MIFIR REVIEW

VERENA ROSS
Chair - European Securities and Markets Authority (ESMA)

Contributing to strong EU capital markets – success factors for MiFID II/MiFIR

It may not seem so long ago but already more than a year has gone by since the European Commission presented its proposal for the MiFID II / MiFIR Review in November 2021 as part of the Capital Markets Union package. Many things have changed since then. ESMA remains strongly supportive of the main elements of the proposal, notably on increasing transparency and enhancing investor protection. As the co-legislator will need to find compromises in the legislative negotiations before a final agreement can be reached, the key factors for the success of the future regulation should be kept in mind.

From its inception, one of MiFID II / MiFIR's key objectives was to establish a more transparent financial system following the lessons learnt from the great financial crisis in 2008. Since the MiFID II/MiFIR implementation, this has been one of the main elements that ESMA has worked and continues to work on.

Providing transparency includes ensuring that the information available is accurate, meaningful, comparable and accessible. The consolidation of all transparency information from various data sources into one single consolidated tool, that would be available to end-investors and reduce costs for them, would be a catalyst to achieve these goals. A CTP would contribute to democratise access to market data and increase data quality. While it was originally foreseen already by MiFID II/MiFIR, the fact that a CTP has so far not been established has been a vital missing piece in building a truly integrated single capital market.

Considering ESMA's foreseen mandates within the MiFID II/ MiFIR Review to appoint, authorise and supervise the CTP, we have been closely monitoring developments in the Level 1 negotiations. We welcome the improvements introduced by the co-legislator to the proposal, notably the introduction of a staggered approach for the different asset classes and the separation of the selection and authorisation procedures. Nevertheless, while ESMA very much shares the ambition to have a rapid establishment of the CTP, in our view, some essential pre-conditions for the successful establishment of the CTP remain to be addressed. One such condition relates to the timing of certain Level 2 measures specifying key aspects of the CTP, such as the revenue redistribution and the bond transparency regime, which would need to be in place before ESMA launches the selection procedure.

A CTP would contribute to democratise access to market data and increase data quality.

In addition, we would recommend increasing the time available for the overall selection procedure to provide all potential applicants with sufficient time to participate in the procedure and for ESMA to appoint the successful candidate to provide the CTP.

The success of the CTP will be determined by a number of factors. Firstly, an appropriate calibration of the transparency regime will be paramount to appropriately define the scope of the tape. Currently, concerns remain that the proposal introduces some overly complex requirements, particularly for bonds, and we would recommend a simpler approach. Secondly, the CTP will rely on the ability to receive and publish good quality data. Further work is needed in this area, in particular on the quality of data for OTC transactions. In this regard, the European Commission has recently adopted reviewed RTS, prepared and submitted by ESMA, to address data quality concerns, which we welcome. The remaining key dimension is ensuring the alignment of the data to be published across trading venues, investment firms and the CTP. For this purpose, we consider that ESMA is well placed to ensure consistency of data standards and formats.

In addition to promoting transparency, another key objective of MiFID II / MiFIR has been to improve investor protection. It is therefore welcome that the Review includes proposals to tackle the conflict of interest between firms and clients present in payment for order flow (PFOF), as PFOF incentivises firms to choose the execution venue offering the highest payment, rather than the best possible outcome for clients when executing their orders. A PFOF ban can therefore in ESMA's view contribute to enhancing outcomes for investors.

I am hopeful that the MiFID II / MiFIR Review can increase the competitiveness of the EU's capital markets, as markets that are functioning efficiently, transparently, with integrity and in an orderly fashion are attractive for firms and investors. To achieve this, ensuring that the Review delivers on the elements outlined above to further promote transparency and investor protection will be crucial.

PROF. DANUTA HÜBNER

MEP, Committee on Economic and Monetary Affairs - European Parliament

The future of the CMU requires us to be bold and ambitious in the MiFIR Review

European co-legislators are currently negotiating the MIFIR review, which modifies the rulebook governing participation in European capital markets and aims at reducing market fragmentation and market data costs, harmonise and simplify the transparency rules in Europe, enhance the levels of investors protection and increase the competitiveness of EU markets.

One of the core elements of the review relates to the staggered introduction of a consolidated tape (CT) for each asset class. Going further than the Commission and the Council, for the equity CT the European Parliament (EP) sets the scope to cover real-time, pre-trade data up to the first five layers of the order books, in addition to post-trade data. Smaller trading venues are excluded from the mandatory contributions of data to the CT, although a dedicated revenue participation scheme is established to promote voluntary opt-in.

