ICMA

International Capital Market Association

ICMA position paper: Proposal for a new post-trade transparency regime for the EU corporate bond market

ICMA MiFID II/R Working Group Transparency Taskforce

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Author: Elizabeth Brooks Callaghan

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Overview

ICMA fully supports the establishment of a single consolidated tape for EU bond markets. ICMA views this as being the necessary vehicle for providing comprehensive, meaningful market transparency. In April 2020, ICMA published a report with recommendations for the establishment of an optimal post-trade consolidated tape for EU bond markets.[1]This report addressed a number of fundamental questions relating to the context, relevance, comparability, scope, design, and governance of a potential consolidate tape.

In summer of 2021 as an important follow up to this work, ICMA, through its Transparency Taskforce (Taskforce), began extensive discussions and analysis to determine what should be the appropriate 'transparency regime' to support the consolidated tape. That is, what information should be made available on the tape, and when? While in many, if not most cases, full and immediate disclosure of transactions can be considered desirable, there is also a broad recognition that there are instances where it would be beneficial to the overall integrity and efficiency of the market to delay the dissemination of certain details, and possibly of the transaction itself.

The ICMA Transparency Taskforce

The ICMA Transparency Taskforce **(Taskforce)** is made up of buy-side and sell-sides heads of trading (some global) and senior traders and firm representatives. These buy and sell-side investment firms represent views from various EU countries such as Germany, France, Netherlands, Italy, Norway, Sweden, UK, and the US (operating in EU countries). They also represent varied transparency preferences, some requiring more transparency and some requiring less, based largely on their business models and their relative sensitivity to information leakage. While recognising that there is no single transparency model that could be considered optimal for every market participant, most importantly this **ICMA transparency proposal puts forward a regime that the majority of buy and sell side Taskforce members agree that they 'can live with'.**

On 25 November 2021, the European Commission (EC) published a Communication on the delivery of its 2020 'Capital Markets Union (CMU) Action Plan'. This package of announcements included proposals for amendments[2] to the MiFID and MiFIR texts. Specifically, the EC proposes that "ESMA should specify the deferral buckets for which the deferral period shall apply across the Union by using the following criteria: a. liquidity determination, b. size of the transaction (in particular, transactions in illiquid markets or that are large in scale), and c. the classification of the bond (investment grade or high yield)."

With regard to the EC's amendments to the MiFIR bond transparency regime, ICMA welcomed the proposed inclusion of market liquidity and IG and HY instrument classification as methodology variables in the future bond deferral regime. We look forward to engaging with ESMA on implementing measures. However, ICMA is concerned that the suggested maximum deferral for the reporting of a transaction price for large and illiquid trades is end of day. If this proposal is adopted, it will likely disadvantage EU fund managers, asset managers, pension funds and banks by compromising their market positions. ICMA recommends for large and illiquid bond trades a two-week price and size deferral. ICMA also notes there was not a suggested methodology for liquidity determination, for example using the amount outstanding.

This paper summarises the Taskforce's findings and sets out ICMA's position regarding a bond market transparency regime methodology for EU corporate bond markets. One that benefits large and small industry participants. Under the umbrella of ICMA's MiFID II/R Working Group, the Transparency Taskforce aims to provide a workable transparency methodology for ESMA, in their 'implementing measures' capacity, to strongly consider.

1 See: https://www.icmagroup.org/assets/documents/Regulatory/MiFID-Review/EU-Consolidated-Tape-for-Bond-Markets-Final-report-for-the-European-Commission-290420v2.pdf.
2 ICMA-Preliminary-Thoughts-on-CMU-Package-29-November-2021-291121.pdf (icmagroup.org).

Background

Why is transparency important for bond markets?

The goal of the bond post-trade consolidated tape (CT), as perceived by Taskforce members, is to improve transparency, assist decision making, and provide market insights to end-investors, large or small. Adoption of the appropriate structure would benefit the whole market, by providing a centralised, high quality, affordable, trustworthy data source, offering a comprehensive market view. This would bring immediate benefits to professional bond markets and benefit the retail sector as well.

