Frankfurt,
1 November 2024

ESMA consultation on bond transparency: BVI Bond Deferrals Framework

The BVI[1] gladly takes the opportunity to present its bond deferrals framework in response to ESMA's consultation on the MIFIR Review in relation to non-equity trade transparency (RTS 2).

On 28 August 2024, BVI, on behalf of its members, responded to ESMA's consultation on the MIFIR Review in relation to non-equity trade transparency (RTS 2). BVI's response at that time only proposed general principles on the ESMA proposed post-trade deferral framework for bond markets and based on the model drafted by the co-legislators in the Level 1 Regulation. Thereafter BVI members close to the discussion on this subject within another trade association proposed a draft bond deferrals framework which particularly focused on the regulatory technical standards. BVI with the support of Etrading Software (ETS) in September 2024 adopted a data-driven and analytical approach in assessing the framework proposed by ESMA as well as making several changes intended to enhance the transparency of the EU transparency regime. BVI in broad alignment with other associations[2] proposes compared to the ESMA framework:

(i) More granular groupings of bonds. BVI proposes a distinction between the seven largest and most liquid sovereign issuers (EU, France, Germany, Italy, Spain, UK, and US), as well as between the three most liquid currencies in the corporate bond markets (EUR, GBP, and USD – the later as a substitute for a preferable distinction between investment grade and high yield credit issues).
(ii) A more quantitative, but still simple approach to establishing the appropriate liquidity determinant. BVI focused on broad alignment with the ESMA proposal on outstanding issuance size as an important liquidity determinant.
(iii) A more detailed deferral matrix, which allows for a better distinction between liquid and illiquid trade size thresholds.
(iv) A data-driven approach to establishing the appropriate trade size thresholds for the relevant deferral categories, based on historical traded average daily trading volumes.

Average daily volumes

In identifying helpful modifications to the ESMA proposal, as well as suggesting an alternative, more accurate approach to determining the appropriate thresholds (both for liquidity determination and deferral category calibrations), BVI uses the historical average daily volumes (ADV) of notional amounts traded for various classes of liquid and illiquid bonds. This is based on a historical data set of MiFIR EU reported trades for January to September of 2024. BVI, in a similar fashion to the French supervisory agency AMF and the trade associations AFME and ICMA uses ADV as a measure of liquidity, allowing for liquidity profiling of different broad classes of corporate and sovereign bonds including estimating

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] Joint association statement on MIFIR RTS 2 post-trade deferrals for bonds, 3rd October 2024, available at: https://www.afme.eu/Portals/0/DispatchFeaturedImages/Joint%20Association%20Statement_MiFIR%20RTS%202%20post%20trade%20transparency%20for%20bonds.pdf

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market depth, from which one can infer the potential time required to trade out of a risk position for a given bond and size.

Corporate bond groupings

When establishing groupings of corporate and sovereign bond classes for the application of a deferral regime, BVI made sure that the bonds within each grouping have broadly similar liquidity profiles. This is because these bonds will be subject to the same liquidity determinant and the same trade size thresholds. BVI used ADV analysis of the broad bond classes to identify where more different groupings than those in the ESMA proposal were required, while making sure that the framework is not overly complex. BVI tried to categorise groupings relatively easily, transparent, consistent, and still broadly

Category [Liquid Currencies: EUR, USD & GBP]	Issuance size	Size	Price deferral	Volume deferral
0 - Small/Liq	≥ €500 Mn	< €2 Mn	Real time	
0.5 - Small/Ill	< €500 Mn	< €2 Mn		
1 - Med/Liq	≥ €500 Mn	≥ €2 Mn – < €15 Mn	15 mins	T+3
2 - Med/Ill	< €500 Mn	≥ €2 Mn – < €15 Mn	EOD	1 Week
All other currencies	Any	< €15 Mn	T+1	1 Week
3 - Lrg/Liq	≥ €500 Mn	≥ €15 Mn – < €50 Mn	EOD	1 Week
4 - Lrg/Ill	< €500 Mn	≥ €15 Mn – < €50 Mn	EOD	2 Weeks
5 - Extra Lrg	Any	≥ €50 Mn	T+4 Weeks	
All other currencies	Any	≥ €15 Mn		