To ensure that data quality is improved and data costs are reduced, both the Council and the EP mandate ESMA to develop RTS on the quality and substance of market data, and on the criteria for the provision of market data on a reasonable commercial basis (RCB).

Significant changes to market structure and transparency rules applicable to market participants are also being discussed. The EP proposes to empower ESMA to define the threshold for the use of the Reference Price Waiver (RPW) and for Systematic Internalisers (SIs) quotes and execution. Above said threshold, midpoint matching will be allowed without complying with the tick size regime, in line with other international jurisdictions. In its proposal, the Commission set said threshold at twice the standard market size, while the Council does not have any minimum size.

The EP maintains the Commission's proposal of a single volume cap set at 7%, and it asks ESMA to assess the threshold and the methodology used to define it every two years. The Council, conversely, set a 10% cap only to the RPW.

On non-equities, the Council and the EP both establish five categories of deferrals for bonds and derivatives, with varying length of deferrals based on the transaction size and the liquidity of the instruments (to be calibrated by ESMA).

Seeking to simplify and introduce greater clarity in market structure, the EP also amends the definition of SIs - moving it to a qualitative basis - and both the EP and the Council 'decouple' the SI status and the post-trade reporting requirements.

The EP maintains the horizontal ban on the payment-for-order-flow (PFOF) arrangements proposed by the Commission, while the Council give Member States discretion on whether to implement the ban or allow PFOF within their national market.

We must not lose sight of what is at stake - MiFIR will shape EU capital markets for years to come.

Additionally, the EP introduces new elements stemming from the energy crisis which neither the Council nor the Commission included: it 'tightens' and harmonises the rules on circuit breakers, and calls for a review of the position limit and position management regimes and the criteria for the ancillary activity exemption, as well as for an assessment of the viability of minimum holding periods for energy derivatives.

Overall, it is clear that the co-legislators share the main objectives of the review. The emergence of a CT will give investors a single view of the EU markets and will contribute to the reduction in market data costs and fragmentation. Properly calibrated transparency rules will ensure that the EU market structure gives our firms the ability to compete globally and to increase their attractiveness.

Differences remain in how these changes should be implemented. While the Parliament favours an ambitious CT and a higher degree of caution with respect to market structure (i.e. the maintenance of artificial limits to certain execution methods), the Council proposes a CT model limited to post-trade data and aligns market structure rules with those of other international centres.

There are several points in common, such as the dedicated treatment of smaller exchanges on the CT, inclusion of RCB provisions, harmonisation of deferrals, decoupling SIs status from reporting obligations. On these matters, the discussions will focus on the exact calibration of these measures, and differences do not seem irreconcilable.

Throughout the negotiations, co-legislators must not lose sight of what is at stake. The MiFIR review will shape EU financial markets for years to come, channelling capital where it is most needed. Efficient capital markets will be key in financing the sustainable and digital transition, and fostering economic growth. It is therefore essential that the EP and the Council find the best way to strengthen the competitiveness and attractiveness of the EU Capital Market Union.

CARLO COMPORTI

Commissioner - Commissione Nazionale per le Società e la Borsa (CONSOB)

MiFIR Review: the positive outcome of a long and puzzling story?

The MiFIR Review is hopefully coming to an end with an intensification of negotiations around few critical points, presented here below.

Projects are already underway for the establishment of a consolidated tape in both the equity and the non-equity space, sign of strong demand to find all needed information in one single place for such asset classes. In February, 14 European exchange groups, geographically representing 26 different Member States, agreed to participate in the future selection process for the provision of a consolidated tape for equity, in the form of a joint venture. This initiative seems to give substance to the expectation of a rapid and effective implementation, given the experience matured by the participating exchanges in providing market data and the degree of comprehensiveness that their number has the potential to ensure.

These developments come at the right time despite concerns about the latest developments of negotiations, i.e. the removal of a fall-back clause if lacking a private solution, and the narrowed scope in connection with the opt-in mechanism for smaller trading venues. On the latter point, both the ECON and the Council, though with different nuances, seem to strike an appropriate balance between opposite positions. On the one hand, it is acknowledged that especially smaller regulated markets and SME growth markets might be put at a disadvantage if giving up the commercial value of transaction data. On the other hand, it is also recognised that equity trading is characterised by high concentration, for which the contribution of smaller exchanges is of a limited marginal value.

Consensus seems to be reached on the sequence of implementation, starting with bonds, followed by equities and ETFs, and finally derivatives. On whether including pre-trade information alongside post-trade data, the solution agreed at Council level envisages the publication of the best bid and offer available at the time of the executed transactions. Going beyond will ever be possible, after an initial implementation, if supported by a clear business case. It is important to ensure that the final agreement does not discourage these initiatives.

