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Anamarija Staničić

Head of Division, Policy and International Cooperation Division, Croatian Financial Services Supervisory Agency (HANFA)

Taking the long view in the equity market transparency debate

Now could be a good time to take a step back and asses if the transparency rules in the EU equity market would benefit from a larger overhaul, not just one that is Brexit related. Technology is distorting the application of MIFID/MIFIR rules, and data challenges in post-trade transparency will only get more demanding. Two years is not enough to assess if MiFID has led us in the right direction or not, but in the Brexit context, there is no question that a focused review is needed. Many of the requirements and thresholds in the current framework were calibrated to accommodate UK data. Consequently, rules like the double volume cap (DVC) cannot remain unaffected by the UK's departure.

The extraterritorial scope of the trading obligation carries its own pitfalls, with the potential to fragment liquidity and drain it away from EU venues. It is also difficult to assess how the systematic internaliser (SIs) regime will look like without the UK. It is a very fraught time to be a legislator, or an interpreter of rules, such as ESMA. So far, ESMA has concentrated on fixing the perceived failure of MiFID II to reduce trading on "dark" venues; through the use of waivers, the DVC, SIs, as well as on issues such as the trading obligation, and the (lack of) consolidated tape (CT). This is the technical side of the equity market transparency debate. And that is important – it truly is. However, we also need to look ahead, to the market as we want it to be, twenty years from now. Brexit is taking away what was a significant and integral part of the EU equity market for decades, but, at the same time, it is an opportunity for us to redefine what remains.

The real review of MiFID II should focus on the long view – how do we structure our equity markets to bring the most benefit to the real economy? How do we want our retail investors to predominantly access that equity market? Do we want to incentivise direct access, access through a financial product like an investment fund, or do we want to push a balance of both. This choice has an impact on the optimal structure of the transparency rules. We are currently trying to occupy the middle ground, which implies trade-offs in between types of access, as the optimal structure will at times conflict, favouring one type and penalising the other. Funds will benefit from a different set of rules than individual retail or even other institutional investors.

Waivers, thresholds, frequent batch auctions, SIs – they all have their benefits and drawbacks. Instead of focusing on the details, we should first ask how a rule or exemption incentivises our preferred policy choice. If a waiver or a venue of execution is justified in that context, then it should be permissible. The MiFID II framework also banked on being able to centralise all the data provided by Approved publication arrangements (APAs), but there is currently no CT in sight and one may be unlikely to emerge without some form of public sector backing. However, the viability of a CT may depend on legally obligating APAs to provide free data to the CT, or for a symbolic nominal fee. If so, a privately owned CT could be problematic, and a public infrastructure CT has its own challenges.

There is no doubt that we need to fix what Brexit broke, but we also need to acknowledge that some issues have not yet matured enough for long term policy decisions.