Category [Liquid Currencies: EUR, USD & GBP]	No. of unique ISINs	No. of trades	% of total trades	ADV	Implied trade out days	Volume traded	% of total volume traded
0 - Small/Liq	16,470	1,316,089	71%	€ 2,322,106	0.43	€ 417,356,186,685	25%
0.5 - Small/Ill	15,480	272,653	15%	€ 1,247,692	0.8	€ 76,000,569,632	4.6%
1 - Med/Liq	10,524	160,874	8.7%	€ 2,322,106	3.7	€ 702,784,782,581	42%
2 - Med/Ill	4,031	20,501	1.1%	€ 1,247,692	6.8	€ 80,789,411,017	4.9%
All other currencies	4,836	63,400	3.4%	€ 1,924,195	3.9	€ 49,408,384,920	3.0%
3 - Lrg/Liq	2,630	7,615	0.4%	€ 2,322,106	14	€ 166,191,471,083	10%
4 - Lrg/Ill	402	747	0.04%	€ 1,247,692	26	€ 17,499,399,132	1.1%
5 - Extra Lrg	401	823	0.04%	€ 1,924,195	26	€ 92,295,111,191	5.6%
All other currencies	299	820	0.04%	€ 1,924,195	26	€ 26,700,405,464	1.6%

aligned with the ESMA proposal giving a premium on transparency over sell-side market making capacity in the medium sized trades.

Sovereign bond groupings

The data shows a difference between government bonds of the largest sovereign issuers and other sovereign and public bonds. In its primary analysis BVI focused on the government bonds of the sovereign issuers issued by France, Germany, Italy, Spain, the UK, and the US. Later, following member wishes, we added the EU to the list. There are several factors that make these bonds distinct from all other sovereign bonds. Firstly, they account for 89% of the total notional value of government bonds traded in the EU in 2024. Secondly, their issuance sizes are significantly larger than most other sovereign bonds, with an average notional outstanding of €37.1 billion and a median value of €26.0 billion, compared with €7.1 billion and €5.4 billion respectively for all other sovereign issuers' bonds. Thirdly, the government bonds of these issuers are widely used as reference bonds for pricing and hedging, including for other sovereign bond markets. Unlike most other sovereign bond markets traded in the EU, they also have deep and active futures markets. Furthermore, when we look at the ADV of this group of bonds (€48.9 million), compared to that of other sovereign bonds (€10.3 million), there is no comparison.

Category [Liquid issuers: FR, ES, IT, DE, GB, US, EU]	Issuance size	Size	Price deferral	Volume deferral
0 - Small/Liq	≥ €1 Bn	< €5 Mn	Real time	
0.5 - Small/Ill	< €1 Bn	< €5 Mn		
1 - Med/Liq	≥ €1 Bn	≥ €5 Mn – < €50 Mn	15 mins	EOD
2 - Med/Ill	< €1 Bn	≥ €5 Mn – < €50 Mn	EOD	T+3
3 - Lrg/Liq	≥ €1 Bn	≥ €50 Mn	EOD	1 Week
4 - Lrg/Ill	< €1 Bn	≥ €50 Mn	2 Weeks	
All other sovereign issuers	Any	Any	T+4 Weeks	

