Proposal to amend the Markets in Financial Instruments Regulation (MiFIR). International Bulletin, March 2022.

Within the framework of the Capital Markets Union (CMU), the European Commission (EC) intends to review certain MiFIR provisions in order to favour access to market data for investors (retail investors in particular) and foster stronger market infrastructures. It also seeks to improve the liquidity of the capital markets while at the same time encouraging their function as a funding source. To achieve this objective, three priority areas have been identified in this framework: improving transparency and availability of market data; improving the level playing-field between execution venues and ensuring that European Union (EU) market infrastructures can remain competitive at international level.In the first place, the design and application of a consolidated tape, as foreseen in the 2020 CMU Action Plan, represents the main effort aimed at offering a global view of trading throughout the EU. In relation to transparency, emphasis is placed on the objective of maintaining a balance between the existing different types of trading venues. From a competitiveness point of view, the proposal seeks to foster innovation and development in the EU's regulated markets, specifically in the area of traded derivatives, as well as to strengthen clearing capability in the EU. Consequently, on the one hand, the revision is intended to rationalise the complex transparency framework governing trading venues – regulated markets, alternative platforms (multilateral trading facilities and organised trading facilities) or systematic internalisers (SIs) – and, on the other hand, to amend the relevant provisions so as to facilitate the existence of a Consolidated Tape Provider (CTP) for four financial instruments classes (shares, exchange-traded funds -ETFs-, bonds and derivatives), in the absence of any CTP, despite its being already provided for in MiFIR.

CTP

The lack of correct and timely information on prices and available trading volumes for traded securities gives rise to the appearance of risks related to insufficient depth of market (lack of liquidity) and the inability to execute transactions at the given time period and the given price determined. In the absence of a complete picture of all available liquidity, some investors may not be in a position to execute all transactions or may only execute them in part or at a less attractive price, which is contrary to the objectives of the CMU.In this regard, this fragmentation of the existing market has a particular impact on smaller market participants, whose ability to access information on market data in multiple venues is more limited. The total estimated cost of not having an exact vision of the equity markets could amount to €10.6 billion, according to the study carried out by Market Structure Partners[1] on the creation of an EU consolidated tape . In relation to the bond markets, asset managers also recognise the cost deriving from this lack of consolidated and accurate market data. In the same way, the derivatives markets show a unique characteristic given that over-the-counter trading represents approximately 85% (in notional terms) and gives rise to reduced post-trade transparency that results in greater difficulty when setting prices and information asymmetries, which, in turn, harm smaller market participants to a greater extent. Regarding collective investment, the effect of a lower presence of funds linked to indices that channel capital towards smaller capitalisation issuers is also recognised.

After the entry into force of the MiFID/MiFIR framework, the consultation carried out on the matter by the EC in 2020 showed that most investors do not have a complete vision of the prices and volumes available and, in the absence of information on liquidity existing in alternative markets and SIs (which are of significant volume), significant obstacles to transparency are created. This scenario makes it difficult for intermediaries to ensure that investors opt for the most advantageous transactions in terms of price and costs.

In this regard, the impact assessment reviewed by the EC's Regulatory Scrutiny Board focused on the consolidation of market data and incorporated five options for its achievement, resulting in the option of a single and independent CTP for each asset class as the preferred option. Specifically, the option proposes that each CTP (of shares, ETFs, bonds and derivatives) collect data for securities by type of instrument in geographically separate venues. In turn, they would consolidate the data in a centralised data centre and then disseminate them from that central location to subscribers elsewhere. It is recognised that such a model could be less punctual/immediate, but it would guarantee greater data integration.

In addition, the same impact assessment considered three options on how to ensure fair remuneration of market data contributors, with the option of mandatory contributions with “minimum revenue targets” for market data consolidators being the favourite. Minimum revenue targets are expected to be established and reviewed by an independent operating committee, which would take into account the various uses of the consolidated tape as well as other significant parameters. Additionally, levels could be set such that retail access is at little or no cost.

In any case, the expected revenues from the CTPs are expected to significantly exceed the costs, thus building a strong revenue sharing system where CTPs and market data contributors share harmonised business interests. In this regard, ESMA will provide the EC with an evaluation of the revenue participation scheme designed for regulated markets for its provision of trading data in the context of the consolidated tape for shares, twelve months after the entry into operation of the CTP.

Obtaining basic market data on financial instruments is a costly and difficult process, which to date has resulted in no entity requesting to act as CTP. Supported by the introduction of high-quality harmonised templates and the establishment of an obligation for all contributors, ESMA is preparing to periodically organise[2] competitive selection procedures to choose a single CTP for each asset class. ESMA will adopt a decision three months after the start of the selection procedure. The proposal indicates that for shares, in the first instance, it is planned to collect post-trade transparency data and, subsequently, ESMA will assess whether there is also a demand for pre-trade data, for the EC to decide ultimately.

The EC has also provided, in the event that a CTP is not established for any class of assets one year after the entry into force of this reform, the possibility of revising the framework by introducing as a proposal that ESMA be the CTP. Finally, other responsibilities assumed by ESMA in this matter are the preparation of draft regulatory technical standards[3] on the characteristics of the public information obligation of the CTPs and on the level of accuracy to which the clocks of the trading venues, the SIs, the authorised publication agents (APAs) and the CTPs will have to be synchronised.

