			
	liquid	**illiquid**	**liquid**	**illiquid**	**liquid**	**illiquid**	**liquid**	**illiquid**	**liquid**	**illiquid**	**liquid**	**illiquid**	**liquid**	**illiquid**	**liquid**	**illiquid**
Sovereign bonds	12%	88%	95%	5%	13%	87%	96%	4%	14%	86%	97%	3%	18%	82%	98%	2%
Other public bonds	1%	99%	31%	69%	2%	98%	43%	57%	2%	98%	53%	47%	4%	96%	62%	38%
Corporate bonds	1%	99%	55%	45%	2%	98%	64%	36%	3%	97%	70%	30%	4%	96%	77%	23%
Convertible bonds	3%	97%	91%	9%	4%	96%	92%	8%	4%	96%	92%	8%	4%	96%	92%	8%
Covered bonds	1%	99%	33%	67%	1%	99%	38%	62%	2%	98%	44%	56%	3%	97%	51%	49%
Total	**2%**	**98%**	**79%**	**21%**	**3%**	**97%**	**83%**	**17%**	**3%**	**97%**	**85%**	**15%**	**5%**	**95%**	**88%**	**12%**

TABLE 3: TRAX IBIA CALIBRATION WITH PHASE-IN BASED ON 2015 DATA

Year-1: 15 ADC

	ISIN Count	
Corporate bonds	Liquid	Illiquid
Feb-15	19	23,558
May-15	13	22,501
Aug-15	13	21,594
Nov-15	13	21,822
Sovereign bonds	Liquid	Illiquid
Feb-15	315	3,627
May-15	289	3,645
Aug-15	223	3,702
Nov-15	206	3,723

Year-2: 10 ADC

	ISIN Count	
Corporate bonds	Liquid	Illiquid
Feb-15	65	23,512
May-15	34	22,480
Aug-15	29	21,578
Nov-15	42	21,793
Sovereign bonds	Liquid	Illiquid
Feb-15	420	3,522
May-15	381	3,553
Aug-15	341	3,584
Nov-15	360	3,569

Source: Trax traded bonds in 2015

Year-3: 7 ADC

	ISIN Count	
Corporate bonds	Liquid	Illiquid
Feb-15	169	23,408
May-15	95	22,419
Aug-15	73	21,534
Nov-15	89	21,746
Sovereign bonds	Liquid	Illiquid
Feb-15	523	3,419
May-15	479	3,455
Aug-15	447	3,478
Nov-15	456	3,473

Year-4: 2 ADC

	ISIN Count	
Corporate bonds	Liquid	Illiquid
Feb-15	1,065	22,512
May-15	746	21,768
Aug-15	652	20,955
Nov-15	594	21,241
Sovereign bonds	Liquid	Illiquid
Feb-15	908	3,034
May-15	810	3,124
Aug-15	769	3,156
Nov-15	742	3,187

Source: Trax traded bonds in 2015

4.1.2 ESMA's annual assessment of the liquidity levels in the bond market

45. In order to ensure that moving to a lower schedule of daily trades does not result in lower market liquidity, DG FISMA suggested in its letter of 14 March 2016 that every move to a lower schedule of average daily number of trades during the phase-in period should be preceded by an annual ESMA assessment of liquidity levels based on a set of predefined criteria.

46. ESMA appreciates that an approach which allows ESMA to monitor and assess the impact of the transparency requirements prior to moving to a subsequent stage appears sensible to avoid detrimental liquidity effects from making bonds that are not sufficiently liquid subject to the transparency requirements. However, ESMA has serious concerns regarding the feasibility of the annual liquidity assessment as proposed in the letter.

47. The proposal raises concerns regarding the legal basis for such an assessment. In order to address this issue, DG FISMA proposes in its letter to use a set of pre-defined criteria to be tested by ESMA. In order to ensure that the proposed assessment does not infringe EU law it appears important that such criteria are of objective nature, provide for binary decisions and do not entail subjective judgement.

