MiFIDII/ MiFIR review – BVI-EFAMA-EFSA-NSA priorities

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Brexit, the pandemic crisis, and an unstable geopolitical environment have further underlined the necessity for the European Union to develop its open strategic autonomy and to deepen its Capital Markets Union.

The main goals should be to enable EU markets to further contribute (i) to the economic recovery at national and European levels and (ii) to the financing challenges the Union is facing, in relation to the mitigation of climate change, the ageing of the population and the development of EU champions in strategic fields such as digital and sustainable finance.

With Brexit, the Union is facing an unprecedented challenge with the UK as a strong competitor which is very agile from a legislative/regulatory perspective and has already shown concrete proof of its willingness (i) to diverge as per the Wholesale Markets Review (*e.g*. end of the share trading obligation and double volume cap, lighter transparency constraints for non-equity market) as well as (ii) to create a more competitive UK financial sector which features as a core objective in the Edinburgh Reforms announced in December 2022.

As part of the CMU project, the MiFIR review proposal presented by the European Commission in November 2021 is of critical importance to increase the competitiveness of financial market actors operating in the EU-27 and the attractiveness of the Union's regulatory framework.

In this context, the purpose of this note is to highlight the abovementioned associations[1] core priorities in relation to the ongoing MiFIR negotiations taking place in the European Parliament.

1. Creating an EU consolidated tape to bridge EU capital markets

An appropriately constructed Consolidated Tape (CT) would help to build deeper and more open capital markets in Europe. In line with the European Commission's vision for the CMU, a key aim should be to democratise access across European markets to provide all investors regardless of resources or sophistication with a comprehensive and standardised view of European trading.

In order to be attractive to users and ensure its commercial viability, the equities consolidated tape should deliver data in as close to real-time as technically possible.

To support the aim of democratizing access to market data, an appropriate governance framework should be elaborated to ensure the broad representation of market participants, including the data user community, with full voting rights. The governance entity should be empowered to make decisions on setting policies and fees on market data

Consumption of the tape should remain voluntary. It is impossible at this time to predict the pricing of the tape, the quality of the data, and the speed of delivery. Market participants should therefore be free to choose to use it or not, so long as they continue to fulfill their best execution requirements vis-à-vis clients.

The revenue sharing systems for the shares/ETFs and the bond CTs should focus on providing a competitively priced offering, subject to the Reasonable Commercial Basis principle. The current provisions for the equities tape appear to support this. The bond tape should also be priced on a cost recovery plus reasonable margin basis. Any additional language around loss of revenue for the bond CT is profoundly misguided and could be open to abuse.

[1] BVI, EFAMA, EFSA and NSA – please see annex for further information.

2. Market Data cost must be properly addressed at level 1 and level 2

The associations members do not believe that a CT is the solution to the concerning issue of increasing market data costs as the requirement for proprietary data is indispensable for market participants to conduct their business and to comply with regulatory requirements. The challenge with high and increasing market data costs must be addressed head-on, including through strengthening of the MiFID II and MiFIR requirements, standardisation of pricelists, policies, audit procedures, etc., regardless of the existence of a CT. There must not be exemptions for CTs.

We consider as a positive step forward the proposal from the European Parliament to outline in the level 1 text that the price of market data should be based on the cost of producing and disseminating, with reasonable margin as foreseen in the recommendations featuring in ESMA 2019 December report[2]. The approach from both European Parliament and the Council allows for further specification at level 2 as also recommended by ESMA bearing in mind that the market data is a by-product of the trading activity and that providing market data on a reasonable commercial basis furthermore means that the price of market data shall **not** be based on the value generated by the data user as also stressed by ESMA. ESMA also recommends regular review of compliance and the mandate to include additional measures in case of non-compliance. We strongly recommend that these recommendations are included.

3. Reforming the transparency regime for equity in a pragmatic way

Some proposals – both in the initial proposal for the review of MiFIR by the Commission and in amendments[3] to the ECON draft report – tend to further constrain the activity of systematic internalisers, which play a key role as liquidity providers, by limiting their ability to trade below certain thresholds or to trade at mid-spread, or by integrating their volumes in the monitoring of the double volume cap. Other proposals would restrict the access to waivers of pre-trade transparency through the lowering of the double volume cap or other limitations on the use of the Reference Price Waiver (RPW) and the Negotiated Trade Waiver (NTW) in the equity space.

