# Improving EU securities market transparency and infrastructure

Markus Ferber

MEP, Committee on Economic and Monetary Affairs, European Parliament

## A robust market infrastructure for a successful CMU

Since the financial crisis of 2008/2009, Europe's financial markets infrastructure has become more robust and resilient. The excessive market volatility induced by Covid-19 is prove of that. The spike in volatility, trading volume and uncertainty has not led to substantial financial stability problems. On the contrary, EU financial markets have coped well and it is fair to say that the EU's market infrastructure has successfully passed a major stress test.

However, while robustness and resilience are important features of our market infrastructure, they are not all that matters. After all, the key feature of efficient markets from the perspective of most market participants is a price discovery process that is accurate and enables meaningful capital allocation. A prerequisite for an efficient price discovery process is market transparency.

The recast of the markets in financial instruments directive (MiFID II) was meant to specifically address this issue by "turning on the light, without turning off the tap", i.e. improving market transparency without hampering market liquidity. The recast resulted in a substantial revamp of the EU's market structure and improved transparency rules combined with a set of waivers to address certain exceptional circumstances.

About two and a half years after the entry into force of MiFID II, we can draw the first firm conclusions about the effects of the MiFID review. While the overall market infrastructure has become more robust, the results in terms of transparency are mixed. Unfortunately, we have seen that regulated markets, which come with the strictest transparency requirements and the greatest contribution to price discovery, have seen their share of trading decrease.

Instead, systematic internalisers and other less transparent trading venues have gained ground, often because the operators of those trading venues have proven to be quite apt at identifying loopholes to circumvent the rules.

While some of the loopholes might have been in line with the letter of the law, they were certainly not in line with its spirit. This leads to the inevitable question of how to address the still existing problems in the framework of the upcoming MiFID II review and beyond. Arguably, the guiding principle should be that strong in order to facilitate price discovery trading should take place as transparently as possible strong.

That means that the default trading venue for most trades should be regulated markets and not systematic internalisers or dark pools. Such a notion also implies to limit the waiver regime to what is necessary. A reduction of the overall options in terms of waivers as well as revisiting the double volume cap in principle would be logical steps.

Changes to the market structure and transparency rules will only have a very limited effect though as long as enforcement of the rules is not stepped up in a meaningful way. Many of the circumvention attempts that happen in a regulatory "grey zone" could have been prevented with more robust interventions by supervisory authorities. Most of the blame has to be attributed to national competent authorities who have often been too lenient when applying the rules, but ESMA has also failed in its coordination function to apply a stricter approach across the Union.

> *In order to facilitate price discovery trading should take place as transparently as possible.*

Lastly, a consolidated tape is high up on the wish list of many sell-side market participants. The original approach envisioned in MiFID II has not delivered the desired solution, which points at certain complexities in the process of designing a consolidated tape. It is therefore probably best to moderate our ambition and look at what is feasible. A real-time consolidated tape with the widest possible scope is probably not the right starting point for any discussion. An end-of-day record of transactions for a first subset of liquid and transparent financial instruments is probably a more realistic goal.

One thing is clear though: a consolidated tape, no matter its scope, will only work under one condition: consistent and high data quality across all venues. The data obtained must give the full picture, i.e. include all trading venues, and be of high quality as a consolidated tape or tape of record that one cannot trust is essentially worthless. Bumping up data quality to a sufficiently high degree across all venues is therefore an absolute necessity. ●

# Ugo Bassi

Director, Financial Markets
and Acting Director, Horizontal Policies,
DG for Financial Stability, Financial
Services and Capital Markets Union,
European Commission


## Improving EU securities market transparency and infrastructure in CMU context

The Capital Markets Union (CMU) is a key structural reform programme to remove barriers to investing across borders. Notwithstanding the fact that the Commission has successfully delivered on the CMU Action Plan, capital market integration remains insufficient, and certain fundamental aspects of a functioning single market are still outstanding.

The strength of economic recovery will decisively depend on supportive financial flows and the functioning of capital markets, reinforcing the need for a CMU that supports transparent markets. In addition, as a consequence of Brexit, key market infrastructures outside the EU will increase the risk of dependency of the EU financial stability on non-EU interests and capital markets. This could lead to greater market fragmentation in the EU and loss of liquidity.

