

Regulators Accelerate Fixed Income Transparency in Europe

Discussing the Consolidated Tape with Matthijs Geneste of the Dutch Regulatory Authority

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Alexander Sedgwick: Thank you for joining us today for our fireside chat with Matthijs Geneste of the Dutch Authority for Financial Markets (“AFM”).

My name is Alex Sedgwick, and I'm the Head of Fixed Income at Abel Noser. Today we're going to be discussing the state of bond market transparency and the evolution of a consolidated tape in Europe.

It's my pleasure to introduce Matthijs, who is currently a senior supervisor of the AFM's Capital Markets supervision team, where he coordinates the Capital Markets International Desk. His primary focus is on a broad range of supervision and policy topics related to EU secondary market structure and transparency. Most importantly, for today's conversation, Matthijs is also the project lead for the AFM's Consolidated Tape project. Thank you for joining us.

Matthijs Geneste: Thanks a lot for having me, Alex. Great to be here.

Alexander Sedgwick: Let's start with some background. I think many people in the US are familiar with TRACE and fixed income transparency in the US markets, so could you describe the current state of corporate bond transparency in Europe?

Matthijs Geneste: Yes, so I think the US and EU situations are quite difficult to compare. If you look at the level of transparency in the US, it's significantly higher than in Europe, and I think that all has to do with the way corporations, or the real economy rather, is funded.

In the US, there's much more experience with capital markets funding either true equity or true debts. Whereas in Europe, there's still quite a large dependency on bank financing, mostly through term loans. I think one of the key objectives of the European Union and European Commission is to create a capital markets union that becomes much more attractive or much easier to tap for issuers to fund their businesses. I think they're very difficult to compare, but

there's a very clear direction in Europe where we want to head to and how we want to make capital markets work for the real economy.

Alexander Sedgwick: From your point of view, what do you think the goal of creating a consolidated tape is, and what are the benefits in the EU?

Matthijs Geneste: If you're coming back to the transparency point, the level of transparency of corporate bonds is very low, and that all has to do with the way the legislation is structured at the moment. Corporate bonds only have to be made transparent if they're considered liquid, and the parameters for assessing that liquidity is based on how much an instrument is traded in the secondary market. Some of the parameters are not calibrated or reflecting the way the secondary markets currently operate.

So, the level of transparency is lagging behind, which I think has to do with the many ways that you have, under the current legislation, to defer the publication of that transaction. The deferral period ranges from a day up to a month, so it's very difficult to get this total view. That's one point. The other point is that the European market is quite fragmented, so you have maybe 400 trading platforms in Europe, and there's no single way to get a reference price on a single instrument.

If you're a very sophisticated investor, you probably have the means to compile all that information into your own systems. But if you're less sophisticated, you're looking at a very fragmented landscape. On the one hand, it's good because fragmentation also means competition. But for this Capital Market Union to really kick off and for issuers, in particular, and for investors, a clear view on the price of certain instruments is critical. And for issuers to get an idea on the bandwidth if they want to issue new debts, the consolidated tape is one of the things that is very necessary. The third aspect is the need for a better means to assess execution quality by a broker or an intermediary. Of course, if you want me to talk about use cases, we can sit here for days, but these are the key ones from our review.

Alexander Sedgwick: Thanks, that's helpful. Given all the benefits that you've just outlined, and for example, being able to determine the prevailing market price for an asset, or all the use cases thinking, for example, in our case TCA [Trade Cost Analysis], why haven't we seen a consolidated tape emerge to date? With all the market inertia behind a need for something like this and being something that was contemplated under MIFID II already, why haven't we seen one emerge?

Matthijs Geneste: That's a very interesting question because the consolidated tape is there in the current legislation, and it has been there since MIFID II came about in 2018. But I think there are a couple of reasons why it hasn't kicked off. On the one hand, the regulatory requirements are quite tedious. For example, there's a coverage requirement of 100% for an equity consolidated tape and 80% for non-equity asset classes, which means that you have to be able to cover 80% of the corporate bond instruments in this case. And that sort of leads to

this chicken and egg situation when it comes to data quality. So, people argue it's not up to standards, and maybe we all know that there's quite a lot of room for improvement based on the current data quality.

Nobody would raise their hand and say, "well, you know I can build this, I can do this," because the quality is just not up to standards. The other bit is that under the current rules, the consolidated tape must make the data free after 15 minutes, so I think the business case for a consolidated tape is also quite shaky. If you combine those two things, and there are a few other requirements, I think these are the main barriers and why a tape hasn't emerged in Europe since MIFID II came about. That said, the business use cases are most definitely there.

Alexander Sedgwick: When I think about the challenges of creating a consolidated tape or some of the barriers to seeing it emerge, I imagine that in creating the principles, you are really trying to address some of those items. Can you talk a little bit about some of the specific goals in creating the principles and the AFM's role in doing so?

Matthijs Geneste: Absolutely. I think we started with the consolidated tape project just over a year ago. The AFM has been traditionally vocal on fair, transparent, open, and ideally multilateral markets in Europe. So, a consolidated tape was one big piece of the puzzle that was missing in terms of getting meaningful transparency out there for investors and every issuer.

The consolidated tape has been quite close to our hearts. We at the AFM have been operating a so-called innovation hub, or regulatory sandbox, where we aim to work with fintechs on new developments and new solutions. That innovation hub has attracted a number of fintechs with consolidated tape solutions, prospective solutions, or various stages of proof of concepts for a tape. This, in turn, triggered us to work with some of these fintechs to try and steer the debate for a consolidated tape a bit as well.