Transparency is important to bond market participants because it assists decision making and provides market insights to end-investors. Transparency also promotes price competition as investors are able to demand more accountability from their liquidity providers. Additionally, transparency facilitates automation advancements. Finally, market participants can assess accurately current market and liquidity dynamics, increasing overall investor confidence, particularly during times of market volatility.

Importantly, the establishment of a CT for bonds can be viewed as integral to the objectives of Capital Markets Union (CMU).[3] A post-trade CT for bonds strengthens EU capital markets by linking together the disparate trading venues and Approved Publication Arrangements (APAs) across the EU, enhancing investor confidence due to increased transparency in the market. Stronger and more liquid EU capital markets promote capital formation, job creation, and economic growth.

Transparency vs liquidity

The Taskforce notes that while regulatory frameworks should be calibrated in a way that achieves a high level of post-trade transparency, they should also take into account the potential impact that post-trade transparency may have on market liquidity. This is a recognition that, particularly in bond markets, too much information can be a bad thing. This is an acknowledgement of differing market structures and in particular a recognition of how bond market liquidity is created.

In illiquid markets, especially those that rely on market-makers as the principal source of liquidity, prices can be extremely sensitive to information dissemination, particularly in response to public knowledge that a trade is trying to be executed or has just been executed. Such information leakage creates risks for both the liquidity provider and the liquidity taker. In the case of the former, the liquidity provider will be taking a position onto their books that they will subsequently look to offlay. If during this period (which could range from hours to weeks) the details of the original transaction are publicly disseminated, the market will anticipate the offlaying trade and adjust the price of the securities accordingly, to the detriment of the liquidity provider. In the case of the liquidity taker, if it becomes market knowledge that somebody is looking to execute a particular trade, either before they are able to execute (pre-trade) or as they attempt to execute the transaction in increments (post-trade), the market will similarly adjust in response to this information. Here the liquidity dimension of depth (i.e., the ability for the market to absorb size) becomes a fundamental consideration (see next section).

Accordingly, too much transparency can have an adverse effect on market efficiency and liquidity, either forcing liquidity providers to adjust their pricing (assuming that they do not withdraw liquidity completely) or amplifying market moves in response to any request for quote or partial execution. In both cases it is the investor who ultimately suffers (*see also Annex I: Best execution*). In its response to the consultation document for the IOSCO transparency

3 See the 2020 CMU Action Plan: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:590:FIN.

recommendations,[4] ICMA stressed that efficient and liquid markets are the most important considerations for investors, and which are valued far more than transparency in itself, since inefficient markets fail to serve both investors and issuers.

Thus, any public transparency framework needs to ride a fine line between improving market efficiency and undermining market liquidity.

This is what the Taskforce proposal aims to achieve: balance the benefits of improved overall market transparency while protecting not only market-makers and liquidity providers, but also investors, particularly in the case of large transactions, or transactions in less liquid bonds. This is why it proposes longer deferral periods (up to two weeks) not only for the publication of certain transaction sizes, but also prices.

Simplicity vs complexity

Defining and measuring liquidity is not straightforward. In its 2016 report on the European corporate bond market, ICMA settled upon the following definition: the ability to execute buy or sell orders, when you want, in the size you want, without causing a significant impact on the market price.[5] This essentially captures the three dimensions of liquidity outlined by Kyle (1985) and Harris (2003): cost, depth, and time.

In recent years a number of data providers have begun to produce 'liquidity scoring' metrics for individual bonds. These generally take into account a range of dynamic and static variables, such as historical prints, observable quotes, price sensitivity, issue size, credit rating, maturity, age since issuance, index inclusion, and liquidity in similar bonds or related derivatives. Again, what these metrics attempt to map are the three dimensions of liquidity, estimating the time required to buy or sell a specified amount of bonds without a significant change in price, or the cost of executing the full size immediately.