48. The letter of 14 March 2016 proposes to assess the following criteria:

    i. The number of bonds (or ISINs) satisfying the liquidity criteria corresponds to the coverage estimated by ESMA in its analysis of transaction reporting data (i.e. Year 1: 1.100 ISINs, Year 2:1.500 ISINs, Year 3: 1.900 ISINs, Year 4: 2600 ISINs);

    ii. The annual trading volumes of bonds that are subject to pre-trade transparency do not decline following the move to a subsequent daily trading threshold;

    iii. The annual number of trades for bonds that are subject to pre-trade transparency do not decline following the move to a subsequent trading threshold.

49. ESMA is concerned, that while those criteria are quantifiable and provide for binary decisions, they may not be fit for the purpose of adequately monitoring the liquidity of the bond markets and the impact of the new transparency provisions on those markets.

50. Firstly, ESMA notes that these criteria are backward-looking and do not take into consideration the effects that might be triggered when moving to the next stage of the daily trading threshold but rather the impact the latest decrease in terms of average daily number of trades had on the bonds captured by the new definition of liquidity.

51. ESMA understands that defining forward-looking criteria, that are sufficiently specific and do not entail subjective judgement, is challenging. While it could be argued that the proposed criteria would capture the liquidity effects of the current schedule of daily trades on bonds that meet those liquidity criteria and could, hence, serve as a proxy for anticipating the possible effects of moving to the next stage, the proposed criteria would, in ESMA's view, only provide very rough estimations and not be sufficiently accurate for assessing the impact of the new schedule of trades on liquidity.

52. Secondly, such pre-defined criteria would not allow for a holistic assessment of the liquidity of bond markets. A decline in one of those criteria may be triggered by a multitude of other factors that are not linked to the MiFIR transparency requirements, ranging from changes in general liquidity conditions, in monetary policy, in behaviour of market participants to changes in market structures etc. Under the proposed approach ESMA cannot compensate for the effect of those external factors, which may result in a distorted assessment.

53. In ESMA's view, the distortion introduced to the annual assessment by those external factors would be further exacerbated by the fact that, at least initially, the population subject to the liquidity assessment, that is the bonds that are considered to be liquid and therefore subject to the full transparency requirements, would most probably be of a limited size (in particular for corporate bonds and for more exotic types of bonds such as convertible bonds) and may be geographically concentrated, thereby not representative of trading across the Union.

54. Thirdly, regarding the proposed coverage ratio, ESMA does not consider that a criterion specifying ex ante the ISIN coverage ratio would be appropriate. This criterion would not only defeat the original objective of introducing a dynamic determination of liquidity based on trading data but might also lead to arbitrary results considering the current lack of a comprehensive data set as highlighted by the Commission in its letter and by the diverging results provided by other stakeholders. According to the data provided by TRAX less than 300 bonds would be determined as having a liquid market at the start of the phase-in on (15 trades/day) which is far from the ESMA estimation (i.e.1100 ISINs). Therefore, the lack of a comprehensive and a 100% accurate data set prevents tying the move to the next stage to a certain coverage ratio of bonds.

55. While the two other proposed criteria may be more appropriate for the purpose of the liquidity assessment, they would need to be amended in order to account for the fact that the population size to be included in the assessment may change from one stage of the phase-in to the next. As an example, when moving to a lower schedule of daily trades, more bonds (i.e. bonds satisfying less stringent liquidity criteria in terms of average daily number of trades) are considered to have a liquid market, and hence overall trading activity is expected to increase, whereas the effect on the average trading activity per bond is less clear.

56. Finally, ESMA notes that the implementation of the proposed annual assessment of the liquidity levels would raise numerous practical challenges covering questions such as: at what level of granularity should the annual liquidity assessment be carried out (all bonds/per bond type/per bond)?; what reference period should be considered?; when would the first annual liquidity assessment be carried out, having in mind that the transparency data required for the liquidity assessment would only be available with the application of MiFID II/MiFIR?; etc.

