July 2021

MIFID 2 Review – Market Structure: EBF priorities

- **General comments**

The European Banking Federation (EBF) is the voice of the European banking sector, uniting 32 national banking associations in the EU representing some 4.500 banks – large and small, wholesale and retail, local and international – employing about 2,1 million people.

The EBF is a true supporter of the Capital Markets Union Action Plan[1] and the ambition to further integrate capital markets in the EU. We therefore welcome a review of MiFID II/MiFIR that is aimed at facilitating issuers' and end-clients' use of EU capital markets for the purposes of their financing and risk management.

As a general comment, the EBF wants to underline that the characteristics of an effective market structure depend on a large number of factors such as:

- ✓ the features of the financial instruments (e.g. level of standardization);
- ✓ the type of trading (e.g. frequency, trade size and liquidity);
- ✓ the type of clients (e.g. retail or professional);
- ✓ the purpose of the transactions (e.g. investment or hedging).

In order to achieve the policy objectives of the CMU, it is important that the MiFID framework is calibrated in a way that accommodates end-clients' and issuers' needs on different segments of the market with an aim to keep EU capital markets attractive for end-clients and issuers alike. Maintaining or enhancing today's high levels of market liquidity and investor choice should therefore be the guiding principles for the review.

- **Multilateral trading and bilateral trading**

For a well-functioning capital market, it is very important that the regulatory framework in MiFID II/MiFIR continues to allow for a range of **both multilateral and bilateral trading models to co-exist since they serve different functions and needs.**

[1] See EBF High Level position available here

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

www.ebf.eu

In particular, the EBF wants to stress the fact that bilateral OTC trading is not interchangeable with on-venue trading. For instance, in less liquid financial instruments, where trading is infrequent and in very large sizes, an order-book trading on a venue is often not possible because there are not enough buyers and sellers active on the market. The same applies to non-standardized or bespoke instruments which are structured according to the needs of a particular client.

For these types of transactions, **many EU banks offer their clients services which consist of executing orders against their own account** – as systemic internaliser or another type of liquidity provider. When performing this type of bilateral trading, **banks fulfil a very important role on the market by bridging the gap between demand and supply of financial instruments and/or limiting the risk of market impact from large transactions.**

The EBF wants to underline that it is the needs of the real economy – meaning clients (retail and wholesale, e.g. pension funds or asset managers) and issuers - that matter. If **amendments to MiFID II/MiFIR restrict the ability of EU banks to take on risk by trading on own account, this would be to the detriment of end-clients.** It should be noted that if clients cannot get the services they need from EU banks there is a significant risk that best execution rules may force them to move their business outside the union.

- **Transparency for Equity**

The EBF is concerned about the **quality of the data used to analyse the effects of the transparency regime for equity in MiFID II/MiFIR**. To our understanding, some reported transactions that are flagged as over-the-counter (OTC) and systematic internaliser (SI) trades are in fact technical transactions (such as collateral transfers, give-ups and give-ins) and inter-affiliate trades undertaken for operational purposes.[2] As a result, **the data gives the impression that the market share of SIs in EU is larger than it de facto is**. The EBF is worried about which impact this will have on forthcoming policy decisions and legislative proposals and urges the Commission and the co-legislators to take a cautious approach when analysing the data.

It has been proposed as one measure to increase transparency for equity **to remove SIs as eligible execution venue for the Share Trading Obligation (STO) or to limit the scope of SIs to only deal above Large-In-Scale (LIS)**. The EBF strongly objects to these proposals which would de facto re-introduce a concentration rule in the EU. In our view **SI's are important sources of liquidity and as such valuable execution alternatives for end-clients.** In fact, if MiFID II/MiFIR review results in limitations to SIs, then the Share Trading Obligation (STO) and Double Volume Cap should be deleted.

According to the EBF, issues that are identified in relation to the level of transparency on the EU equity market, if any, should be tackled by reviewing the transparency regime in MiFIR and not by restricting end-clients' access to different types of execution venues such as SIs[3].

Against this backdrop, from a post-trade transparency perspective, **the "seller reports"** rule has clearly created a number of unintended consequences that have led to duplicate reporting or investment firms' inability to ascertain whether a trade is required to be reported by themselves or another counterparty in the trade chain. For example, this has

[2] https://www.oxera.com/insights/reports/the-landscape-for-european-equity-trading-and-liquidity/

[3] In ESMA70-156-2682 ESMA generally agrees that SIs remain an important source of liquidity (para 243). ESMA adds that there is the question about whether trading with SIs in shares should be further limited and only permitted for trades above LIS – but we do not read this calling for the abolishment of SIs altogether.

led to many firms opting to become an SI just to satisfy the client reporting obligations, which directly impacts how much "true" SI activity in the marketplace there is. The EBF proposes that as a solution to this problem, the rule from MiFID I should be re-introduced in the framework which allow parties to agree between themselves on who should be the reporting party. Moreover, we consider that the accuracy and granularity of flagging in post-trade reports should be improved, through suppression of double reporting, addressing the divergence of interpretation, and providing for explicit categorization of technical transactions which do not indicate a trading interest so these can be excluded. To protect firms from undue risk when taking significant risk positions (multiple times LIS levels) through provision of liquidity, longer transparency deferrals should also be provided, with full waivers in the case of most significant size trades.

