EFSA

European Forum of
Securities Associations

EFSA members:
Asociación de Mercados Financieros (AMF)
Association for Financial Markets in Europe (AFME)
Association française des marchés financiers (AMAFI)
Associazione Intermediari Mercati Finanziari (ASSOSIM)
Belgian Association of Stock Exchange Members (BASEM)
Bundesverband der Wertpapierfirmen (bwf)
Danish Securities Dealers Association (DSDA)
The Polish Chamber of Brokerage Houses (IDM)
Swedish Securities Dealers Association (SSDA)

For more information on EFSA, see appendix 1.

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EFSA – initial comments on MiFID 2/R Review

1. Introduction

MiFID 2/R, in conjunction with Level 2 and Level 3, forms the cornerstone of financial regulation for securities markets in EU. However, there are some areas of MiFID2/R which need recalibration in order to deliver the intended policy outcome and to avoid unintended harm to the market, liquidity and investor choice.

Considering that the timeline for the Commission's reports on certain parts of MiFID 2/R is approaching, EFSA members would like to contribute to the discussion by highlighting a number of issues which we believe should be a priority in the context of a review.

As a general comment, it is of utmost importance that a MiFID 2/R review is evidence-based and that any proposals for amendments to level 1 and 2 are developed in order to (i) deliver good outcomes for investors (investing both directly and indirectly), (ii) to improve the competitiveness of the EU financial sector, (iii) to ensure together with the Capital Markets Union reform (CMU) that EU markets are able to finance the EU economy, (iv) to introduce more proportionality and to better reflect the specificities of the wholesale market, and (v) to ensure that investment firms of all sizes are able to provide services for the benefit of all kinds of issuers or investors. Moreover, all amendments should be made subject to rigorous consultations with stakeholders.

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EFSA members welcome the opportunity to engage in dialogue with European co-legislators, ESMA and national competent authorities on any of the topics below.

2. Key issues

Market structure

The MiFID2/R regime on market structure has led to significant changes of the securities market in the EU. However, there are some areas where targeted amendments are needed in order to achieve the intended policy outcome. In terms of priority, EFSA members would like to underline the need to review the rules relating to the trading obligations for shares and derivatives and parts of the SI-regime.

Trading obligation – in general

In order to avoid market disruption resulting from the share trading obligation and the derivatives trading obligation, it is important that both EU and third country regulators take the necessary equivalence decisions and/or reconsider the extraterritorial application of the rules, in particular for branches (see below). EFSA members agree that the scope of the trading obligations should be narrowed down and balanced taking into account other policy priorities, such as the CMU reform and maintaining the EU's attractiveness as a listing location for issuers.[1]

Share trading obligation (STO)

Scope
A primary shortcoming of the STO regime is the apparent scope of the STO which captures all shares traded on a trading venue (ToTV) within the EU. Article 23 of MiFIR is binary in nature and does not make any calibration with respect to the levels of liquidity within the EU. This is likely to result in less optimal outcomes for end-investors, as EU firms subject to an STO which is comprehensive in scope are less able to deliver best execution in its truest form.

Our members agree with the German Ministry of Finance which, in its position paper dated September 2019, said:

> *The scope of the share trading obligation is overly broad and leads to legal uncertainties and unintended consequences. The intended benefits and the shortcomings of the share trading obligation should be thoroughly analysed. On this basis the requirement should be recalibrated or repealed if necessary.*

[1] See report by German Ministry of Finance https://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Gesetze_Gesetzesvorhaben/Abteilungen/Abteilung_VII/19_Legislaturperiode/Position-paper-MiFID-and-MiFIR.pdf?__blob=publicationFile&v=10 as well as speech by Robert Ophèle, AMF chairman (https://www.amf-france.org/en_US/Actualites/Prises-de-paroles/Archives/Annee-2016?docId=workspace%3A%2F%2FSpacesStore%2Fac5c4822-fd35-4764-8e22-2e940d86266d

Interaction with best execution interests of end investors
A problem that arises with the STO is that even if even a small proportion of liquidity is accessible outside of the EU then the prohibition on accessing that liquidity is a clear disadvantage to investing via EU-based investment managers. Thus, to the extent this is a policy the EU wishes to pursue, EFSA members would like to engage with the authorities on problematic outcomes and potential solutions. Some of the options that could be considered include the instrument currency, ISIN country code, and where geographically the majority of the trading takes place.