57. For instance, regarding the definition of the sample, ESMA understands that the liquidity assessment may be carried out at different levels of granularity ranging from a

determination per ISIN to a determination per type of bond (i.e. sovereign bonds, corporate bonds, etc.) to a determination treating all bonds as one class.

58. While the per type of bond approach would allow ESMA to take into account the specificities of different bonds, and acknowledges that transparency may have a different effect on different (types of) bonds, this approach has the shortcoming of only covering a small population when carrying out the liquidity assessment. For example, for convertible bonds, only 6 bonds, on the basis of the ESMA data, would be subject to transparency at the start of the phase-in. This calls into question whether a liquidity assessment based on such a small population produces statistically sound and meaningful results. ESMA considers it important to ensure that the results are statistically sound and that the calculations are based on a sufficiently large population.

59. Carrying out the assessment on an ISIN level would permit ensuring the declining schedule of daily trades best meets the specificities of each bond. However this has the drawback of resulting in a patchwork of stages for the liquidity assessment of bonds, and creates a situation with an indefinite phase-in to cater for newly issued bonds. This would also probably significantly increase the trading costs for market participants which would have to analyse a myriad of different treatments and almost consider on an individual basis the applicable regime for all bonds available.

60. Carrying out the liquidity assessment for the whole universe of bonds may have the advantage of allowing for statistically sounder results due to the higher population range of bonds subject to transparency but it also has the drawback of not taking into account the specificities of different types of bonds.

61. ESMA is therefore of the opinion that the annual ESMA assessment as proposed in the letter of 14 March is not appropriate and does not recommend this approach. However, ESMA sees the benefit of accompanying the phase-in by a close monitoring of the bond market in order to allow for corrective action should negative liquidity effects emerge.

62. The formal notification letter of 20 April 2016 suggests a revised approach and proposes to initially set the liquidity criterion ‘average daily number of trades’ at 15 and to require ESMA to submit annual amendments to the RTS over a period of four years until the liquidity criterion ‘average daily number of trades’ reaches two trades per day. In order to avoid negative impact on bond market liquidity the Commission suggests that ESMA carries out an annual assessment of the operation of the applicable threshold, taking into account the evolution of trading volumes and other relevant factors. In case ESMA does not submit an amendment of the RTS to the Commission to trigger the move to the next threshold, ESMA would be required to explain why a move to the next threshold is not warranted.

63. While ESMA appreciates that the Commission reconsidered the initial proposal and considers that the current proposal would address the legal risks and methodological drawbacks of the initial proposal, ESMA is very concerned that this approach might be very burdensome for both ESMA and market stakeholders, lower significantly the predictability of the legal requirements and possibly result in a regime which would

deviate quite substantially from the ESMA proposal as submitted in September without providing strong evidence for doing so.

64. In particular, ESMA notes that in practice there would be no “phase-in” since only the higher threshold for the “average daily number of trades “ criterion (i.e. 15 trades a day) would be inserted in the RTS. ESMA does not consider that the mechanism mentioned by the Commission whereby ESMA would have the possibility to submit an amended draft RTS together with its annual report allows to conclude otherwise.

65. The discussion on the impact of the phase-in on bond market transparency, and in particular during the first stage of the phase-in, raises the question whether this proposal would allow for meaningful transparency in the bond market and, in this respect, whether it satisfies the objective of the co-legislators to strengthen transparency as stated, among other, in recital 1 of MiFIR. Furthermore, including only the first stage in the RTS would not go substantially beyond current transparency practices in bond markets. ESMA notes also that there is no legal certainty as to when and if the amendments of the RTS would be adopted. In any case, it is very unlikely that such a procedure would allow for a yearly move to the next stage due to the time necessary for drafting, consulting on and approving a technical standard by ESMA and the subsequent endorsement process by the Commission plus objection period by Council and Parliament. This would hence imply a significantly longer phase-in, if it comes to a phase-in at all.

