International
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ICMA

Q6: Do you agree with our approach to implementing the SI regime in MAR 6? If not, please give reasons why.

ICMA considers the FCA approach to SI implementation concerning. This is due to the draft delegated acts that were widely circulated discussing the class-based approach to the Systematic Internaliser determination regime (Draft Delegated Act – Article 13: Thresholds for further specifying the definition of systematic internaliser for bonds . Effectively, the draft delegated acts require an SI in a given bond to become an SI for all of the bonds in the relevant class of bonds. The unintentional significance of this draft delegated act wording is: it forces an SI investment firm to become an SI in instruments where the investment firm may trade infrequently, ad-hoc or not at all. This is a risk factor that most investment firms and their commercial policies would find unacceptable. It is also wholly unfair for small specialist firms who choose to make markets in very specific corporate or sovereign bonds. For example, a Spanish SI in Spanish Government bonds will suddenly find themselves under the obligation of being an SI in Lithuanian Government bonds.

Furthermore, the SI regime applies to "an investment firm which, on an organised, **frequent and systematic**, and **substantial** basis, deals on its own account by executing client orders outside a RM, MTF, or OTF." There is nothing organised, frequent, systematic or substantial about a Spanish Government bond SI being forced to become an SI for Lithuanian Government bonds. The draft delegated act ruling also does not pass the MiFIR test for becoming an SI in the first place. The SI 'tests' are as follows:

Frequent and systematic test

- For **liquid bonds**, this is where the number of trades during the last six months is equal to or larger than 2.5% of the total number of transactions in the relevant financial instruments in the EU executed on any venue or OTC during the same period. At a minimum, the firm should deal on its own account in the instrument once a week.
- For **illiquid bonds**, this is where the firm has dealt on its own account OTC in the financial instrument on average once a week during the last six months.

Substantial test

- The firm internalises on a substantial basis if the size of OTC trading on own account during the last six months is equal to or larger than:
  - **25% of the total nominal amount traded** in that financial instrument executed by the investment firm on its own account or on behalf of clients, and carried out on any trading venue or OTC; or
  - **1% of the total nominal amount traded** in that financial instrument executed in the EU and carried out on any EU trading venue or OTC.

Lastly, publishing this superfluous data in Article 27 (3) of MiFID II for an SI on execution quality of non-frequent, systematic or substantial bonds is erroneous. While it is an additional use of resources, IT or individuals to report the ad hoc occasional data, there is also nothing the market can glean from this published data. See the following tables requiring population.

Annex I

Table 1 - identification information to be published in accordance with Article 3

Venue	Name	Identifier (ISO 10383 Market Identifier Code (MIC) or the Legal Entity Identifier (LEI)	
Country of Competent Authority	Name		
Market Segment	Name	Identifier (ISO 10383 market segment MIC)	
Date	ISO 8601		
Outages	Nature	Number	Average duration
Scheduled Auction	Nature	Number	Average duration
Failed Transactions		Number	Value (as % of total value of transactions executed on that day)

Table 2 - identification information to be published in accordance with Article 3

Financial Instrument	Name	Identifier(ISO 6166)
Written description of financial instrument, if no identifier available (including the currency of the underlying instrument, price multiplier, price notation, quantity notation and delivery type)		
Instrument classification	(ISO 10962 CFI code)	
Currency	(ISO 4217)	

Q8: Do you agree that we should use our power to grant waivers from pre-trade transparency in bonds, structured finance products, derivatives and emission allowances in relation to: orders that are large in scale; orders held in an order management facility pending disclosure; actionable indications of interest in request-for-quote and voice trading systems; and, derivatives that are not subject to the trading obligation under article 28 of MiFIR, and other financial instruments for which there is not a liquid market? If not, please give reasons why.