While these proposals initially aim at increasing transparency and consolidating the price formation process in the EU, we consider that, were they to be adopted, they are most likely to run counter to these objectives and to weaken the attractiveness of EU markets and the competitiveness of actors operating in/from the Union to the benefit of the United-Kingdom and other attractive third country jurisdictions, who offer a more attractive setting:

- Alternative venues of execution (dark MTFs and systematic internalisers) provide liquidity services that are critical for end investors and that cannot be substituted by the sole access to lit multilateral venues. As a consequence, the limitation of their activity would be detrimental to investors,
- Non-EU market participants – that represent a significant portion of trading in EU shares – would then likely encourage the emergence of alternative pools of liquidity in more competitive third country jurisdictions like the United Kingdom, if only to offer better execution outcomes to their clients. This would entail a transfer of liquidity outside of the EU and the weakening of the price formation process of EU shares,
- EU market participants, who can only trade with EU trading venues, would have access to a less liquid market than their non-EU peers. This would significantly reduce their ability to offer high quality services at the best price to EU institutional investors, that is to say to EU pensioners and retail investors. In the end, it is them who will bear the impact of less competitive EU equity markets.

[2] ESMA Final Report on market data costs, points 58-65, page 26-27.
[3] In particular we refer to the following amendments: 111 ; 112 ; 128 ; 129 ; 236 ; 240 ; 248 ; 250 ; 279 ; 280 ; 290 ; 294 ; 296 ; 298 ; 299 ; 300 ; 301; 302 ; 307 ; 309.

While a continuation of the volume cap has been suggested in some of the amendments, our view is that a removal/suspension of the VC as in the UK would be the preferred option in order to create the needed level playing towards the UK.

However, if that is not an option in creating viable compromise amendments, we kindly ask you to beware of the consequences if a VC is introduced on the NTW: A VC for NTW is counterproductive as this will undermine the attempt to reduce the number of SIs with the introduction of the Designated Publishing Entity (DPE)/Designated Reporting Entity (DRE) and the qualitative assessment of becoming an SI. This is because of the Share Trading Obligation (STO), whereby an investment firm shall ensure the trades it undertakes in shares shall take place on a RM, MTF or SI unless certain conditions apply. Firms can "avoid" becoming SIs but still fulfilling the STO by using the NTW (negotiating a trade outside a trading venue within the rules of the trading venue, report it to the trading venue, whereby the trade is labelled as an on-venue trading). With a VC on the NTW, the operational uncertainty will prevent firms from opting out as SIs as they do not know when the VC hits. In short, if the NTW cannot be used freely, there is no alternative to becoming an SI due to the STO. Hence the DPE/DRE is basically worthless, and the number of SIs will not decrease.

We suggest that if a VC is unavoidable for a compromise – it should be introduced on the RPW only in order to reach the goal of reducing the number of SIs and to make use of the DPE/DRE.

4. Preserving the precarious balance of the transparency regime for non-equity

We consider it is of paramount importance to take into account the specificities of the bonds and derivatives markets to enable market makers to (i) hedge their risks as well as (ii) unwind their positions and hence their ability and willingness to enter into transactions of significant sizes or on illiquid instruments.

Considering pre-trade transparency regime, the associations support the removal of pre-trade transparency requirement for request-for-quote (RFQ) and voice systems as proposed in the ECON draft report approved by the Council, since these mechanisms do not bring any clear value, while increasing the operational complexity for market participants. We also consider that the deletion of the pre-trade requirement should apply equally to multilateral venues and systematic internalisers (SI), where the latter (the SI regime for non-equities) should be de facto deleted as agreed in the Council.

Regarding the non-equity SI regime, we support the proposed simplifications in the ECON draft report[4] as well as in the Czech Council compromise text especially the replacement of the ToTV concept with derivatives subject to the clearing obligation and the deletion of the obligation to provide quotes in illiquid instruments on demand.

With regards to post-trade transparency, we consider the Council agreement a good step forward with that caveat that considerable decisions must be made at level 2 by ESMA to ensure appropriate level of deferrals for the right sizes of transactions. In this context it is of utmost importance that open dialogue with the relevant stakeholders are ensured due to the delicate balance between transparency and liquidity and the need not to expose liquidity providers to undue risks.

Moreover, with regards to covered and sovereign bonds, the use of issuance size may not be a good proxy to determine the actual liquidity of those bonds. As such, we would recommend to only use the issuance size as a proxy for corporate bonds, leaving other bonds to include liquidity measurement as well.