66. Regarding the amendment mechanism suggested in the letter, ESMA notes that the possibility for ESMA to submit amendments to technical standards is not limited to the case at hand but can be used in all areas where ESMA has been delegated powers to adopt technical standards. Furthermore, the Commission’s proposal to further formalise this mechanism will require significant resources, at ESMA but also for other stakeholders, for preparing the annual amendments as well as the yearly amendments to the RTS for the gradual adjustment of the liquidity thresholds, including the consultation of stakeholders.

67. It should also be stressed that such an approach would be extremely burdensome for market participants and issuers of bonds given the lack of legal certainty on the timing of the move to the next stage of the phase-in. Furthermore, the ongoing adjustment of the RTS will require constant changes to the underpinning IT-systems to ensure that the latest parameters are in place and such changes to be made in a probably very short timeframe.

68. ESMA considers it hence as very unlikely that the four year timeframe proposed by the Commission would work in practice.

69. Giving these drawbacks , ESMA suggests the following alternative approach:

   i. An automatic phase-in that is not linked to the results of an annual liquidity assessment on the basis of the approach suggested in above. That is, an automatic move to the next stage on a yearly basis until stage 4 is reached.

ii. ESMA monitoring developments in bond markets and preparing an annual report assessing the liquidity situation in the bond markets, based on quantitative and qualitative data, and including, but not limited to, the criteria proposed by the Commission. Those reports would assess the impact of the new transparency regime on the trading of bonds while also reflecting general market developments affecting the trading of bonds overall thereby controlling for factors that are not linked to the MiFIR transparency provisions. ESMA would publish these assessments in order to allow for a transparent process and to provide for a high level of accountability.

iii. In case ESMA identifies a significant negative impact of the transparency provisions on market liquidity, ESMA would propose an amendment of the RTS. In order to ensure that such a proposed amendment would be delivered sufficiently quick ESMA would accompany the ESMA report with a proposed amendment to the draft RTS that would be subject to a public consultation of reduced length.

70. ESMA therefore suggests to opt for an automatic phase-in that will be accompanied by monitoring of the impact on market liquidity by ESMA and corrective action where needed. ESMA provided drafting changes in the draft RTS 2 in the Annex.

4.2 Determination of the pre-trade size specific to the instrument (SSTI) - thresholds

71. According to Article 9(1)(b) of MiFIR actionable indications of interest in request-for-quote and voice trading systems that are above a size specific to the financial instrument (SSTI) may be waived from pre-trade transparency.

72. Based on an extensive data analysis, ESMA proposes in its draft RTS 2 different methodologies for setting the threshold for determining the pre-trade SSTI which reflect the specificities of the respective asset classes:

73. For some classes of instruments, a fixed threshold value applies. This concerns:

i. ETC and ETN bond types,

ii. Securitised derivatives,

iii. Some equity derivatives classes (stock index options, stock index futures/forwards, stock options, stock futures/forwards, stock dividend options, stock dividend futures/forwards, dividend index options, dividend index futures/forwards, volatility index options, volatility index futures/forwards, ETF options and ETF futures/forwards),

iv. Foreign exchange derivatives;

v. Illiquid sub-classes of interest rate derivatives, commodity derivatives, credit derivatives, C10 derivatives, and contracts for difference,;

vi. Illiquid sub-asset of emission allowances, and emission allowances derivatives; and

vii. Structured finance products (SFPs) where the liquidity Test-1 is not passed, or in case the liquidity Test-1 is passed, those SFPs that do not pass the liquidity test-2.

74. For bonds it is proposed to set the pre-trade SSTI at the trade size below which lie 60% of the transactions (40% for covered bonds);

    i. For all remaining classes of instruments to set the pre-trade SSTI at the greater of the trade size below which lie 60% of the transactions and a threshold floor:

    ii. Liquid sub-classes of interest rate derivatives, commodity derivatives, credit derivatives, C10 derivatives and CfDs;

    iii. Liquid sub-asset classes of emission allowances and emission derivatives allowances;

    iv. Structured finance products that have passed both liquidity tests.

75. The Commission is concerned that the calibration of the pre-trade SSTI on basis of the 60th percentile might lead to thresholds being too high that might expose liquidity providers to undue risk.