<u>Tick sizes for SIs</u>

Following the political agreement reached on the Investment Firm Review in trilogues[2], EFSA members remain concerned by the new amendments to the MiFIR tick-size regime for systematic internalisers. The application of the tick size regime above Large-in-Scale (other than trades executed at mid-point) will in our view not contribute to the price discovery process for LIS trades and may actually inhibit appropriate price formation between systematic internalisers and their clients. Furthermore, the ability to execute Large-in-Scale trades on a sub-tick basis provides meaningful price improvement for clients trading in large sizes which brings benefits to end investors.

On this basis we believe that tick sizes should not apply to any transactions that are above the LIS threshold and that for all order sizes, the mid-point should remain a valid execution price permitted to trade at a half tick, both on trading venues and with systematic internalisers.

<u>SI-regime</u>

Trade reporting hierarchies
Linking a higher position in the trade reporting responsibility waterfall to systematic internaliser status has had unexpected outcomes, for example a number of firms have opted to be systematic internalisers in order to shoulder reporting responsibility for their clients. EFSA notes that an inability to trade report is a barrier to entry for new entrants and could result in suboptimal outcomes for end investors. Investment firms' institutional clients (buyside) currently feel compelled to transact with systematic internalisers to ensure their reporting requirements are met (in the frequent case they have not built their own reporting capabilities).

Furthermore, there are technical difficulties with systematic internaliser to systematic internaliser trading in the absence of an official source of SI data (golden source). Available trade data does not indicate in which capacity the counterparty has done the trade. This sometimes creates uncertainty around who should report and there is a risk that either both

[2] In order to meet a legislative deadline, the amendments to the tick size regime were introduced through a fast track procedure, using the Investment Firm Review as a vehicle. This procedure did not allow for an impact assessment of the proposals which, in the view of EFSA members, is very unfortunate and can lead to unintended consequences. In accordance with the Commission's better regulation agenda, is always important to ensure that significant changes to EU legislation are made subject to a thorough analysis of the implications for firms and end-users.

of the parties or none of the parties publish the trade. This hampers the data quality (see below).

Therefore, EFSA would strongly support an amendment which allows counterparties to agree contractually who will report, with the existing reporting waterfall providing a backup (and certainty of reporting) in case the counterparties do not enter into such an agreement.

SI-determination
The type of activities that trigger SI status ought to be reviewed to avoid business in certain derivatives accidentally causing the derivatives trading entity to qualify as systematic internaliser in the underlying instruments. This is particularly important given the transactions in question are not price-forming as regards the underlying, do not provide liquidity to the market, and that the derivatives trading house may quite legitimately decide not to be in the equity trading business.

Transparency and data quality

In order to have a sound and reliable transparency regime, the quality of market data needs to be improved. EFSA members acknowledge that market data quality has been a key priority for ESMA in 2018 and 2019 but consider that there is room for additional improvement in terms of completeness of data, classification on financial instruments and liquidity assessment. Thus, it is important that data quality remain a high priority in an upcoming MiFID 2/R review and EFSA members are happy to be part of further discussion on this topic.

Moreover, EFSA members consider that the MiFID 2/R review should include an analysis of the concept of “traded on a trading venue” (ToTV). For instance, it must be confirmed that the requirements for SIs to report reference data does not apply to non-ToTV instruments.

EFSA members welcome the Commission’s ongoing work in relation to a consolidated tape (CTP). A *properly constructed CTP* could help in improving the level of transparency in EU markets. However, we want to underline that a CTP is not a solution to the problems of poor data quality or the conceptual flaws and insufficient enforcement of the “reasonable commercial basis” provisions. Moreover, it important that the establishment of a CTP and its pricing structure do not increase costs of market data even further.

Market data costs

The rising cost of market data is a significant issue for market participants in the EU. Although MiFID 2/MiFIR requires that market data must be offered on a reasonable commercial basis (RCB),[3] lack of clarity around how to this concept should be interpreted as well as the insufficient enforcement mean that market data costs have increased dramatically.

Trading venues’ dominant position in the supply and pricing of market data is a consequence of market data being a by-product of orders and trades. Market data is unique for each trading venue and market participants have to purchase data from the trading venues in order to

[3] MiFIR, art. 13, MiFID II, art. 64-65, Delegated Regulation (EU) 2017/567 art. 6-11 and Delegated Regulation (EU) 2017/565 art. 84-89.

ensure compliance with, for example, the best execution requirement. Since investment firms are, in effect, forced to purchase market data from each of the trading venues, and since there are no alternatives, in most cases, to the data generated by each venue, there is very little or no competition, and the prices keep rising. The present situation hinders the development of market data services for the industry as well as for clients. Moreover, the costs hamper competition and distort the development of efficient capital markets, which in turn harms companies and investors and ultimately the real economy.