Given that, on their side, UK authorities and other third country jurisdictions show no intention to reinforce the constraints imposed on market makers, it is critical that the EU proposal, everything else being equal, does not result in dealers preferring to provide liquidity at a better price in the UK/other third country markets, rather than in the Union. Ultimately, this would result in a transfer of liquidity from the EU to the UK/other third country markets, and in a loss of attractiveness of the Union's markets.

[4] European Parliament, Economic and Monetary Affairs draft report, amendment 46, pages 49 to 52.

5. Definition of systematic internaliser

We support the fact that the SI definition should not be subject to quantitative criteria and as such we support the approach proposed in the ECON draft report and in the Council compromise text maintaining the capacity of investment firms to opt-in as SI for any financial product.

6. Alleviating investment firms' best-execution reporting constraints

We strongly support the decision by the European Commission to repeal the RTS 27 "Best Execution" Reports. However, and as already regularly requested since the implementation of MiFID several years ago, we think that this repeal of RTS 27 "Best Execution" Reports should be accompanied by the repeal of RTS 28 "Best Execution" Reports and as such we support the approach in the ECON draft report.

7. Payment for order flow: defining precisely scoped in practices

We believe that MEP Hübner has taken huge steps in the right direction to address this issue. We agree that PFOF should be allowed if measures are taken to address transparency, conflicts of interests and Best Execution issues.

On the other hand, we are concerned by some MEPs statements and proposed amendments making the link with the inducement regime which we believe is misguided. Not only are retail commissions subject to their own extensive set of rules, which will be separately addressed as part of the upcoming Commission's Retail Investment Strategy, but there is substantial and concerning evidence on the negative impact of forcing radical changes to the advice regime for European retail investors.

Further, should there be a ban on PFOF, we consider there is a need for a more precise definition of the practices and the EEA and non-EEA instruments that would be scoped in. Currently, there is a real ambiguity which should be overcome to avoid ex-post interpretation which could be too restrictive to investors and market participants whose practices could be wrongly assimilated to PFOF.

Finally, we call for coherent supervisory practices whether there is a ban on PFOF or not.

8. Modification of the existing reporting regime

We support the creation of the status of designated reporting entities, as proposed in the European Parliament draft report and by the Council (called Designated Publishing Entity), which should remove the uncertainty of the existing SIs reporting regime and has led to duplicative reporting and higher costs for small investment firms in particular. We believe the creation of a register managed by ESMA should result in a more realistic view of market participants.

9. Modification of the transaction reporting regime (extension of Article 26 reporting)

We are strongly against the proposal of the European Parliament draft report to add AIFM/UCITS firms to the scope of entities obligated to report transactions to NCAs. We consider this would have huge detrimental impact on the current regime of the reporting mechanism for investment firms. It would place a disproportionate burden on firms without targeting any regulatory rationale.

Moreover, we consider that the ECON proposal to include a transaction identification code generated by the trading venue within the reports would, in reality, be very difficult to put in place and would demand huge investment for investment firms with no actual benefits for regulatory purposes.

About BVI

BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

About EFAMA

EFAMA is the voice of the European investment management industry, which manages over EUR 30 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book. EFAMA's ID number in the Transparency Register is: 3373670692-24.

About EFSA

EFSA is a forum of European Securities Associations gathering, the French Association of Financial Markets (AMAFI), the Spanish Asociación de Mercados Financieros (AMF), the Italian Association of Financial Markets Intermediaries (ASSOSIM), Capital Market Denmark (CMD), the Bundesverband der Wertpapierfirmen (bwf), the Belgian Association of Stock Exchange Members (ABMB-BVBL), the Polish Securities Dealers Association (IDM) and the Swedish Securities Markets Association (SSMA). ID-number in the Transparency Register is 038014348035-13.

About NSA

The Nordic Securities Association (NSA) is a Nordic cooperation that works to promote a sound securities market primarily in the Nordic region. The NSA is formed by Capital Market Denmark (Kapitalmarked Danmark), Finance Finland (Finanssiala), the Norwegian Securities Dealers Association (Verdipapirforetakenes Forbund) and the Swedish Securities Markets Association (Svensk Värdepappersmarknad), NSA - Nordic Securities Association (nsa-securities.eu). Nordic Securities Association's public ID number in the Transparency Register is: 622921012417-15