Another area on which co-legislators seem to agree is the double volume cap, where the single threshold will bring the benefit of streamlining the previous process though abiding the objective to curb dark trading, which remains an important goal to be achieved, also in comparison with the US.

A further delay could hinder the realisation of other important goals within the CMU action plan.

The mechanism of deferrals to the post-trade transparency regime is also due to benefit from a simplification by allowing consideration of both size of transactions and liquidity of asset classes and a higher level of harmonisation. In that respect, the data available at ESMA level will help the authority to determine the most appropriate degree of calibration, to reduce the discretion in delaying post-trade transparency.

The trilogue will also discuss the pre-trade transparency waiver granted to systematic internalisers (SIs) for transactions executed at midpoint, with the general approach text having removed the large in scale threshold and the ECON more prudently keeping the concept of a certain size, in order not to harm transparency.

Although the identification of a designated reporting entity for transactions in which SIs are part will solve practical problems faced so far, it should not inadvertently and unjustifiably lead to complete de-regulation of SIs for non-equity instruments, as this would undermine the degree of transparency in the non-equity space. It is rather preferable that SIs remain subject to identification through qualitative criteria as well as to an opt-in mechanism. Additionally, it is worth considering to ask such entities to report to NCAs on the policies applied in the management of orders received, that concurs to levelling the playing field between Sis and trading venues.

Another point possibly needing further reflection during the trilogue could be the derivatives trading obligation and the provision of a smoother mechanism at ESMA level to temporarily suspend the DTO and/or for issuing proper no-action letters in exceptional situations.

While it is possible to recognise, in light of the achievements referred to above, that the negotiations so far helped in better catering for the real needs and focusing on appropriate solutions though not exacerbating the burden on the regulated entities, it is now time to finalise the MiFIR text. A further delay could hinder the realisation of other important goals within the CMU action plan.

NIELS
BRAB

Head of Group Regulatory Strategy & Chief Regulatory Officer - Deutsche Börse Group

Make MiFID II/ MiFIR fit for the EU strategic autonomy

Global realities continue to challenge the strategic autonomy of the EU and require new answers to defend our values and to preserve our ability to shape the future of our society in a sustainable manner. With high inflation, questions around the future of monetary policy and an overall challenging macroeconomic reality, key EU leaders are reemphasising the need for stronger EU capital markets.

The MiFID II/ MiFIR Review provides a key opportunity to make the framework fit for an EU strategic autonomy, improving competitive realities at a critical juncture in history. As Trilogue negotiations are kicking-off, policymakers should use the chance and realise that the debate goes way beyond complex abbreviations, waivers, and deferrals – it is time to fundamentally reflect on how EU capital markets should evolve and how we will really get there.

If the EU is serious about the CMU endeavour, it is clear that there must be a fit for purpose regulatory framework that promotes strong primary and secondary markets, with competitive EU financial market infrastructures as the backbone. And: We should not lose sight of some of the key lessons learnt since the MiFID II/ MiFIR application in 2018. The EU has witnessed hyper market fragmentation, lower levels of transparency and a drop of market share on exchanges as the key drivers of our equity markets – empirical realities that strongly contrast with the original objectives.

The creation of an EU Consolidated Tape (CT) could certainly add significant value to provide a full overview of the EU's trading landscape – but we should not forget that the discriminatory rule books of certain alternative execution venues will continue to mean that investors would often not even be able to access such venues. And while a lot of voices have been calling for the creation of a CT, European exchanges acted and recently announced to participate in the future selection process on a CT for shares – symbolic of their serious commitment to improve the EU's ecosystem.

However, with the legislative discussions overshadowed by PFOF and the CT, let us not forget to address market structure – the very starting point to the design of our markets and their future success story at global level. Simply copying some of the proposals discussed in the UK, which are still far from any potential implementation, will not do the trick. A fundamental vision that matches the EU's strategic autonomy aspirations is needed.

A new vision with EU interests at the heart is needed to succeed in an unfolding new world order.

The much-debated single volume cap is key in this regard. ESMA should be tasked to determine an appropriate threshold, based on an in-depth analysis that also assesses how dark trading affects the efficiency of the price formation process. And the SVC should not only capture trading venues using waivers (incl. the reference price waiver and the negotiated trade waiver) but also any non-transparent venues, such as SIs, dark pools or other relevant set-ups (e.g. frequent batch auctions).