EFSA members therefore agree with the German Ministry of Finance which, in its position paper dated September 2019, stated that:

> *it should be assessed whether competition authorities rather than financial supervisory authorities would be better suited for ensuring that pricing policies are set up at a "reasonable commercial basis.*

It must also be noted that ESMA's regulatory power only applies to regulated entities. Yet, the market structure and value chain in which market data is produced and consumed is complex and does not only rely on trading venues but also on data vendors which are not regulated for this type of activities. Changes in prices faced by end-users are therefore not only due to trading venues, since data redistributors charge mark-ups and/or additional fees. The role of data venders should be given a higher level of regulatory attention.

EFSA members consider that, a first step would be to enforce the existing regulatory requirements in MiFIR and the delegated regulations[4] and ensure that the required framework is in place to enable enforcement. Additionally, the authorities should ensure that:

- The pricing lists published by trading venues are easily comparable. The fee schedules provided by the trading venues should be harmonised and simplified.
- Some limit is put on the current ability of market data providers to change the market data policies frequently and unilaterally.[5]
- Audit procedures are simplified and harmonised.
- High level definitions (information/market data, derived data/other original created work/etcetera, display use, non-display use) are harmonised.

In case these steps are not leading to significant results within a reasonable period of time, additional steps should be taken.

Cost & Charges

EFSA members support a simplified and proportional approach to the cost and charges disclosures in MiFID2.

[4] MiFIR, art. 13, MiFID II, art. 64-65, Delegated Regulation (EU) 2017/567 art. 6-11 and Delegated Regulation (EU) 2017/565 art. 84-89.

[5] At the moment this can happen because the market data policies are incorporated by reference into the main agreements, which include a power for the provider to change the policy by publishing a new version on their website. This means market data buyers have to be continually on watch for changes and spend a considerable amount of resources reviewing new versions as they are published.

EFSA members consider that the rules on costs and charges should be calibrated in relation to the type of clients. The main task of the cost transparency rules is to protect investors and to provide them with information relevant to that category of investor in order to make informed investment decisions.

Wholesale clients have the expertise and the necessary sources of information (or they are be able to negotiate an appropriate mechanism of information provision) to make informed and responsible investment decisions. Accordingly, they do not need and equally important, they do not want this form of "protection" which is not considered helpful but de facto hindering established business processes.[6] Therefore, they should not be forced under a regime which for them is burdensome and useless at the same time.

Even for retail investors, the information required by MiFID 2 should be relevant and proportionate taking into account the features of the product being offered. It is also necessary to work for a better synergy between MiFID II and PRIIPs (for retail clients).

Product Governance

EFSA members believe that the product governance rules in MiFID 2 should be applied in a more proportionate manner, taking the type of client, financial instrument and investment service into account.

Firstly, it is important to consider the utility of the product governance requirements for end-investors. In our experience the rules are of little use as regards wholesale markets and opt-out possibilities for wholesale clients should be included. Secondly, more proportionality should be introduced in the way product governance requirements apply to ordinary shares and bonds, notably where traded in the secondary market.[7] EFSA members would welcome a discussion on how the rules could be made more consistent with primary markets practice. In this connection, the concepts of "manufacturer" and "distributor" needs to be further analysed.[8] Finally, it is important also to take the type of investment service into account. In particular, with respect to individual portfolio management, EFSA members takes the view that the relevant target market should be determined by the characteristics of the portfolio mandate granted by the client to the portfolio manager.[9]

In addition to the above, EFSA members would also like to express our great concern in relation to the effects which the PRIIPs regulation has had on the retail bond market in EU.

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[6] See section 4.2 on page 4 of the European Fund and Asset Management Association (EFAMA's) response to ESMA's call for evidence on the impact of the inducements and costs and charges disclosure requirements under MiFID II, available here: https://www.efama.org/Publications/Public/MiFID-MiFIR/19-4071.pdf

[7] Notably the requirement to identify a negative target market and to regularly review target market. Also, a market maker providing two way prices in a continuous manner on a trading venue should not be considered as either manufacturer or distributor.