Category [Liquid issuers: FR, ES, IT, DE, GB, US, EU]	No. of unique ISINs	No. of trades	% of total trades	ADV	Implied trade out days	Volume traded	% of total volume traded
0 - Small/Liq	1,570	2,237,566	76%	€ 54,534,227	0.046	€ 1,931,369,288,361	30%
0.5 - Small/Ill	1,227	44,833	1.5%	€ 16,593,164	0.15	€ 42,974,458,260	0.7%
1 - Med/Liq	1,255	275,636	9.4%	€ 54,534,227	0.5	€ 2,365,708,127,184	37%
2 - Med/Ill	473	5,485	0.2%	€ 16,593,164	1.7	€ 88,738,279,859	1.4%
3 - Lrg/Liq	691	10,336	0.4%	€ 54,534,227	2.8	€ 1,164,445,461,832	18%
4 - Lrg/Ill	86	727	0.02%	€ 16,593,164	9	€ 98,499,716,802	1.5%
All other sovereign issuers	3,406	355,135	12%	€ 10,015,875	15	€ 735,013,549,929	11%

Determining liquidity thresholds

Recognizing also the work of other trade associations in this field, especially ICMA, we used outstanding issuance size as the next most important feature. Depending on bond class, other features may also have an impact, including time to maturity, currency denomination, and credit rating. For sovereign bonds, the analysis may be complicated further by e.g. the distinction between on-the-run and off-the-run bonds and futures deliverability. For the purposes of the BVI deferrals framework, however, we focused primarily on outstanding issuance size as the sole liquidity determinant, consistent with ESMA's proposal. However, BVI agrees with AFME and ICMA that the framework could be improved by incorporating other liquidity determinants, for example time to maturity, particularly in the case of sovereign bonds. To isolate the optimal issuance size threshold for each grouping, BVI plotted the ADV associated with the bonds that fell into each issuance size bucket. At each issuance size interval, it is assumed that all bonds with an equal or greater issuance size are liquid and those with a smaller issuance size are illiquid. As one would expect, the plot for both sets of bonds (liquid and illiquid) is upward sloping, with ADV increasing with issuance size. To identify the optimal point on the curve, BVI looked to find the point at which the difference between liquid and illiquid ADV is at its widest (maximizing the spread between liquid and illiquid). Essentially, this aims to optimize the difference between liquid and illiquid bonds based on their relative ADV. While this works well in the case of a non-linear (quadratic) relationship between ADV and issuance size, it is observed that in most cases the relationship is linear (i.e. the gradient of the curve is relatively constant). Here BVI applies a different methodology, whereby we look for the point on the illiquid curve where the gradient of the curve is at its lowest: i.e. where an incremental increase in issuance size has the least effect on ADV. ICMA also looked at the issuance size distribution for each grouping to ensure that the proposed thresholds are not too far from the mean and median values.

Refining the real-time and deferral categories

The ESMA deferral matrix, which is largely based on the one prescribed in the Level 1 legislation, partly attempts to distinguish between liquid and illiquid bonds in the case of medium and large trade sizes but does not apply the same logic to the threshold for real-time (small trades) or for the longest four-week deferral (very large). Given the significant difference in ADV between liquid and illiquid bonds for each bond grouping, BVI like other associations sees this as a weakness in the proposed framework as it will naturally result in trade size thresholds that are too low for most liquid bonds, and too high for

most illiquid bonds. By splitting both the real-time and very large categories into liquid and illiquid sub-categories, it is possible to apply more precisely calibrated trade size thresholds that recognise the different ADVs between liquid and illiquid bonds in each grouping.

Time to trade out

BVI believes that the presented deferrals framework achieves an equilibrium between transparency and risk management by establishing the size thresholds for each category based on their implied tradeout time. Essentially, for transactions that are not reported in real-time, the post-trade deferral should allow enough based on the estimated time to trade out of a risk position for a given bond and size time for a liquidity provider to trade out of the position before the details of the trade are made public. However, the estimated times to trade out of a position should also be treated with some caution for the following reasons:

(i) Using different ADV methodologies (daily ISIN count vs total ISIN count) will result in different ADV calculations for the same data set.
(ii) The ADV is an average of a distribution of daily volumes for different bonds within a grouping. For a given trade size, some bonds in that grouping will have a lower ADV, and require a longer average trade-out time, while some will have a higher ADV and require a shorter average trade-out time.
(iii) In the case of bonds that trade relatively infrequently (such as illiquid corporate bonds), the averaging methodology could underestimate the trade-out time quite significantly.
(iv) The ADV reflects the total daily traded volume in a bond (essentially a measure of market depth), and not necessarily all the factors which go into a liquidity provider decision making process.
(v) For the sake of transparency also in very large trades, there is the four-week deferral provided by ESMA.