76. In its letter of 20 April 2016 the Commission raises concerns that the proposed calibration does not take into account that (1) there has been a reduction in market making activities, and (2) inventories of financial instruments and balance sheet capacity to support market making have declined. The Commission considers that there is no conclusive evidence as to why the pre-trade SSTI is determined on basis of the 60th percentile.

77. The Commission therefore proposes for bonds except, ETCs and ETNs, as well as all other non-equity classes for which the percentile calibration is applied to provide for a phase-in period of 4 years according to the following schedule:

    i. Year 1: 30th percentile;

    ii. Year 2: 40th percentile;

    iii. Year 3: 50th percentile;

    iv. Year 4: 60th percentile.

78. Furthermore, the threshold floors for liquid derivative and emission allowances classes as well as for liquid SFPs would remain unchanged to ensure a minimum level of transparency.

79. Prior to moving to a subsequent range of percentiles, ESMA would be required to carry out an assessment of the operations of the applicable percentile to ensure that an increase of the percentiles does not pose undue risks to liquidity providers.

4.2.1 SSTI pre-trade and phase-in

80. ESMA understands the concerns of the Commission that, given the lack of a comprehensive data set on the trading of bonds and other non-equity asset classes, uncertainties remain concerning the precise value of the pre-trade SSTI thresholds calculated on basis of trade percentiles.

81. ESMA tried to limit the risks of wrongly calibrating the transparency thresholds by opting for a dynamic approach for determining the pre-trade SSTI for bonds and for most liquid classes of other non-equity instruments. This dynamic approach has, in ESMA's view, two main advantages:

82. Firstly, to deal with deficiencies in data availability and data quality for most non-equity asset classes instruments. Since reporting of derivatives transactions to trade repositories has been applied to date for only two years, and for even a shorter time when ESMA was developing the draft RTS, data from trade repositories is still suffering from some quality issues. ESMA considers that by the time the transitional calculations for the first determination of the transparency calculations will be carried out, the data set should be more complete and of a higher quality thereby allowing for obtaining robust results. Once the MiFIR transparency requirements are in place, the calculations would be carried out on the basis of the MiFIR transparency data which again should be of higher quality as it is designed to be used for exactly the statistical purposes relevant for MiFIR calibrations.

83. Secondly, the dynamic methodology has the advantage for allowing the thresholds to reflect market developments and thereby to take changes in trading patterns and market liquidity into account.

84. Developing this dynamic approach has been a reaction by ESMA to many concerns raised in its consultations that fixing static thresholds does not adequately reflect the dynamic nature of markets and risks being out of date soon after adopting the technical standards. Of course, having dynamic thresholds introduces an element of uncertainty as they "self-adjust" in line with market developments

85. ESMA believes that the dynamic methodology has the advantage of being reflective of the changes in market structures highlighted by the Commission. It should also be noted that the trend of a reduction in market making activity in fixed income markets has been accompanied by and/or accelerated a number of other trends such as an increased trend of electronic trading and the development of new protocols, such as all-to-all trading platforms, to bring together buyers and sellers.[1] It can hence be observed that the market adjusts to compensate for the change in behaviour of market makers.

86. The dynamic methodology allows taking all these trends into consideration and thereby ensures that the thresholds adjust to changes in the market environment. ESMA

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[1] See BIS (2016): Electronic trading in fixed income markets, Markets Committee, January 2016 (http://www.bis.org/publ/mktc07.htm)

therefore does not share the Commission's assessment that the observed changes in the behaviour of market makers require significantly reducing the pre-trade SSTI thresholds calibrated on basis of trade percentiles.

87. ESMA agrees that, particularly at the start of applying MiFIR to a multitude of asset classes on which mandatory transparency requirements in most cases are being imposed for the first time in history, a cautious approach is warranted.

88. As concerns the suggested calibration at the 60th percentile and the Commission's claim that this threshold lacks conclusive evidence as to why it does not expose market makers to undue risk, ESMA points out that the calibration of the thresholds has been carried out on basis of an extensive data analysis following two public consultations and numerous dialogues with market participants.