[8] Recital 15 Commission Delegated Directive 2017/593

[9] And not pursuant to the single financial instruments chosen by the portfolio manager. Retail clients who appoint a portfolio manager acting according a discretionary mandate should have the opportunity to access financial instruments whose target market is professional only (especially when they are non-complex securities).

Plain vanilla corporate bonds are not "packaged" or otherwise "complex" instruments and should therefore not fall under the scope of the PRIIPs regulation - also if the bonds include a so-called make whole clause. Thus, EFSA members agree with the interpretation made by the ESAs in the statement published on 24 October 2019 [10] and support a review of the PRIIPs regulation as soon as practically possible.[11]

Lastly, EFSA members believe that there is room to clarify and simplify the requirement to notify sales outside of the target market.

Best execution reporting

One area of MiFID2/R where the rules clearly have not achieved the intended policy objective is the execution quality reporting regime set forth in RTS 27. Due to the extreme level of detail, the uncertain scope and one-size-fits all approach, large volumes of unhelpful data are currently being published which is of very limited use to investors, investment firms and trading venues. In the opinion of EFSA members, an upcoming MiFID2/R review should include an analysis of how the reporting requirements in RTS 27 apply to different asset classes, the need for additional clarifications regarding scope as well as a standardisation of the format of the reports. However, considering the significant investments in new technology already made by investment firms and venues in order to be compliant with the execution quality reporting regime, a rigorous consultation process needs to take place in advance of such review. EFSA members will of course be very happy to contribute to this work.

Research

Article 13 of the Commission Delegated Directive (EU) 2017/593 has modified the economic model of financial analysis for equity markets by de facto prohibiting the commonly used "bundled model". Henceforth, research has to be paid by asset management companies independent of the transactions they carried out with their brokers, at least when acting on behalf of client portfolios.

Several EFSA members testify that there is a general consensus amongst issuers, asset management companies and research providers in their jurisdiction that, given the new MiFID II rules on unbundling, the total amount paid for research has diminished and will likely continue to fall in the coming years. So will the supply of research. In particular there is a concern relating to the research coverage of SMEs, taking into account that the full negative effects of the regulation will become even more apparent in the next major economic downturn or recession.

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[10] In relation to make whole clauses, EFSA members support the statement by the ESAs that "where the mechanism to calculate the discount rate is known in advance to the retail investor, this could be considered as a separate case, which does not satisfy the criteria in Article 4(1)"

[11] https://www.esma.europa.eu/sites/default/files/library/jc-2019-64_priips_kid_supervisory_statement_bonds.pdf.

EFSA members therefore supports the proposals by the Next CMU High Level Group that the Commission does future work on the unbundling rules in MiFID 2 in the context of CMU 2.0,[12] and are happy to contribute with our experience.

The territorial application of MiFID 2/MiFIR regarding trading obligation

At a time when there is a widespread consensus that financial markets and investment firms are to be given a greater role in the financing of the EU's economy, it is crucial to ensure that regulations do not needlessly affect the competitiveness of EU investment firms. From this standpoint, the question of the territoriality of EU regulations, and superficially the costs and benefits stemming from their application to branches of EU firms in third countries, should be thoroughly considered. This includes the share trading obligation (STO), [13] the derivatives trading obligation (DTO)[14] as well as the transparency requirements in MiFIR.

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[12] https://nextcmu.eu/wp-content/uploads/2019/10/The-Next-CMU-HL_DO.pdf
[13] Article 23 MiFIR
[14] Article 28 MiFIR

About EFSA:

EFSA is a forum of European Securities Associations.

EFSA is composed of the Association for Financial Markets in Europe (AFME), the French Association of Financial Markets (AMAFI), the Spanish Asociación de Mercados Financieros (AMF), the Italian Associazione Intermediari Mercati Finanziari (ASSOSIM), the Belgian Association of Stock Exchange Members (Basem, which is part of Febelfin), the Danish Securities Dealers Association (DSDA), The German Federal Association of Securities Trading Firms (bwf), The Polish Securities Dealers Association (IDM) and the Swedish Securities Dealers Association (SSDA).

EFSA is a forum for information sharing and mutual understanding. It also helps to deliver joint messages to policy makers, regulators and supervisors on policy issues in European securities markets which benefit from a coordinated approach. EFSA complements the existing activities of the Associations. EFSA maintains active collaboration with sister associations in Europe and worldwide and is open to further partnership with similar counterparts.