Conclusion

BVI believes that the proposed bond deferrals framework balances transparency and market making needs of the sell-side. This is because BVI proposes on sovereign liquid bonds:

- wider size thresholds for deferred trades, and
- Greater transparency for trades €15 Mn - €50 Mn
- Categorising by liquid vs illiquid sovereign issuer
- Greater transparency for trades >€50 Mn

In the same vein BVI proposes on corporate bond deferrals:

- Higher real-time threshold size
- Greater transparency for trades <€2Mn
- Wider size thresholds for deferred trades
- Greater transparency for trades €5 Mn - €15 Mn
- Categorising by liquid vs illiquid currencies
- Greater transparency for trades >€15 Mn

BVI is confident that its proposed framework is an improvement on the current ESMA and sell side proposals and will lead to improved market outcomes. However, deferral setting is as much an art as a science. and therefore, there is no perfect solution on which the entire market can agree. However, BVI like the associations on the joint statement believe that a data-driven approach, particularly based on

the notion of traded average daily volumes, is the right basis for ensuring an adequate design and calibration of the EU deferral framework for bonds which also reduces the risks of adverse outcomes. BVI would hope that ESMA adopts the methodology and principles underlying our proposal and, working with the industry, arrives at a revised bond deferrals framework that is data-driven and better calibrated to the market it is designed to serve.

BUY-SIDE-BOND-DEFERRALS
A BVI PROPOSAL

1 NOVEMBER 2024

ESMA PROPOSAL BOND-DEFERRALS (I)
SOVEREIGN AND PUBLIC BONDS

- **Liquiditätsschwellen für Rentenprodukte**

Bond Type	Liquidity threshold
Sovereign and other public bonds	>= EUR 1Bn
Corporate, convertible and other bonds	>= EUR 500Mn
Covered bonds	>= EUR 250Mn

- **Verzögerte Veröffentlichung für Preise und Volumen**

Category	Issuance Size	Size	Price Deferral	Volume deferral
N/A	Any	< 5 Mn	Real time	
1	>= 1 Bn	[5Mn – 15Mn[	15 minutes	
2	< 1 Bn	[5Mn – 15Mn[	End of trading day	
3	>= 1 Bn	[15Mn – 50Mn[	End off trading day	One Week
4	< 1 Bn	[15Mn – 50Mn[	End off trading day	Two weeks
5	Any	>= 50Mn	Four Weeks	

Table 10: Deferral regime for sovereign and other public bonds

ESMA PROPOSAL BOND DEFERRALS (II)
CORPORATE AND COVERED BONDS

Category	Issuance Size	Size	Price Deferral	Volume deferral
N/A	Any	< 1 Mn	Real time	
1	>= 500 Mn	[1Mn - 5Mn[	15 minutes	
2	< 500 Mn	[1Mn - 5Mn[	End of trading day	
3	>= 500 Mn	[5Mn – 15Mn[	End of trading day	One Week
4	< 500 Mn	[5Mn – 15Mn[	End of trading day	Two weeks
5	Any	>= 15 Mln	Four Weeks	

Table 11: Deferral regime for corporate, convertible and other bonds

Category	Issuance Size	Size	Price Deferral	Volume deferral
N/A	Any	< 5 Mn	Real time	
1	>= 250 Mn	[5Mn – 15Mn[	15 minutes	
2	< 250 Mn	[5Mn – 15Mn[	End of trading day	
3	>= 250 Mn	[15Mn – 50Mn[	End of trading day	One Week
4	< 250 Mn	[15Mn – 50Mn[	End of trading day	Two weeks
5	Any	>= 50Mn	Four Weeks	

Table 12: Deferral regime for covered bonds

JOINT STATEMENT ON BOND-DEFERRALS (I)

- Bond market encompasses a vast array of acutely heterogenous classes and sub-classes, with very different liquidity and risk profiles, and varying sensitivities to information leakage.