89. ESMA notes the ambiguity of the concept of 'exposing liquidity providers to undue risk' which applies for both the pre-trade SSTI waivers and the post-trade SSTI deferrals. Furthermore, the pre-trade SSTI thresholds will also be applicable for the Systematic Internaliser (SI) regime. When calibrating the pre-trade SSTI thresholds, ESMA aimed for a balanced approach that provides liquidity providers with the needed protection, while avoiding providing incentives to move trading in non-equity instruments that currently trade with a high level of transparency to a less transparent trading environment. Therefore, ESMA proposed pre-trade SSTI thresholds that are below the pre-trade large in scale (LIS) thresholds while not providing for a too large gap between those two thresholds.

90. In particular, it is important to stress that the pre-trade SSTI waiver is limited to only certain types of trading systems (i.e. request for quotes and voice trading) while other trading systems can only use the pre-trade LIS waiver. The proposed phase-in for the determination of the pre-trade SSTI which would result in increased gaps between the applicable pre-trade SSTI and LIS thresholds especially during the first years of application of the Regulation therefore creates incentives for market participants to execute more trades on request for quote and voice trading systems compared to other trading systems, in particular, central order books.

91. ESMA also notes the lack of conclusive evidence on why the 30th trade percentile would not expose liquidity providers at undue risk given that the Commission letter does not further justify its approach. ESMA is aware of the work of an industry body with a high representation of swap dealers on quantifying at which point liquidity providers are exposed to undue risk and a recommendation to set the pre-trade SSTI at the 30th trade percentile. However, it is important to stress the shortcomings of this study which call into question the general applicability of the 30th percentile.

92. Firstly, the analysis does not build on a comprehensive data set but builds on data provided by a set of selected market participants covering a period of six months, While ESMA agrees that those market participants may represent a significant part of the market, it nevertheless does not constitute a comprehensive picture.

93. Secondly, to ESMA's knowledge, the analysis covers only a few interest rate derivatives sub-asset classes, mainly single currency fixed/float swaps in major currencies.

94. Thirdly, in order to assess whether liquidity providers are exposed to undue risk, two potential reference points are taken into account: (i) the notional sizes where dealers are willing to quote a firm price and (ii) the notional sizes of a swap that can be hedged in the futures market without moving the market. ESMA agrees that the two chosen reference points may be appropriate to assess whether liquidity providers are exposed to undue risk, but notes that these reference points nevertheless provide for large scope of interpretation, in particular when considering that concerning the first reference point only a reference period of a very short period was used.

95. ESMA questions whether it is appropriate to extrapolate the results obtained for few specific interest rate derivatives sub-asset classes only (even if they might be deemed the most liquid derivative sub-classes) to all derivatives sub-classes and to bonds and whether this can be considered as conclusive evidence.

96. ESMA believes that it had already erred on the side of caution while maintaining a meaningful level of transparency which after all is one of the major goals of MiFIR. If the option is available now to phase-in the transparency requirements ESMA also welcomes that for the pre-trade SSTI calibrations. Furthermore, a staged approach provides market participants with more time to adjust to the new framework and may hence be beneficial for the smooth implementation of MiFID II / MiFIR.

97. Accordingly, ESMA has introduced a phase-in for the determination of the pre-trade SSTI in draft RTS 2 for those non-equity instruments for which the percentile approach is used. The ESMA proposal assumes a one year delay in the application of MiFID II/MiFIR as it was proposed by the Commission in its proposal amending MiFIR and MiFID II of 9 February 2016 and therefore starts on 3 January 2018 only.[2] ESMA suggests to use the following staged application:

Stage	Pre-trade SSTI trade-percentile	Application period
1	30	3 January 2018 – 31 May 2019
2	40	1 June 2019 – 31 May 2020
3	50	1 June 2020 – 31 May 2021 (excluding covered bonds)
4	60	From 1 June 2021 (excluding covered bonds)

[2] However, given that there is to date no legal certainty on the final application date of MiFID II/MiFIR, ESMA did not delay the dates provided in the annexed draft RTS. ESMA assumes that once an agreement on the delay of application of MiFID II/MiFIR has been reached those dates will be amended accordingly.