For those in Europe, I think most would be aware about all the politics that are currently surrounding the consolidated tape. A number of incumbent players are quite concerned with business models, particularly when it comes to when it comes to market data. Whereas a lot of these arguments that were being used were very much around development costs, building costs, and technical barriers to the tape. And I think what we learned a lot from talking to these guys, who said the technical barriers were quite limited and that development costs would be relatively low, or at least not in the range that some of the incumbents would like us to believe. And the European Commission is currently reviewing the current MIFID and MIFIR framework, which is the main set of rules for secondary markets and secondary market transparency in Europe. And I think those two things came together there, and we set up this project to work with fintechs. Since we believe in this, we wanted to make a positive contribution to the debate to focus on what is possible rather than calling out all these barriers that everybody else is aware of.

We tried to really focus on what do we need to do to build a consolidated tape. For instance, how can we work towards a product that could work for everyone and for every user type? And what are the main barriers to moving forward, and how can we reduce those barriers or even solve those barriers? So, we focused around the Amsterdam-based ecosystems, where we have three very large electronic corporate bond trading platforms under our supervision. We took that market segment as the baseline and reached out to industry groups serving the buy-side and the sell-side. And I think what we very much tried to do is focus on the technical discussion on some of the things that people can actually agree on.

We invited technical experts, people who would be actually using consolidated tape data, rather than, say, the more public affairs type of player. We were quite happy to have real experts and real users in the room, and with that group, we managed to identify some of the main barriers in terms of data quality and current reporting standards. In the end, we managed to deliver some high-level technical principles that could really move this debate forward. At the same time, we came up with some tangible and meaningful solutions on some of the issues around data quality and particularly the consistency of data.

Alexander Sedgwick: I think the data quality issue is one that's top of mind for us. What was interesting to me was just the effort and the focus put into very clearly defining some fields that I think people struggle to interpret from a reporting standpoint. With that in mind, do you think you could describe some of the high-level areas of consensus outlined in the principles? I know beyond just data quality, you address things like the input and output standards. Could you describe what those look like?

Matthijs Geneste: I think we took the trading lifecycle, or the consolidated tape data lifecycle, as a baseline. It's very simple. You're looking at the information that comes from trading venues and APAs that need to go into the tape, and then you look at what is the user demand of what to get out of the tape.

But I think if you start with this input bit, there's already quite a detailed framework for post-trade transparency reporting. So, whatever is executed on a trading venue or reported by an APA is already out there, and European regulators have put quite a lot of effort in putting something together there the industry has implemented. So, we took that as a baseline. I think the problem is that the instructions on reporting can be a bit ambiguous and are open for interpretation.

What you saw happening when all these legislations came out a couple of years ago was that the industry was really struggling to get it implemented within the right time frame. What you usually see is that you have business analysts and IT analysts going through very detailed legal documents. They do that interpretation, then get it signed off by their corporate lawyers, or they keep a law firm on retainer to sort of sign off that their interpretations were right. And if everyone does that, it gets messy very quickly. You're not singing from the same hymn sheet, so to say, and that's often where the main issues lie.

One of the things that we've managed to do with this group is to pinpoint the reporting fields that were most commonly misreported or where there were mistakes made. And the main finding was a very simple one: if you come up with more detailed instructions with more prescriptive conventions, you're already halfway there. To give a very concrete example, bond prices for corporate bonds are usually quoted in percentages, but some of the reporting was done as the monetary value or as yields. And then things are already going wrong. You don't even want to think about what the other fields might look like.

The same for how quantity on corporate bonds is commonly reported or quoted. So, we took those real-life insights as a baseline to try and address and then come up with some solutions to fix that. The main finding there was also that it's not so much the data quality but the consistency of reporting and being able to, sort of, sing from the same hymn sheet.

Alexander Sedgwick: I think it was an incredible step forward in terms of getting some consensus around issues like that and also showing that regulators and the industry are working together proactively. You were reaching out to, as you said, experts in the data space to inform some of the ideas that went into the principles. So now that the principles have been made public, what's most important is the call to action. What are the next steps, from your perspective, now that the principles are out there?

Matthijs Geneste: There are a few next steps that we see. We're a market regulator, so we don't have a seat at the table in Brussels where the negotiations for the new framework are taking place. We are in close dialogue with some of the stakeholders there, and I think what we can do is to present them with these principles and say, "well, you know, this is what we and the industry believe is a way forward."

So, that's one angle. The other one is that we have a seat at the table at ESMA, where the secondary legislation, as it is commonly referred to in Europe, is being created. There are quite a few things that we can do there. For example, more or better-reporting instructions are something that can be done at the ESMA level. We've taken it up with ESMA, and we aim to be working with them on that for the next couple of months. And I think at a later stage, once the new rules are agreed on in Brussels, which hopefully will happen by the end of the year, there's quite a lot of work that needs to be done on the sort of the practical details that we can contribute to and that the principles will also strongly contribute to.

It's all about spreading the gospel and giving a positive vibe to the debate, which the principles can play a key role in. It's important to focus on what is possible and also demonstrate a certain level of consensus in this part of the market that the buy-side, sell-side, and venues are all quite aligned on the need for a consolidated tape.

Alexander Sedgwick: Excellent. Matthijs, thank you so much. This has been informative. I think you know it's important for market participants, both in Europe and importantly in the US, to



be engaged on this topic. I think everything that you've said today it's going to be both educational and informative for many. Thank you for your time.

Matthijs Geneste: Thanks for having me, Alex.