- In the case of many bonds, particularly when the trade is in larger than average size, information leakage can lead to an immediate repricing of the market to the detriment of the liquidity provider. Disseminating details of such trades too quickly will not serve investors or the wider market well and would likely degrade liquidity in some bond classes and market segments. This becomes even more material in times of stress, where the ability and willingness of market makers to provide liquidity and immediacy becomes the basis for market stability and resilience.

- The Sell-Side approach uses **historical trading data (average daily traded volumes) to estimate the time required by liquidity providers to trade out of risk positions, for a given size, whether in terms of classes or subclasses of bonds, or at the individual security level.**

JOINT STATEMENT ON BOND-DEFERRALS (II)

The Associations would ask ESMA to consider:

- More appropriate groupings of bond types based on similar liquidity profiles, and not be constrained solely by FITRS classifications.
- Additional liquidity determinants to outstanding issuance size, which help to capture the associated risk and liquidity of certain bond types. These could include time to maturity, credit rating, and currency denomination.
- An assessment of the time required to trade out of positions of a given size as the basis for selecting the appropriate size thresholds for the various deferral categories.

BUY-SIDE TRANSPARENCY FRAMEWORK
SOVEREIGN BONDS, LIQUID SOVEREIGN BOND ISSUER BASED

Liquid sovereign bond issuers are EU, IT, US, FR, DE, GB, ES

Category [Liquid issuers: FR, ES, IT, DE, GB, US, EU]	Issuance size	Size	Price deferral	Volume deferral
0 - Small/Liq	≥ €1 Bn	< €5 Mn	Real time	
0.5 - Small/Ill	< €1 Bn	< €5 Mn		
1 - Med/Liq	≥ €1 Bn	≥ €5 Mn – < €50 Mn	15 mins	EOD
2 - Med/Ill	< €1 Bn	≥ €5 Mn – < €50 Mn	EOD	T+3
3 - Lrg/Liq	≥ €1 Bn	≥ €50 Mn	EOD	1 Week
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All other sovereign issuers	Any	Any	T+4 Weeks	

BVI proposes…

- Wider size thresholds for deferred trades
  - Greater transparency for trades €15 Mn - €50 Mn
- Categorising by liquid vs illiquid sovereign issuer
  - Greater transparency for trades >€50 Mn

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BUY-SIDE TRANSPARENCY FRAMEWORK (II)
CORPORATE BONDS, LIQUID CURRENCY BASED

Liquid currencies are EUR, GBP and USD

Category [Liquid Currencies: EUR, USD & GBP]	Issuance size	Size	Price deferral	Volume deferral
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BVI proposes…

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All other currencies	299	820	0,04%	€ 1.924.195	26	€ 26.700.405.464	1,6%