Moreover, the threshold for the suggested minimum quoting and trading size for SIs should be determined with a view to creating a level playing field. It should be at least four times the standard market size, which would help to refocus SI activities on their original purpose, the execution of large orders.

In line with this and to increase transparency, thresholds for order handling provisions, the execution at midpoint and the application of the tick-size regime for SIs cannot be dropped but are to be applied in a well-calibrated manner. All these provisions need to be combined with much stricter governance and due diligence requirements and a thorough enforcement by supervisors to address regulatory arbitrage whilst ensuring compliance.

Especially the market events over the last couple of months have reminded us of some of the key lessons learnt during the financial crisis: Transparency is key. Reporting is key. Supervision is key. And: Neutral and independent market infrastructures, such as exchanges, will foster the integrity of our markets in a more aspirational way than entities mixing proprietary trading activities with the execution of customer flows.

Finally, let us remind ourselves of some of the core realities in our markets: EU companies are leaving the listed universe and move abroad. The participation of our citizens is shrinking in relative comparison to 3rd country investors who have long understood that the participation in our value creation is certainly positive.

There are many more proxies we could list to illustrate empirical realities around the erosion of our ecosystem and how it negatively affects the EU's interests. All of this should make us reflect on the question if we have followed the right strategy over the past two decades of legislative attempts to boost our capital markets – or if a new vision with EU interests at the heart is needed to succeed in an unfolding new world order within which the EU runs the risk of becoming the playground.

JAMES MCKEONE

Vice President and Head of European Data Product - Nasdaq

The Capital Markets Ecosystem: unlocking innovation through regulation

Regulation can be a powerful catalyst for driving innovation, and when done well, it can contribute to a more efficient capital markets ecosystem. Right now, the European markets are at an inflection point driven by the reform of the directive and regulation on Markets in Financial Instruments (MiFID/R).

The anticipated outcome is to create more opportunities to finance major investor-, market- and demand-driven initiatives, such as the transition towards a more environmentally conscious and digital economy.

For example, it is estimated that to reach Net Zero by 2050, Europe will have to finance an estimated cost of €28 Trillion, and market financing needs to take the biggest share. To allow for progress, the European capital markets must evolve, underpinning the importance of the Capital Markets Union project and regulatory framework resulting from the MiFID/R review. This reform may be the last chance to get things right for the establishment of a well-functioning European capital market.

Doing so will help the capital market ecosystem address significant priorities such as enabling the green and digital transition. Nasdaq's distinct position at the intersection of the market gives us a unique perspective on the current challenges and opportunities, and we are supportive of productive changes to the market structure. But to allow for real progress, the market organizations must incentivize all players while ensuring a sound environment for financial investments.

The various parts of the MiFID/R framework are all key and interact with each other: market organizations; the functions performed by various intermediaries and market participants, like the systematic internalisers; the control of dark trading; incentives to market transparency; market data quality; and a useful consolidated tape (CT). All these various pieces need to be appropriately calibrated to deliver the anticipated result and advance the expected financing objectives.

The tape will constitute a great tool to verify the quality of execution and market dynamics.

A crucial aspect of market structure is addressing how to ensure the best result for investors via incentives and appropriate regulations. It is not clear that the current provisions will incentivize market transparency. For instance, the cap on dark trading is narrow and could apply to only one of the transparency waivers. Additionally, systematic internalisers are unlikely to be limited in their ability to execute transactions away from transparent venues even if those transactions, being limited in size, could be successfully executed on transparent venues and contribute to the price formation process.

If the market structure does not incentivize transparent trading and neglects price formation, the tape cannot ensure the best result is delivered to investors; however, a CT can be useful if well-designed and appropriately used. What are the key characteristics of a useful CT? First, it must include all transactions. With any exemptions, many transactions could escape the tape. Transactions executed in non-transparent protocols must be on the tape. A CT would have limited significance if it only gathers data from easily accessible, transparent venues.

Data quality is also very important as a tape can only be attractive if it displays reliable and timely data. The tape must also remunerate data contributors adequately to ensure upstream investments and quality data. There are several challenges, which can be overcome with the support of all market players and the involvement of regulators.

Also fundamental to a CT are its use cases. A European CT will always be delayed. The laws of physics and European geography create inherent latency. The information displayed will be later than various venues and trading protocols. Consequently, a CT should not be used for trading as it will not be a true representation of the trading possibilities available in the market. Best execution should continue to be required on the best available opportunities at the time of execution. The tape will constitute a great tool to verify the quality of execution and market dynamics.

