MiFID II state of play and remaining challenges

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Time for a MiFID II refit

MiFID II stands as the cornerstone of European financial markets regulation. It governs the provision of investment services and the proper functioning of markets. This sweeping piece of legislation was designed to enhance transparency and strengthen investor protection as well as pursue efforts to foster competition introduced by MiFID I.

After a year and a half of implementation, some preliminary lessons can be drawn. While MiFID II has improved transparency, the new regime has not met all expectations, especially in relation to non-equity instruments where results are mixed.

With regard to equities, dark trading has been constrained by the share trading obligation, which mandates trading on venues or systematic internalisers (SIs) and the limitation on the use of waivers in particular with tools such as the double volume cap mechanism. However, some findings raise questions. Trading on lit venues has not increased. It stagnates around 50% of total volumes while trading on SIs, which was insignificant prior to January 2018 has surged to 25% before gradually decreasing to 20%, capturing a large share of OTC trading. Regulators are keeping a close eye. The AMF 2019 Markets and Risk Outlook provides a first analysis of this trend, underlining that transparency is quite limited and only a small portion of volume traded on SIs actually contribute to price formation. Finally, there is still a significant portion of pure OTC trades (about 30%) which needs to be better understood.

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> \- NATASHA CAZENAVE

In parallel, MiFID II has extended transparency requirements to non-equity instruments, with so far mixed results. Pre-trade transparency in this area is challenging due to the RFQ systems on which these instruments trade, while post-trade transparency brings useful information. Yet, some argue that post-trade publications come too late to be fully useful and that the universe of instruments considered as liquid remains too narrow.

Data is one area where improvement is tangible. MiFID II has required regulated entities to provide an unprecedented amount of data. From the angle of market integrity, this represents a positive step forward since trading and reporting data offer regulators critical information to identify, in a timely manner, market abuses and to monitor market >>>

>>> events. For participants, trading and best execution data play a useful role to inform investment decisions. Difficulties nevertheless remain in terms of data quality and accessibility that will require further work.

While the European Commission is defining its priorities for the next 5 years, the AMF considers it would be appropriate to conduct a targeted review of MiFID II to correct the inefficiencies identified and address the challenges raised by the UK's decision to withdraw from the EU. Such an exercise should not call into question the essence of the reform but aim at ensuring MiFID II fully achieves its objectives. In that sense, we are in favour of a MIFID REFIT rather than a MIFID III.

In our June EU2024 paper[1], we sketched out a few areas that would merit reconsideration and are keen to exchange views with colleagues and stakeholders to refine and complement these avenues: transparency thresholds may require a recalibration to reflect the new perimeter of EU27 markets; the share trading obligation has proved difficult to implement and may require some streamlining. In light of experience, we may also envisage reducing the number of position limits to certain commodity derivatives, based on the type of underlying and trading volume. Such a review can be the occasion to measure the usefulness of certain provisions to analyse whether their granularity brings valuable information.

One issue to be tackled is the development of a framework to support the emergence of a European consolidated tape. Such a long-awaited tool will provide greater transparency to the market. ESMA and the EC's recent efforts to ponder the conditions of the emergence of this tape are encouraging.

More generally, it is crucial to avoid distortions of competition of the EU with the rest of the world. We could explore avenues to make sure European actors do not face an unwarranted disadvantage. ●

1. EU2024: Shaping EU27 capital markets to meet tomorrow's challenges – Focus areas and initial proposals of the French AMF.

Niels Brab

Head of Government Relations, Deutsche Börse Group

MiFID is dead. Long live MiFID!

While a number of instruments have made a critical contribution to the EU's post-crisis financial market regulation, MiFID II undoubtedly constitutes a key cornerstone with central political objectives covering a wide array, stretching from transparency, over resilience and efficiency to consumer protection. However, almost a decade after the planning around MiFID II started and about 18 months of practical application experience later, there is growing discontent that some important areas have not fully delivered on the intended political objectives.

This may not necessarily come as a surprise when considering that the final and arguably complex set of rules stretches beyond 25000 pages. But while it may retrospectively occur ironic that the Commission's 2011 announcement of the MiFID Review stated that "the main benefits of MiFID will be very tangible, but are not readily quantifiable", let us take a step back and ensure to set the right context in understanding the importance of MiFID.

With a number of indicators pointing to an overall weaker global economic performance, it is critical to understand that the EU is rather leading the race on sluggish performance with a forecasted 2019 GDP growth of only 1%. This is where the fundamental thinking around the Capital Markets Union as well as key future-oriented, accompanying initiatives, such as around the International Role of the Euro, come in.

