ISDA Safe, Efficient Markets

11 June 2021

ESMA Consultation paper on annual review of RTS 2 - Transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives

Final ISDA response

ISDA welcomes the opportunity to respond to the ESMA consultation paper on RTS 2 annual review.

ISDA members have raised in response to consultation papers that the effectiveness of the transparency regime for derivatives largely depends upon the quality and accuracy of available data.

They agree with ESMA's view that "*despite an improvement for many asset classes, the level of completeness and the quality of the data were still considered insufficient to perform the annual transparency calculations in the year 2020 for a number of instrument classes*" (paragraph 30 of the consultation paper).

ISDA members also agree with ESMA that 2020 could not serve as a basis for moving to MiFIR transparency regime stage 2 for derivatives (i.e. move the trade percentile to determine the SSTI pre-trade threshold from 30% to 40%). As rightly pointed out by ESMA, it is premature to make an assessment notably given the impact of the Covid-19 pandemic.

Lastly, ISDA members agree with ESMA that the first full year of data relating to the trading activity excluding the UK will be 2021 and as a result an assessment will be possible only in 2022.

ISDA members nevertheless note that ESMA, in paragraph 42 of the consultation paper, re-iterate their conclusions included in the MiFIR review report for non-equity instruments that '*the removal of the pre-trade SSTI waiver and a lowering of the LIS threshold would lead to a more appropriate level of transparency*'. Although ISDA members understand the willingness of ESMA and of regulators to simplify the transparency regime, they note that the SSTI waiver is intended to protect market makers from undue risks and that the removal of this waiver may affect the functioning of the markets and the ability of end-users to find appropriate hedging tools.

We note that this conclusion is based on the statement in paragraph 40 that "*a reduction in market making activity in fixed income markets could be observed*". Although ISDA does not focus on the functioning of fixed income markets, we would like to make raise two thoughts regarding this statement. Firstly, the fact that increased prudential constraints already have a disincentivising effect on dealers should lead to considering thoroughly, rather than neglecting, the risk that modified thresholds may further affect market making activities. Secondly, we consider that the analysis of market data during the pandemic crisis, therefore in a period of stressed markets, contradicts the ESMA statement. ISDA, IIF and FSF recently published a report on the role of financial markets and institutions in supporting the global economy during the Covid-19 pandemic[1] that shows the crucial role played by banks to take on risks to support the economy. In the executive summary, the report notably states, regarding secondary markets and market-making, that "*liquid secondary markets in corporate and government securities are essential to help ensure investors can manage their financial risks at low cost, while reducing the cost to governments and companies of borrowing money. During the pandemic-related market turbulence, there was evidence that some markets experienced relative illiquidity. At the same time, data shows that large banks increased their inventory holdings during this period to support customer trades and built up their securities holdings across an array of sectors and instruments. There was evidence that market making in derivatives and secondary markets strengthened*." Graphs 4.8 and 4.9 on page 47 of this report show this critical role played by market makers.

Specific answers

Q1: Do you agree with ESMA's proposal to move to stage 3 for the determination of the liquidity assessment of bonds? Please explain.

ISDA is not responding to this question which concerns bond markets only.

Q2: Do you agree with ESMA's 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.

ISDA agrees with ESMA that it is premature to move to stage 2 for the determination of the pre-trade SSTI thresholds for derivatives and emphasize that if ESMA will be able to analyse 2021 data in 2022 and have a first estimate of trading activity in the EU without the UK, 2021 will likely be a transitional period due to continued effects of the pandemic and to on-going adjustments after Brexit. ISDA members believe that a comprehensive and relevant assessment may not be possible in 2022 as 2021 might not be considered a year of reference for trading activity in the EU.

Q3: Do you agree with ESMA's proposal to move to stage 3 for the determination of the pre-trade SSTI thresholds for bonds (except ETCs and ETNs)? Please explain.

ISDA is not responding to this question which concerns bond markets only.

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[1] ISDA – IIF - FSF, May 2021: the-role-of-financial-markets-and-institutions-in-supporting-the-global-economy-during-the-covid-19-pandemic