The tape is not a simple endeavor and will become an important element of European capital markets. Nasdaq as well as thirteen other exchanges recently announced a joint venture to participate in the future selection process for the provision of a CT for equities in the European Union. The participating exchanges are cornerstones of financial markets across Europe and are well-positioned to advocate on behalf of industry stakeholders and collaborate with regulators to develop a strong pathway forward for investors.

The time for action is now. Through a productive, data-driven regulatory framework, industry participants can work together and find a path forward to modernize the European capital markets and ultimately create opportunities to further finance key initiatives, ensuring economic growth and stability.

NICHOLAS
BEAN

Chief Executive Officer -
Bloomberg Trading Facility BV

Imperfect trilogue risks persisting an imperfect MiFIR

As the MiFIR review enters its final phase several critical issues for its success remain in flux. The trilogue parties need to avoid a fatigue of negotiation during the finalisation of the level 1 framework - most notably in relation to consolidated tape providers (CTPs), transparency requirements and market data costs.

Consolidated Tapes

The 2021 legislative proposal positively modified MiFIR to optimise it in respect of its objectives. It recognised that consolidated tapes (CTs) did not emerge due to a lack of commercial incentives for prospective providers and mitigated this by the one tape per asset class model in addition to the abolition of the requirement for a CTP to give away its product for free after 15 minutes of publication.

However, the proposal also unexpectedly introduced new challenges - effectively two steps forward and one step back. In particular, the stance that only Equity regulated markets (RMs), and not Fixed Income venues (MTFs), should receive a share of the profits of CTPs.

Beyond the obvious inequality of this proposal, it is also counterproductive to bringing a bond CT to market. Revenue sharing has a role in the commercial viability of Trading Venues (TVs) and Approved Publication Arrangements (APAs), and in particular APAs at a time when the proposed designated reporting entity regime threatens their revenue model. Furthermore, it is a key mechanism for ensuring that market data contributors provide reliable data of good quality.

Presumably this approach relates to concerns that revenue sharing may drive up costs of a bond CT product - although why this concern only applies to a bond CT and not an equity CT is wholly unclear. However, mitigation could be easily achieved by stipulating that revenue sharing shall be consistent with a cost recovery mandate plus a reasonable margin, where ESMA would be given extra policing powers.

Making CTPs responsible for applying waivers and deferrals is another item for which the objective is unclear and thus detrimental to the policy goal of seeing a CT emerge. TVs and APAs are obliged to perform this function. But what value is a CTP adding in also fulfilling this responsibility? Indeed, a CTP can only do so if it has the 'raw' data, which the TV and APA will not be providing. If the expectation is that the TV and APA should provide the CTP with the 'raw' data then what value is the TV and APA providing in relation to transparency? Essentially there is no practical way for a CTP to exercise this obligation - and it creates the kind of uncertainty which is unattractive to potential CT operators.

Transparency

Another key area that the legislative proposal sought to fix was the overly complex and burdensome fixed income transparency system. In general, this regime has not lived up to expectations, so it was surprising to see no ambitious reforms proposed. Rather, the focus was on increasing post trade transparency largely by eliminating supplementary deferrals.

Listen to the bond market, or be prepared to miss objectives.

Notwithstanding the missed opportunity for complexity reduction - it is worth noting that the focus on post trade transparency does bring the greatest benefit to investors. While ESMA has made valiant efforts to extract value out of pre-trade transparency there can be no hiding the fact that the regime was designed for equities, and it is right that the trilogue parties should look to overhaul the regime for fixed income.

The current regime just does not reflect the practicalities of fixed income trading. The Request For Quote (RFQ) trading system services the bulk of fixed income trading by investors and inherently affords liquidity identification and price formation within its pre-execution phase. The co-legislators are therefore right to suggest curtailing fixed income pre-trade transparency to central limit order book and periodic auctions systems. This will enable ESMA to focus its valuable resources on the simplification of the post trade regime.

Market data costs

A final key issue for the trilogue parties to address is the matter of market data costs. Too little attention has been paid to this issue in the process so far, which is surprising given the resonance it has for market participants. Establishing in Level 1 that Reasonable Commercial Basis means that the price of market data shall be based on the cost of producing and disseminating such data and may include a reasonable margin, is key. Yet this clear principal also needs to be made workable in practice following the review's implementation.

In conclusion, the whole market, law makers and participants alike, are keen to avoid yet another MiFIR adjustment in the near term. We need to learn from our recent history and listen to the wisdom of our collective experience five years on from MiFIR's go-live. The trilogue parties must ensure that the key issues identified above are addressed in light of that wisdom to guarantee the best possible outcome for this review - that being boosting the competitiveness of EU capital markets.