TRANSPARENCY

The EC’s proposed amendment pursues the objective of maintaining a balance between the different trading venues, addressing issues related to the complexity of the transparency framework and, in this sense, it is considered appropriate to make adjustments to these rules that govern trading in the venues. In line with this, ESMA had concluded in its previous transparency review reports (for equity[4] and non-equity[5]) that the current regime is complicated and not always effective in ensuring transparency for market participants, and had therefore also made specific proposals for its improvement.Likewise, although there are discrepancies regarding the evolution of the distribution of market share since the transparency framework entered into force, there is general agreement on the need to maintain a balance between trading venues that operate transparently and the other platforms, with a view to ensuring that trading in the EU is in line with the ratios observed in other international financial centres. To achieve this balance, the current proposal provides for the review of certain exemptions from the regulations, which may have played a counterproductive role in terms of transparency, as well as being rigid and introducing significant complexity, translated, in turn, into greater efforts by regulators.
As a result, the proposed revision includes seven sections with adjustments to the transparency framework related to:

- the delimitation between multilateral and bilateral systems, which moves from MiFID II to MiFIR, in order to achieve a greater degree of harmonisation to increase transparency;
- establishing a minimum trading volume threshold to apply the reference price exemption that prevents any alternative trading venue from executing small trading volumes under the reference price exemption, in line with ESMA recommendations;
- replacing the double volume cap by a single cap set at 7% of the total volume traded with said financial instrument in the EU, on transactions executed under the exemption for the use of the reference price or the exemption applicable to negotiated transactions;
- reducing and harmonising deferrals for post-trade reports of non-equity instruments intended for the public;
- reinforcing the transparency obligations applicable to SIs to increase their pre-trade obligation to quote share prices, in order to cover price quotes of transactions that have a size of up to a minimum of twice the standard size of the market;
- applying the floor of the reference price exemption for SIs without pre-trade transparency and, in line with the floor of the exemption for use of the reference price, SIs will not be allowed to match small trades at intermediate points;
- empowering ESMA to prepare draft regulatory technical standards that specify how the concept of reasonable commercial basis should be applied[6] in relation to non-discriminatory access to pre-trade and post-trade information by the public on transactions with financial instruments.

COMPETITIVENESS AND OTHER MEASURES

With the aim of promoting competition, innovation and the development of derivatives traded on regulated markets in the EU and strengthening clearing capacity, the EC proposes abolishing the open access provisions for these derivatives. By eliminating this obligation, the advantages offered by the vertical integration of trading and clearing are recognised, while it is intended to establish a framework that offers greater freedom to the members of a trading venue to clear in any clearing house.On the other hand, it is also proposed to adapt the MiFIR trading obligation to the “EMIR Refit” clearing obligation and review the provisions related to the possibility of suspending the trading obligation for certain derivatives when the suspension of the clearing obligation of those same derivatives takes place, in light of the close relationship between both obligations. Likewise, a suspension mechanism is also introduced that allows the EC to interrupt the trading obligation of entities that act as market makers with non-European Economic Area (EEA) counterparties when certain conditions are met.
Also regarding the promotion of competitiveness, the measure proposed in the area of the obligation to trade shares introduces a clarification by specifying that this only applies to shares with an EEA ISIN, for the purpose of offering greater security to market participants. In order to avoid possible ambiguities, it is planned to establish an official list of EU shares subject to said obligation, which will be periodically updated.

Among other measures included in the proposal, the prohibition of payment for order flow (PFOF) stands out, and should increase the quality of execution for retail investors, in addition to increasing pre-trade transparency. As a principle, financial intermediaries must obtain the best possible price and the highest possible likelihood of execution for trades that they execute on behalf of their clients. To this end, their activity obliges them to select the optimal trading venue or counterparty, based on the criterion of achieving the best execution for its clients. Consequently, PFOF consisting of the receipt by a financial intermediary of a payment from a trading counterparty in exchange for ensuring the execution of client trades is incompatible with this principle of best execution. The ban introduced is intended to put an end to this controversial practice and the expectation is that these orders will be sent to a pre-trade transparent market.

Finally, it is worth mentioning among the rest of the measures that, in relation to the obligations to report operations and to provide reference data on financial instruments, ESMA is expected to evaluate in the future the integration of information on transactions and rationalisation of data flows. Likewise, in this area, ESMA is empowered to prepare draft regulatory technical standards on the date by which transactions and reference data are to be reported.

[1]MSP (2020), The study on the creation of an EU consolidated tape, commissioned by the European Commission. https://op.europa.eu/en/publication-detail/-/publication/82763219-1cbe-11eb-b57e-01aa75ed71a1/language-en/format-PDF/source-169654830

[2]Initially, 3 months after the effective date of the proposal.

[3]From the entry into force of this proposal, a period of nine months is set to prepare regulatory technical standards on the characteristics of the public information obligation of CTPs and six months for regulatory technical standards on the level of precision with which the clocks of the trading venues, SIs, APAs and CTPs will have to be synchronised.

[4]MiFID II/MiFIR Review Report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares: https://www.esma.europa.eu/sites/default/files/library/esma70-156-2682_mifidii_mifir_report_on_transparency_equity_dvc_tos.pdf

[5]MiFID II/MiFIR Review Report on the transparency regime for non-equity instruments and the trading obligation for derivatives: https://www.esma.europa.eu/sites/default/files/library/esma70-156-3329_mifid_ii_mifir_review_report_on_the_transparency_regime_for_non-equity_instruments.pdf

[6]Once nine months have elapsed from the entry into force of this proposal.

Useful links:

MiFIR amendment proposal
MiFIR Amendment Proposal Impact Assessment Report Summary