Underdeveloped and fragmented capital markets in the EU can be both a cause and consequence of limited benefits that market participants draw from trading, clearing and settling in financial securities. If there is less trading in financial instruments, market infrastructures will not deliver desirable efficiency gains or economies of scale. If settlement processes are subject to inappropriate regulation inefficiencies will persist.

The lack of easily accessible, reliable, understandable and comparable public information is one of the reasons why some companies may struggle to attract investors. An EU Single Access Point (ESAP) for financial information would help improve transparency and thereby help facilitate development of EU capital markets. The setup of the ESAP is still to be decided, but to overcome the obstacle of suboptimal accessibility of information it will need to include a broad scope of information. It will also need to provide easy access for users (both investors and issuers) and ensure that the information is user-friendly, comparable across Member States and both machine and human readable.

An EU consolidated tape (ECT) as a tool for reliable access to consolidated data for all traded assets could also provide benefits to EU capital markets. Together with the single-entry point for company information, this would give investors access to considerably improved information at a pan-European level. The ECT would also foster transparency by rewarding those execution venues that contribute to price forming transaction data. An ECT would require comprehensive coverage, improved quality of data and data standardisation in order to consolidate data in a meaningful manner. The Commission will assess how the ECT should be calibrated as part of the implementation of the CMU Action Plan and of the MIFID II review to be finalised in 2021.

> *The need for a CMU that supports transparent markets.*

Beyond the ECT, the review of MIFID II will provide an opportunity to revisit other market infrastructure topics with the aim of increasing the attractiveness of European capital markets. The Commission will approach these technical aspects in a holistic manner, with a view to ensuring that trading in the Union is transparent and subject to more derogations from transparency where this is justified, while ensuring that EU market participants can trade on markets outside the EU. ●

---


# Gerben Everts

Former Member of the Executive Board,
Dutch Authority for the Financial Markets
(AFM)


## Equity and non-equity transparency: the final pieces of the puzzle

In July 2020, ESMA published its final report on the MiFID II review for equity transparency. For non-equity transparency, the final report will be published in September. In this article, I'd like to describe a few of the current problems with equity and non-equity transparency. The measures proposed by ESMA may alleviate to some extent the observed problems with MiFID II transparency.

In the area of equity transparency, the AFM observes the complexity of the waiver structure, increasing market fragmentation due to increasing competition of systematic internalisers (SIs), issues with post-trade data quality and the lack of a consolidated tape. ▶

▶ Waivers for pre-trade transparency can be useful to bring transactions on venue, in particular the Large-in-Scale waiver (LIS). However, the waiver structure is complex yet not easy to improve. The double volume cap (DVC) has very few supporters. It appears over-engineered and not achieving its purpose. We support simplifying the DVC by eliminating the 4% threshold at the level of individual trading venues.

Trading has become more fragmented across venues, with SIs taking a larger part of the volumes. We support policy measures that will further align the level playing field between trading venues and SIs.

We view a real-time post-trade Consolidated Tape Provider (CTP) as important for enhancing transparency and we see the CTP an essential part of promoting the CMU and its necessary acceleration as proposed by the European Commission. It will enable aggregated information from increasingly fragmented markets. While we support the establishment of CTP, we also note some practical constraints which should temper expectations.

MiFID II has not yet delivered on its goals in the non-equity markets and can still be considered work in progress. In our analysis MiFID II's focus on transparency based on liquidity has proven to be counterproductive given the lack of liquidity in the fixed income markets where many instruments are tailor-made and not designed with the intention to be traded on a secondary market.

Market participants argue that MiFID II has merely sought to replicate equity market conventions onto so-called "non-equity" segments and that enforcing transparency on such markets is counterproductive. Instead, it can be argued that sufficiently liquid fixed income markets with sustainable higher levels of transparency can only be achieved by incentivizing standardization of instruments and addressing primary market fundamentals.