ADV AND IMPLIED TRADE-OUT DAYS METHODOLOGIES

ADV calculation

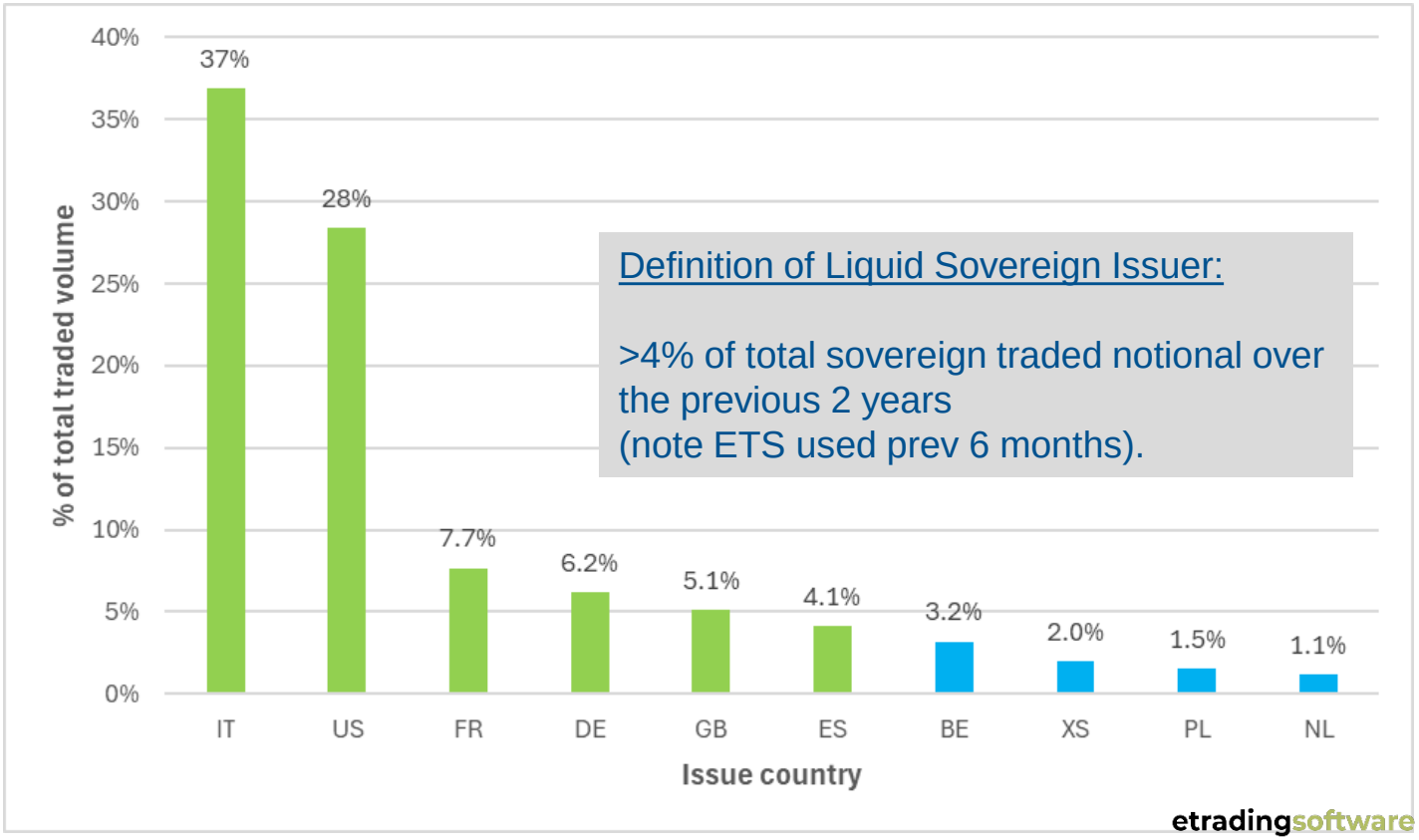
- Sum the total volume traded in 1 trading day
- Divide by the number of unique ISINs traded on that day, giving daily volume per ISIN
- Calculate the average of all daily volume per ISINs for all trading days in the dataset (01/01/24 to 30/06/24), giving average daily volume

Implied trade-out days calculation

- Calculate the median trade size in each deferral category
- Divide by ADV, giving the implied trade out days for each category

BUY-SIDE TRANSPARENCY FRAMEWORK
LIQUID SOVEREIGN ISSUERS

Liquid Sovereign Issuers



BUY-SIDE TRANSPARENCY FRAMEWORK
LIQUID CORPORATE BONDS / CURRENCIES

Liquid Currencies