ICMA agrees with the FCA using its power to grant waivers from pre-trade transparency in bonds. However, the foundation of these waivers is data. The data must be correct in order to build appropriate, accurate and viable waivers. The waiver calculations must take into account all the relevant and available trade data; this includes trades below EUR 100,000. ICMA believes regulators should include the trades below EUR 100,000 as the understanding from TRAX data, based on the period between September through November 2014 is: 32% of institutional trade count is less than EUR 100k for Corporate bonds and 20% for Government bonds. By not including the trades below

EUR 100,000, ICMA's view is that many institutional trades would be excluded, causing the waiver thresholds to become distorted and unworkable.

<u>Q12: Do you agree that we should authorise operators of trading venues and investment firms to provide for deferred publication in relation to transactions that are:</u>
<u>• large in scale</u>
<u>• in financial instruments for which there is not a liquid market</u>
<u>• above the size specific to the instrument, and</u>
<u>• packages If yes, do you agree that we should set up the process for the use of guidance in the Handbook for the application of deferrals? If not, please give reasons why</u>

ICMA agrees the FCA should authorise operators of trading venues and investment firms to provide for deferred publication in relation to the transactions mentioned above. However, ICMA is very concerned about the potential lack of coordination of deferral periods throughout Europe's NCAs. In order to achieve an orderly functioning market, there must be a uniform deferral period throughout Europe and in order to protect participants, ICMA considers it should be the longest available deferral period of four weeks.

<u>Q13: Should we:</u>
<u>• use our powers under article 11(3) of MiFIR further to calibrate post-trade deferrals in accordance with the above options</u>
<u>• require additional information to be made public during the deferral period? and/or, should we:</u>
<u>• permit the omission of the volume, or the aggregation of information, for an extended time period of four weeks? If not, please give reasons why</u>

ICMA agrees that the FCA should use its powers under article 11 (3) of MiFIR to further calibrate post-trade deferrals. However, it is crucial that the post-trade deferral regime is framed appropriately. Most importantly, as mentioned in question 12 above, the deferral period for illiquid, large trades or bonds above the SSTI threshold should benefit from a four-week deferral period. If not, there will be unplanned outcomes. To help answer the first point in question 13, an example of a potential end result follows.

Potential unforeseen effect of MiFID II - RTS 2: "Supplementary deferral regime & investor published holdings data ('gaming' the buy-side)":

RTS 2, article 11 indicates competent authorities under their own discretion may allow the omission of publication of volume and aggregation of transactions for an extended deferral period of four weeks. The key is **competent authority 'discretion'** (based on Article 11 in Chapter 2 under Transparency for Trading Venues – Level 1).

The worry is that if individual competent authorities <u>do not allow</u> the full four week extended deferral and instead choose only the 48-hour deferral, Asset Managers could be 'gamed' based on their publically available holdings data.

Trade information published too early will create the opportunity for certain individuals to data mine the published trade data and cross reference it to asset manager published holdings (which asset managers do on a monthly, quarterly or semi-annual basis), these individuals could gain an insight to potential order flows or trends from asset managers and could look to trade on the back of that information. Any trading on the back of that information is likely to be of a disruptive or of a predatory nature.

To illustrate this point, we can take a hypothetical example of a fund run by an asset manager ("asset manager X") that holds a concentrated position in an illiquid bond ("Bond Y".

The following example of **'Asset Manager X'** (looking to sell [or not] his holding in Bond Y) illustrates the prospective fallout of the proposed requirement to publish trades 48 hours later (vs an extended deferral period of four weeks):

If we assume that the relevant NCA adopts the standard 48hr deferral regime:
Suppose **'Asset Manager X' asks a single dealer for a bid (in order to transact) on their entire holding of this illiquid bond in a size which is greater than the LIS threshold:**

<u>Pre-trade negotiation:</u>

Scenario 1:
- The dealer knows that, even though he is the only one seeing that enquiry for now, the rest of the market will know about the transaction in only 2 days (full price and size disclosure), and this will be sooner than his ability to recycle his position.
- The dealer therefore prices his bid for the bonds defensively as compensation for the fact that the market will know about the trade and may trade against him while he is left holding the bonds.