MiFID II and MiFIR introduced a pre- and post-trade transparency framework for EU bond markets which came into effect in January 2018. This follows a number of other jurisdictions, many with long-established transparency regimes for bonds, most notably the US.[6] In its deliberations over the design of the EU framework ESMA was clearly conscious of the interrelationship between bond market transparency and liquidity. The ESMA model would decide if a trade should be reported close to 'real time' or deferred to a later date based on a determination of whether the market for the underlying security is considered 'liquid'. The resulting liquidity determination and trade size deferral framework is inherently complex, largely based on an ongoing assessment of transactions in individual ISINs. While the objectives of the MiFID II/R transparency regime are well intentioned, the considered view that this has led to an overly complicated framework that has fallen short of its stated goal.

What this highlights is that when designing a transparency regime, balancing simplicity and complexity is also key for a workable solution. Overcomplicating the transparency regime can be counterproductive, while the same is true for oversimplifying it.

The ICMA Taskforce therefore decided to focus on a limited number of easily discernible variables. Two are characteristics of the underlying bond: whether investment grade (IG) or high yield (HY);[7] and the outstanding size of the issue. Taskforce members agreed that there is a marked difference in the liquidity and tradeable sizes of EU corporate bonds, depending on whether they can be classified as investment grade or high yield.[8] Furthermore, the size of the underlying issue (i.e., the amount of tradeable stock available) also plays a key factor in a bond's liquidity. The larger the issue, all things being equal, the easier it is to find secondary market liquidity. Both of these characteristics of individual ISINs are also widely and publicly available, and relatively static.

After careful consideration and data analysis, the Taskforce felt that an outstanding corporate bond issuance size of €1bn (or equivalent) was the appropriate cut-off point in the determination of 'liquid' or 'illiquid'.

4 ICMA's response to IOSCO's consultation paper on Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets (October 2017).
5 Remaking the corporate bond market: ICMA's second study into the state and evolution of the European investment grade corporate bond secondary market (July 2016).
6 An overview of various global bond market transparency regimes can be found on the ICMA website.
7 *See Annex II: High yield / Investment grade guidance*.
8 This distinction is also used by the US Trade Reporting and Compliance Engine (TRACE).

The third variable is based on the actual trade size itself. Here it was felt that again there was merit in the simplicity of using static size thresholds to determine the appropriate deferrals. The result is three trade size buckets: small, medium, and large. These were based on analysing historical trade data and the observations of average and median trade sizes for both IG and HY bonds.

Plotting these three variables (IG/HY, outstanding issue size, transaction size bucket) creates a three-dimensional lens that forms the basis of the proposal.

The next step was for the Taskforce to determine the appropriate calibrations for trade information deferrals, to be applied along the three dimensions. Again, it was important to consider the benefits of not overcomplicating deferrals, while at the same time balancing this against the risks of an overly simplistic model: not least one that started from the perspective of 'real time' reporting being optimal. The Taskforce eventually concluded that both price and size dissemination could be bucketed in terms of: 15 minutes (within 15 minutes), end-of-day, and two weeks.

One of the Taskforce members (a prominent trading venue and data vendor) undertook analysis of different calibrations of the proposed model using historical trade data. This allowed the Taskforce members to understand better the degree of transparency that the proposal would provide (what information would be available and when), and therefore to refine it in an attempt to find the optimal calibration. This also highlights the importance of ongoing data analysis to evaluate the appropriateness and effectiveness of any transparency regime *(see Annex I: Scope)* and to refine it continuously, as required (*see Annex II: Data Expert Advisory Group*).

Importantly, the framework, including the application of deferrals, should be harmonised across all relevant reporting jurisdictions. Another case of simplifying the model.

The final proposed transparency framework for corporate bonds is described below:

Framework

ICMA's transparency regime is based on three buckets of transparency, 'Small', 'Medium' and 'Large'.