98. ESMA is also supportive of maintaining the methodology of threshold floors when determining the pre-trade SSTI thresholds for derivatives and other non-equity asset classes to ensure a minimum meaningful level of transparency.

99. Given the lower percentiles for determining the pre-trade SSTI thresholds under a phased-in approach, ESMA recommends to also introduce threshold floors for the pre-trade SSTI thresholds for bonds to ensure such minimum meaningful level of transparency also for this asset class.

100. ESMA estimated such floors based on the distribution of trades obtained from transaction reporting data (excluding trades below EUR 100,000) when developing the draft RTS 2 and using the 30th percentile and applying the rounding rules as specified in Article 13(12) of RTS 2:

	Pre-trade SSTI
Sovereign bonds	EUR 300,000
Other public bonds	EUR 300,000
Convertible bonds	EUR 200,000
Covered bonds	EUR 300,000
Corporate bonds	EUR 200,000
Other bonds	EUR 200,000

101. Furthermore, since the pre-trade large in scale (LIS) threshold for bonds is determined on the basis of the same methodology as the pre-trade SSTI, and to ensure that the pre-trade LIS is in no case smaller than the pre-trade SSTI, ESMA proposes to apply the same threshold floors for the determination of the pre-trade LIS threshold.

102. Since ESMA proposes for the determination of the pre-trade SSTI thresholds for covered bonds to use the 40th percentile to reflect the specificities of these types of bonds, ESMA suggests providing only for two stages for covered bonds. In a first stage the pre-trade SSTI would be determined on basis of the 30th percentile before moving to the next and final stage using the 40th percentile.

4.2.2 ESMA's annual assessment of the operations of liquidity providers

103. Similar to the ESMA liquidity assessment for bonds, DG FISMA suggested in its letter of 14 March 2016 to trigger the move to a higher percentile range following an ESMA assessment of the operations of liquidity providers. In particular, DG FISMA requested

ESMA to ensure that the move to a subsequent range of percentiles does not pose undue risks to liquidity providers.

104. ESMA agrees that it is important to avoid unintended consequences on market liquidity and in particular to avoid creating situations where liquidity providers would – in case of pre-trade SSTI-thresholds that would expose them to undue risk – decide to retreat from markets. However, it is unclear how the abstract concept of undue risk could be translated into measurable and objective criteria.

105. ESMA notes in that respect that the letter of 14 March 2016 does not specify concrete criteria to be used but simply considers that ESMA should "*regularly assess the operation 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*". ESMA understands the challenge of defining such criteria, in particular, in a context which covers a variety of asset classes such as bonds, derivatives and emission allowances and bearing in mind the tremendous diversity within those asset classes.

106. In addition, as explained in section 4.1.2 in the context of the proposed assessment for measuring the impact of transparency on bond market liquidity, ESMA believes that the implementation of the annual assessment as proposed would raise numerous practical issues and challenges concerning the level of granularity at which the assessment should be performed, the periods to considered, the need to maintain adequate visibility for market stakeholders and, most pertinently, running the risk of having a patchwork of different applicable regimes applying in parallel.

107. All those issues would be exacerbated by the fact that the assessment in this case would not only concern bonds but all non-equity financial instruments to which the percentile approach is applied. Derivatives would create significant practical issues given that, so as to ensure meaningful results, the assessment would need to be performed for each sub-class as defined in Annex III of draft RTS 2. In practice, this would mean that some sub-asset classes may move from one stage to the other based on the risk assessment while others do not so that over the years the said patchwork of differing regimes would be created for different types of derivatives. The overall process would have the potential to last for a long time.

108. While ESMA could invent some non-discretionary, quantitative criteria to assess the risk imposed on liquidity providers, such as the development of trade sizes and quotes while transparency requirements are in place, like in the case of bond market liquidity such pre-defined criteria would not be able to take into account wider market developments or macro-economic factors. Therefore any risk assessment based on such quantifiable factors risks leading to arbitrary results.