-**Scenario 2:**
'Asset Manager X' receives an adverse price or possibly no price at all leading to:

<u>Trade:</u>

Scenario 1:
'Asset Manager X' accepts the price and the transaction takes place:
- This information is disseminated to the market place and may act as a 'trigger event' for predatory market participants, to act in the following manner:

Scenario 2:
-**Asset Manager X** then attempts to trade in clips and:

<u>Post Trade:</u>

Scenario 1:
- On T+2, predatory traders will look at the size & price of the transaction that took place, and if the size is high and the price looks low, take a calculated guess that there was a large seller in the market.
- If on day 3,4,5…. etc. there are no further transactions reported on this bond to suggest that the risk has been recycled into another investor, the predatory traders know that the bonds likely still sit on a dealer's book
- A further check for the predatory traders would be to look at the daily published NAVs of the funds listed as the biggest holders. Even if it is not disclosed that any fund`s holdings in that specific bond were reduced, fund NAVs (that are public and published daily) that are trending lower would add further weight to the calculated guess that there must have been a large seller.
- Due to the "machine-readable" nature of the published data, predatory traders will be able to do this quickly and easily.
- The predatory trader can then also sell/short the bonds in the market, actively gaining by depressing the price for others

Scenario 2:
-Predatory traders cross reference the publically available holdings data and calculates which asset manager is transacting in the market (information leakage).

Outcome for Asset Managers:
The end result is a probable worse price for <u>ALL</u> holders of this bond and lower liquidity and potential losses for any banks willing to provide liquidity.
Bottom line:
-Detrimental pricing for asset managers
-Asset Manager further disadvantaged by being 'gamed' (front-ran)

ICMA considers the linked asset manager published holdings data & 48-hour deferral (vs. four weeks) issue will at best be a disincentive for asset managers from publishing holdings (including UCITS) or publishing them with any frequency and at worst, allow quants the ability to 'game' buy-sides to the detriment of the buy-side participants and their end-clients. Therefore, ICMA recommends **<u>all</u> National Competent Authorities (NCAs) in Europe should agree on the maximum extended four-week deferral period vs. the 48-hour deferral period.**

- **require additional information to be made public during the deferral period?**

To answer point 2 of question 13, ICMA firmly believes there should not be any additional information made public during the deferral period. As just pointed out above, any published information during the deferral period (which should be 4 weeks) might be used in a predatory manner by cross referencing holdings data. This countermands the purpose of the deferral in the first place.

- **permit the omission of the volume, or the aggregation of information, for an extended time period of four weeks? If not, please give reasons why**

ICMA agrees with the omission of volume and the aggregation of information for the extended time period of four weeks. In order to protect both liquidity providers and asset managers, the size of transactions in illiquid instruments and liquid instruments when traded in large sizes should be masked. Furthermore, ICMA recommends for sovereign debt instruments after the four-week period, no publication of volume for <u>an indefinite period</u>. Instead, the FCA should allow publishing of <u>aggregated volume</u> for the sovereign instruments published on the Tuesday following the expiry of the four-week deferral period before 9:00am local time as per Article 11 (2) (c) of RTS 2.

Lastly, providing the liquidity calibrations improve with the soon to be released regulatory technical standards, ICMA agrees with ISDA's proposed dynamic 'Regulatory Deferral Regime Grid':

Recommended Deferral Regime Grid			
Regime	**Liquid/Illiquid**	**LIS**	**SSTI**
Enhanced deferral	Illiquid	above	above
Enhanced deferral	Illiquid	below	above
Enhanced deferral	Illiquid	below	below

Enhanced deferral	Liquid	above	above
Standard deferral	Liquid	below	above
Post-trade real time (no deferral)	Liquid	below	below