- **The 'Small bucket'** provides real-time (+ 15 mins or as soon as technically possible thereafter) transparency for all trades **€1 mm** and below, regardless of amount outstanding or rating.
  - Potentially creating in the near future an 'EU retail market' for those that do not have access to institutional toolkits.
  - Potentially providing wider/deeper market for smaller bond market participants such as private banks and small investment funds.
  - Providing protection for small and retail-sized investors. They are not disadvantaged as they traditionally trade ≤ €1 mm.
- **The 'Medium bucket,'** where trades are larger than €1 mm, these trades are considered 'wholesale' or 'institutional', and therefore require two extra variables besides size; amount outstanding and high yield/investment grade rating.
  - **Amount outstanding (€1bn).** The bigger the amount outstanding, the more liquidity that instrument is likely to have. Also, it is highly unlikely for one venue to classify a bond issue size differently than another. So, the amount outstanding for bond issue size will have essentially the same information from venue to venue and vendor to vendor.
  - **High yield and investment grade:** ***(see Annex II)*** rating-based trade size thresholds **(HY: €2 mm, IG: €5 mm)** reflect the willingness of the liquidity providers to provide liquidity.
    - In regard to high yield/investment grade rating data, the major trading venue and vendor systems in bond markets mostly use the same primary source of rating information (although, some may include their own data). Therefore, they all have effectively the same information, making it improbable for data differences to emerge. Institutional bond market participants can access this information easily and retail and smaller sized participants will not require this information. Therefore, no bond market participant will be disadvantaged.
    - ICMA's chosen HY: €2 mm, IG: €5 mm thresholds are considered accurate as the vast majority of trades are sized up to €5 mm, as illustrated in ICMA's study into the state and evolution of European corporate bond market on page 14.
- **The 'Large bucket'**, which also uses amount outstanding and high yield and investment grade rating-based trade sizes, reflects larger trade sizes and more illiquid trades than the "medium bucket".
- **Deferral periods** should be harmonised throughout the EU and based on + 15 minutes (within 15 minutes), end of day or 2 weeks.
- **Exceptions.** There are a few additional explanations and exceptions to the transparency proposal framework described above. 1. For price deferrals that are beyond EOD, will show at EOD, average price (for 3 or more trades) and # of trades, until full price details are published. 2. For size deferrals that are beyond 15 mins, will show size as €2 mm (HY) +/ €5mm (IG) +, from publication of price, until full size details are published. 3. For trade sizes ≥ €50mm (rare), price and size will be deferred for 4 weeks.

ICMA MiFID II Working Group, Transparency Taskforce (submitted 5 October 2021)

Proposed new EU corporate bond transparency regime

	ICMA Deferral bucket	Amount Outstanding	Trade size (w/ratings as appropriate)	Price - Deferral	Size - Deferral
1	Small bucket (incl retail)	N/A	≤ €1 mm	15 mins	15 mins
2a	Medium/Liquid	≥ €1 Bln	< €2mm (HY) < €5mm (IG)	15 mins 15 mins	EOD EOD
2b	Medium/Illiquid	< €1 Bln	< €2mm (HY) < €5mm (IG)	EOD EOD	2 weeks 2 weeks
3a	Large/Liquid	≥ €1 Bln	≥ €2mm (HY) ≥ €5mm (IG)	EOD EOD	2 weeks 2 weeks
3b[9]	Large/Illiquid	< €1 Bln	≥ €2mm (HY) ≥ €5mm (IG)	2 weeks 2 weeks	2 weeks 2 weeks

- For price deferrals that are beyond EOD, will show at EOD, average price (for 3 or more trades) and # of trades, until full price details are published.
- For size deferrals that are beyond 15 mins, will show size as €2 mm (HY) +/ €5mm (IG) +, from publication of price, until full size details are published.
- For trade sizes ≥ €50mm (rare), price and size will be deferred for 4 weeks[10].

9 ICMA is concerned with the (EU Commission proposed amendments to MiFIR, Article 1 (6). These amendments suggest end of day (EOD) as the maximum deferral for transaction price for large and illiquid trades. It is well known in the bond trading industry that size is 'baked into' price. If this price EOD proposal is adopted, it will likely disadvantage EU fund managers, asset managers, pension funds and banks by compromising their market positions. ICMA recommends for large and illiquid bond trades (3b) a two-week price and size deferral.