109. ESMA is therefore of the opinion that the proposed annual assessment raises legal risks and has too many disadvantages to be considered a viable option. However, as for the bonds' liquidity determination, ESMA sees the benefit of accompanying the phase-in by a close monitoring of the impact of these provisions and, in particular, on the ability of liquidity providers to perform their activity without exposing themselves to undue risks.

110. The formal notification letter of 20 April 2016 suggests a revised approach and proposes to initially set the trade percentile for determining the pre-trade SSTI threshold at the 30th percentile and to require ESMA to submit annual amendments to the RTS over a period of four years until the trade percentile reaches the 60th percentile. In order to avoid a negative impact on market liquidity the Commission suggests ESMA carries out an annual assessment of the operation of the applicable threshold, taking into account the evolution of trading volumes and other relevant factors. In case ESMA does not submit an amendment of the RTS to the Commission to trigger the move to the next threshold, ESMA would be required to explain why a move to the next threshold is not warranted.

111. ESMA appreciates that the Commission reconsidered its initial proposal and considers that the current proposal would address the legal risks and methodological flaws of the initial proposal. However, as already explained above in the context of the liquidity assessment for bonds, ESMA is very much concerned about the approach proposed and in particular about the following aspects:

i. The implementation of a yearly amendment of the RTS would be extremely burdensome and resource consuming not only for ESMA and national regulators but also for market participants who would have to constantly adapt their market practices and IT systems;

ii. It is very unlikely that, assuming that there are no significant impacts on market liquidity, that percentiles would be increased in accordance with the four year schedule proposed in the letter. To the contrary, ESMA expects that the phase-in would at least take twice the time anticipated by the Commission;

iii. It would in practice result in a significant lowering of transparency standards which is not supported by strong quantitative evidence. It is questionable whether this proposal would allow for meaningful transparency and in this respect whether it satisfies the objective of the co-legislators to strengthen transparency.

112. Giving these drawbacks , ESMA suggests the following alternative approach:

113. An automatic phase-in that is not linked to an ESMA assessment on the basis of the approach suggested above, i.e. an automatic move to the next stage on a yearly basis until stage 4 is reached.

114. ESMA monitoring market developments and preparing an annual report assessing the situation of liquidity providers based on quantitative and qualitative data. These reports would assess the impact of the new transparency regime on the ability of liquidity providers to perform their activity while also taking into account overall market development affecting liquidity and the behaviour of liquidity providers. Possible aspects to be considered include the development of the nominal value of the SSTI-threshold over time, and the developments of reference points (such as the notional sizes where dealers are willing to quote a firm price). ESMA would publish these reports in order to allow for a transparent process and to provide for a high level of accountability.

115. In case ESMA identifies a negative impact of the transparency provisions on liquidity providers, ESMA would propose an amendment of the RTS. In order to ensure that such a proposed amendment would be delivered in a sufficiently timely manner, ESMA would accompany the ESMA report with a proposed amendment to the draft RTS that would be subject to a public consultation of reduced length.

116. ESMA therefore suggests to opt for an automatic phase-in that will be accompanied by a close monitoring of the impact on market liquidity by ESMA and corrective action where needed. ESMA provided drafting changes in the draft RTS 2 in the Annex.

4.3 Update of technical elements in the Annexes of RTS 2

117. ESMA would also like to make the European Commission aware that it introduced some technical changes to the Annexes of RTS 2 that were needed (i) for the development of the data reporting system; and (2) to ensure consistency of RTS 2, RTS 1 and RTS 23.

118. Finally, ESMA would like to highlight that the ongoing negotiations on the Commission proposal for an amendment of MiFID II and MiFIR may require further amendments of draft RTS 2. ESMA notes the intention of the European Parliament to address the issue of pre-trade transparency for package transactions at level 1. Should the final agreement provide for a pre-trade transparency regime for package transactions this may require some targeted adjustments to draft RTS 2.

5 Annex: Revised Draft Regulatory Technical Standard