It has been long established that the EU could benefit from a solid development of its capital markets, where key proxies illustrate that we are still far behind globally leading jurisdictions. And with Brexit on the horizon, we can safely agree that the project becomes rather more urgent and serious. >>>

>>> So how does MiFID fit into this picture? With a total of 663 registered trading venues, MiFID II has arguably resulted in a landscape that some may call competitive and others fragmented. Especially the equity trading landscape illustrates that transparency has not been increased with "lit" venues' market share being slightly reduced, accounting for only +/- 40%.

In addition, it is important to observe that well-intended safeguards do not result in the desired outcomes, such as the Double Volume Cap, which does not make a meaningful contribution to "lit" trading.

However, it is highly questionable if such market structure is desirable against the background of key political objectives. In fact, the number of companies listed on exchanges keeps decreasing, and so do the numbers of IPOs and the amount of capital being raised.

This raises the question whether the increased fragmentation, mainly result of an artificial hyper-intra-EU-competition between trading venues facing diverging regulatory requirements, has contributed to the decrease in capital markets funding.

Without doubt, transaction fees have significantly reduced – but it occurs questionable whether this results in the desired outcomes, given that end investors do not appear to see significantly reduced total execution costs while also the overall growth ecosystem seems to suffer.

As the EU's most monumental financial regulatory framework and as a key piece of the puzzle, it is critical to assume the responsibility in reviewing MiFID II to be "fit-for-purpose", notably in light of a new political and economic reality at global and EU level.

Only if we manage to collectively assume our responsibility in ensuring that capital markets are finding themselves in a consistent framework that maximises their growth contribution capacity without compromising financial stability as the cornerstone of sustainable economic growth, we will be able to lay the foundation for an appropriate contribution to critical societal challenges.

Whoever understands the bless and curse in materially contributing to shaping a future financial system that European citizens and broader society are proud to endorse, shall recognise that such endeavour is philosophically probably best understood to be a strive for unachievable perfectionism that is nevertheless worth aspiring to be approximating. MiFID is dead. Long live MiFID! ●

James Hilton

Head of Advanced Execution Sales EMEA, Credit Suisse

Sharpening the focus on investor outcomes

Regulators agree the greatest drag on investor returns is driven by costs. MiFID I was the EU's attempt to create a single financial market to rival the depth and dynamism of US capital markets. It reduced costs to end investors by increasing competition and breaking down monopolies. MiFID II's objectives of investor protection and a safer, more transparent and efficient market appear to have been interpreted in a way that risks increasing costs to investors.

Costs can be explicit, e.g. exchange fees or investment management charges, or implicit, such as market impact, information leakage or opportunity cost. Post MiFID I, we saw a 30% decrease in total transaction costs – a huge success for investors. Unsurprisingly, explicit costs are often driven by competition amongst providers. Around the start of MiFID II, we observed a swathe of price increases amongst primary exchanges as regulation appeared to force trading to lit venues. It is important regulators are aware that policies promoting champions will likely lead to inefficiency, lack of innovation and higher costs as competition reduces.

One-way investors minimize implicit costs is by choosing between different trading modes. Investors have long understood the trade-off between urgency and market impact and sought to find the right balance to fulfil best execution. We see no evidence these choices, and the natural balancing of these factors, have impacted market stability or efficiency over the last decade.

Under MiFID II, the industry has innovated to find solutions which meet all regulatory requirements and also provide best outcomes for end investors. Periodic auctions in particular enable investors to seek liquidity without excess price impact, whilst still maintaining pre-trade transparency. Based on ESMA's Call for Evidence, investors and brokers alike seem to be hugely supportive of this innovation.

Costs are also reduced when a fair price can be achieved. The midpoint is a fair price and is undoubtedly beneficial to end investors across a variety of trading modes. Allowing mid executions does not cause tick size wars between venues or trading modes, nor trades in fractions of a tick, but provides an equitable price without arbitrarily picking winners and losers – penalizing end investors to give the perception of a level playing field between trading modes is surely not the goal of MiFID II.

It is the end investor who bears the costs of choosing champions or prohibiting innovative trading modalities. Central Limit Order Books provide an important service to financial markets but are not always the best solution either at a collective or an individual level. A variety of trading modalities solves for different investor needs without detracting from price formation. In summary, the framework of MiFID II is broadly effective, and therefore a wholesale revision should be avoided. Some fine-tuning would make sense, however, to address some of the issues raised in this article, and we would encourage consideration of the following in particular; calibration of thresholds post-Brexit, additional transaction costs passed to investors, and the share trading obligation. As noted, such targeted amendments must avoid damaging best execution for end investors. ●