10 ICMA acknowledges EU Commission proposed amendments to MiFIR, Article 1 (6): deferred publication for price is until end of day and deferred volume [size] is for a maximum of two weeks.

Annex I

Scope

The Taskforce believes, when considering any changes to the current transparency regime, the Commission should first aggregate EU bond data into one centralised consolidated tape and see how much transparency the current regime is bringing to the market. Once the Commission has that visibility, they should then be able to better review and analyse the scope of data to determine the deferral regime, keeping in mind meaningful variables that reflect bond liquidity status such as amount outstanding of the underlying issue, and trade size based on high yield and investment grade ratings. However, the Taskforce understands the EU Commission will not be taking forward this phased approach.

Liquidity decay

A third underlying bond characteristic was originally considered as a potential liquidity determinant, which is the period since the issuance of an individual bond. There is plenty of research and analysis to illustrate a strong correlation between a bond's secondary market liquidity (measured by trading activity) and the first few days and weeks following its issuance. After around four-to-six weeks, a rapid 'liquidity decay' can be observed for most bonds. However, it was felt that while this was an important determinant in a bond's liquidity profile, it was too dynamic to track and added too much complexity to the model.

Best Execution

A concern was raised by Taskforce members regarding the impacts of a transparency regime, which is based on significantly greater amount of transparency, on best execution obligations. Responsibilities under MiFID II best execution require the obligation to provide 'the best possible result for the client'. The concern is that the 'best possible result' for large/illiquid trades, may not reside in the EU. Lower prices may be found outside the EU and market participants adhering to best execution obligations, may be compelled to use them.

Annex II

High yield/Investment grade guidance

ICMA considers IG and HY credit ratings should be relied upon. These corporate bond instrument classifications are major characteristics of bond markets. ICMA proposes ESMA could have a reference page which uses the ECB ratings standard as the reference: Guideline ECB/2014/60.

Which in summary states:

- If one recognised credit rating agency states the bond rating is IG, the bond is IG.
- If there are multiple recognised credit rating agency ratings and at least one states the bond rating is IG, the bond is IG.
- If there are no IG ratings from recognised credit rating agencies, the bond rating is HY.
- If the bond is 'un-rated', then the recognised credit rating agency rating would be based on Issuer or Guarantor rating.

Annex III

Data Expert Advisory Group "DEAG"

The bond consolidated tape will require a Data Expert Advisory Group (DEAG) to be part of the operating model of the chosen bond consolidated tape provider. The 'DEAG' would consist of buy-side, sell-side, trading venue and APA market participant experts and meet on a semi-annual basis to review and look back at the transparency situation from the previous six months. This expert group will recommend to ESMA to either increase/decrease/hold thresholds based on real market experiences.

- If there are found to be negative market liquidity impacts, perhaps from reduced sell-sides balance sheet risk provision then thresholds could be modified to provide less transparency. If the market is working well with current thresholds and the 'DEAG' agree there would not be any undue risk to increasing transparency, then thresholds could be changed to increase transparency.
- This 'DEAG' would also in times of crisis (e.g., Covid) recommend necessary changes to thresholds/deferrals.
- No transparency threshold modification should be considered, without (analysis-based) agreement from the 'DEAG'.
- The 'DEAG' buy-side and sell-side market participant representation should include a balance of natural transparency preferences. APAs and trading venues will advise on data quality and market operator experiences from the last six months.
- Recommendations from the 'DEAG' should be considered 'actionable'.

ICMA Zurich
T: +41 44 363 4222
Dreikönigstrasse 8
8002 Zurich

ICMA London
T: +44 20 7213 0310
110 Cannon Street
London EC4N 6EU

ICMA Paris
T: +33 1 70 17 64 72
62 rue la Boétie
75008 Paris

ICMA Brussels
T: +32 2 801 13 88
Avenue des Arts 56
1000 Brussels

ICMA Hong Kong
T: +852 2531 6592
Unit 3603, Tower 2, Lippo Centre
89 Queensway, Admiralty, Hong Kong

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