Overall, there is still broad support for the original G20 goals of migrating fixed income markets and derivatives towards more transparent and open markets. At this stage, MiFID II can be considered unfinished business and requires action from regulatory authorities to ensure it reaches its goals. Besides the goal for addressing market fundamentals through creating incentives for more standardization, we support improving the level playing field between bilateral and transparent multilateral forms of trading by creating more regulatory certainty. In addition, the right conditions for meaningful transparency can be achieved by focusing on improving data quality through an enhanced focus on liquid instruments, as well as the introduction of a post-trade consolidated tape. ●

---

## Stephen Berger

Managing Director, Global Head of Government & Regulatory Policy, Citadel


## Course corrections to illuminate the EU bond and OTC derivative markets

The European Commission and ESMA have set forward constructive proposals to put the post-trade transparency regime for bonds and OTC derivatives back on its intended course. As ESMA correctly observed in its March 2020 consultation paper: *"Whilst MiFID II/MiFIR aimed … to enhance the efficiency, resilience and integrity of financial markets notably by achieving greater transparency for non-equity instruments, it is unclear that this objective has been achieved."*

Finally shining light on these historically opaque markets will benefit EU investors and further advance the development and integration of EU capital markets. Transparency will also lower the cost of capital, and increase efficiency in the allocation of capital, for both the public and private sector.

The EC and ESMA have identified a number of concrete steps to address the scarcity, quality, timeliness, and accessibility of post-trade transparency data for bonds and OTC derivatives.

First, ESMA has recognized that very few off-venue transactions are subject to post-trade transparency requirements, despite its acknowledgement that *"MiFID II has the explicit objective to increase the level of transparency, including for OTC-transactions."* ESMA has therefore outlined numerous options to make the post-trade transparency framework more comprehensive, and to ensure a level playing field with respect to on-venue and off-venue transactions. The majority of respondents to ESMA's consultation favoured these revised approaches over the status quo.

> *The EC and ESMA have set out a path to fix the post-trade transparency regime for bonds and OTC derivatives.*

Second, the EC and ESMA have both recognized that inconsistent and excessive deferrals undermine post-trade transparency, with ESMA noting *"that a four-week delay for the publication of a transaction provides information to market participants which is of limited use"* and that the *"patchwork of rules applying across the Union"* should be replaced by a single regime.

Indeed, ESMA has wisely laid out multiple options that would ensure that even for larger size transactions, ▶

post-trade information would be "published as close to real time as possible with the volume being masked". Experience in the US across corporate bonds, mortgage-backed securities, and OTC derivatives illustrates both the efficacy of, and widespread market support for, transparency regimes that mask the full notional of large size trades but nevertheless limit their deferred publication to no more than 15 minutes.

Third, the EC is exploring the establishment of real-time post-trade consolidated tapes across both equities and non-equities, which would ensure that EU investors can efficiently access and benefit from transparency data. Consolidated tapes should be developed for both bonds and OTC derivatives, and should be comprehensive, require mandatory contribution, disseminate information immediately upon receipt (both freely to the public via websites and via real-time data feeds at a reasonable cost), and feature targeted and limited deferral regimes for larger size block trades.

The MiFID II review process provides a critical opportunity to remedy identified implementation shortcomings that together will put the MiFID II post-trade transparency regime for bond and OTC derivatives back on track. The EC and ESMA should remain committed to adopting the common sense fixes they have identified in their consultations. Collectively, these will improve conditions for investors, strengthen EU financial markets, and more efficiently support the financing of the public and private sector in challenging economic times. ●

---

## Nicholas Bean

Head of Electronic Trading Solutions, Bloomberg


### A 'cut & paste' equity CT solution for FI markets may be no solution at all

The MiFID II objective of increasing transparency remains a key measure when considering the success of the legislation. However, a lot of soul searching continues as to why the outcome has not yet lived up to everybody's expectations.

One area of disappointment is the absence of a Consolidated Tape (CT) for either equities or fixed income (FI). Yet, as with the formation of MiFID II itself, many of the questions being asked about their absence seem to be equities orientated, with FI markets appearing to be a second order concern. This is worrying because if we don't learn from past errors, we are destined to repeat them. To avoid this, greater effort must be made to understand how FI markets function so the appropriate value of a FI CT can be determined.

FI transactions are made up of three distinct steps, with equal weighting to the objective, those being i) identification of liquidity, ii) price formation, and iii) execution. Steps i) and ii) are the 'art' of FI trading and, in practical terms, are not largely relevant for equity transactions due to the omnipresence of that information correlated to the commoditised nature of that market and the use of execution protocols suited to highly liquid instruments, e.g. Central Limit Order Books.

Unless FI markets are going to shortly become commoditised in the same fashion as equities (and considering that some market practitioners have been predicting this for several decades but it has yet to come to pass), then an FI transaction will remain a three part process where the identification of liquidity and price formation remain intrinsic to it. Since the inception of FI e-trading, the Request For Quote (RFQ) protocol has been and remains dominant as it accounts for the need of liquidity identification and price formation alongside the final step of execution.

While a CT will not directly change the RFQ experience itself, it may be able to play an additive role in the first two steps of an FI trade by bringing more science to the 'art' of liquidity identification and price formation.

> *A live dog is better than a dead lion.*

A prerequisite for this is data - but which kind? In essence, the most productive type is going to be post-trade, i.e. trade prints, against which market participants can unleash their data scientists, quants, et al - to optimise the three step FI execution process. That leaves us to consider the role of pre-trade data, another emotive issue under MiFID II. While there continues to be healthy debate even within the FI community about the value of pre-trade transparency, there is no debate about the value of post-trade data.

Why not then adhere to the old adage of 'walking before you can run' and save pre-trade discussions for the future so as to not have them hinder the formation of the optimal post-trade solution? Or, as the proverb observes, "a live dog is better than a dead lion" (Ecclesiastes 9:4).

In conclusion, as we head into the MiFID review, it is important to recognise that a functioning CT for FI products is as equally important to the FI market as it is to the equity market. Failure to do so, by in particular employing a 'cut and paste' of an equity solution across to FI, will at the very least result in an ineffective resolution - and at worst will impact the effective operation of our FI capital markets. ●

# Ilse Peeters

Head of Government Relations, Euroclear S.A.


## Has CSDR delivered on CMU objectives?

As post-trade services providers and financial market infrastructures, Central Securities Depositories (CSDs) are essential in capital markets and therefore also core to the success of the Capital Markets Union (CMU). CSDs contribute to the CMU objectives by continuously enhancing their service offering towards issuers and investors and by implementing the CSD Regulation ("CSDR") which confirms CSDs as the safest place to issue, settle and safekeep securities. CSDR also makes CSDs more competitive as it gives issuers choice of which CSD to use for their securities issuance. Also, the technical development of Target2Securities (T2S) has been accompanied by a comprehensive effort to harmonise market practices across those markets which have migrated to T2S.

For CSDs, in a further step towards more integrated and harmonised EU post-trade processes, there are two main focus points in the coming years. First, the upcoming CSDR review which is foreseen to start shortly. Second, implementation of recommendations for harmonisation which have been put forward by the European Commission's CMU High Level Forum (HLF).

On the one hand, the review of CSDR comes (too) early as not all EU CSDs have been authorised. The review should therefore be targeted to a few key elements that could foster further integration among CSDs. A review of CSDR should be focused on easing passporting and improving supervisory convergence - two topics that have proven less successful in the ongoing CSDR implementation.

On the other hand, the delay that was offered by the authorities for the implementation of the Settlement Discipline Regime ("SDR") should also allow time to reflect on the content of such regime. The COVID -19 crisis may provide a valuable data set to analyse the (theoretical) impact the SDR could have had. As a follow-up of the recent market turmoil, we believe it would be prudent for the Commission and ESMA to carefully assess all implications of the SDR. The surge of settlement volumes combined with business continuity arrangements, may cater for new insights on the impact of measures on settlement efficiency and market liquidity.

> *A review of CSDR should be focused on easing passporting and improving supervisory convergence.*

From a CMU perspective,and in addition to the recommendations of the HLF, we believe renewed attention is required on how the trading, clearing and settlement layers operate cross-border, post implementation of major regulations such as MiFID, EMIR, CSDR, taking into account different dynamics of cash instruments (equities, debt). The Commission could seek evidence on the effectiveness of the open access and interoperability requirements included in MiFID, EMIR and CSDR and the reasons for a potential lack thereof.

A well-targeted CSDR review, combined with further harmonisation as suggested by the HLF will contribute to the CMU objectives and global competitiveness of EU capital markets, supporting the International role of the Euro. ●