Finally, in EBF's view, the **double volume cap system (DVC) needs to be revised in particular in consideration of Brexit**. As highlighted by ESMA[4], the DVC has introduced a level of complexity into the EU regulatory framework, which in EBF's view, is unnecessary and reduces flexibility of execution options in EU markets. With no other jurisdiction implementing similar limitations, we would urge EU policymakers to remove the DVC, in particular the 4% cap at exchanges. Failing a full deletion, the EBF would welcome lowering the overall cap from 8% to 7%. At a minimum, it is vital that if DVC is kept that no further restrictions are introduced, for instance minimum order size.

- **Transparency for bonds and derivatives**

In the context of a MiFID Review, it is important to recognize that there are **fundamental differences between the equity market and the bond and the derivatives markets. These differences are rooted in the specifics of each asset class and are also based on the needs of issuers (often governments and corporates) and end-investors**. Most importantly, trading on the bond market is less frequent and in larger sizes than on the equity market which makes it crucial for end-clients to have access to banks that are willing to execute transactions against their own account, i.e. as SIs or other liquidity provider. The transparency information on the bond market is therefore by nature intermittent.

For the purposes of a well-functioning market, the EBF supports a deferral regime that is calibrated and includes a real-time publication (5 or 15 minutes) for liquid instruments and for trades below the SSTI. **However, for illiquid instruments and trades above the SSTI, we recommend keeping the T+2 delay for publication of price and the 4-week supplementary deferrals for volumes.** This is important in order to give enough time to banks acting as SIs/other liquidity providers to hedge their risks or unwind their positions. A calibrated deferral regime for illiquid instruments and large transactions allows SIs/liquidity providers to provide good prices and services to end-clients and ensure market liquidity under all conditions.

The EBF **opposes the proposal by ESMA in its Final report[5] to remove the SSTI threshold and replace it with an "adjusted LIS".** The SSTI threshold was introduced by the co-legislators as a recognition of the fact that liquidity providers/SIs unlike trading venues take risk when trading on own account and therefore need to be protected from adverse market reactions when trading in large sizes, in particular since the quoting is not anonymous. If the SSTI threshold was to be removed from MiFIR and replaced by a pre trade "adjusted LIS" such "adjusted LIS" would therefore have to be set a level to ensure that liquidity providers do not withdraw from the market. If the ambition is to make the

[4] ESMA 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, July 2020
[5] See ESMA review report on transparency regime for non-equity instruments

regime less complex, an alternative approach would be to carry out further analysis as regards amending the pre-trade SSTI into a fixed level rather than a variable level.

- **Scope of Post-Trade Transparency and Transaction Reporting for derivatives**

The EBF opposes the proposals by ESMA relating to extending the Trading on a Trading Venue concept (TOTV) to all derivatives. We consider that this amendment will not only lead to over reporting but also to creating undue risks for liquidity providers when hedging their positions, consequently reducing market liquidity for end-clients.

- **Cost for market data**

The EBF notes that the market data costs have risen considerably since 2007. This is due to a market structure whereby investment firms and banks are compelled to purchase data from trading venues, but there is no competition as to from where the data can be bought due to the uniqueness of data obtained by the venues.

Trading venues are currently subject to a "transparency/cost plus" model, which is intended to moderate the venues' monopolistic advantage, but the evidence indicates that this is not currently working. The significant increase in market data costs creates a barrier to entry for firms and raises costs throughout the system.

The EBF would therefore request that the Level II "transparency/cost plus" model is re-considered to ensure it is sufficiently robust that it can be effectively enforced on venues such as to alleviate the monopolistic advantages.

The EBF generally supports both ESMA's recently proposed Guidelines[6] and ESMA's final report on market data[7] to enhance NCAs' supervision of execution venues' charging practices of market data. We believe that these proposals will ensure that market practices are fully aligned with MiFID expectations and hopefully this would help curbing market data costs' increase.[8] However, we note that ESMA has deferred application until 01 January 2022, but that said, the onus will be on venues to react and NCAs to vigorously supervise to ensure benefits are realized as soon as possible. We would also like to highlight the need for further clarity regarding the guidelines on some aspects in order to avoid any discrepancy of interpretation.

- **Consolidated Tape (CT)**

The EBF agrees that a properly constructed Consolidated Tape (CT) could bring benefits to the EU capital markets such as consolidated information and increased transparency. At present there are however divergent views amongst EBF members as regards features and scope of the CT as well as the link with market data costs. Once the Commission has put forward a proposal, the EBF looks forward to continuing the dialogue and provide more detailed comments.

---

[6] See ESMA Final report on MIFID II obligations on market data

[7] ESMA report on prices for market data and ESMA final report MIFID II obligations on market data, see points 58 to 65, pages 26 and 27

[8] Increase of cost of market data as been recognised by ESMA, see ESMA final report on market data, point 2, page 10

- **Derivatives Trading Obligation**

The EBF is concerned with some unanticipated consequences for market participants should we consider the MIFID/MIFIR framework- or parts of it - extraterritorial, and applicable to non-EU branches of EU market participants. This is the case for example for the EU Derivative Trading Obligation (DTO), applicable to UK branches of EU firms while at the same time the UK DTO is also applicable to the trading on instruments subject to both DTO rules through the UK branch, and leading to further market fragmentation.

- **Potential impact of investor rules on market structure**

The EBF would like to take the opportunity to remind of the potential impact that investor protection rules have on both the structure and attractiveness of EU capital markets.

As regards the best execution reporting requirements, the EBF welcomed the temporary relief from the RTS 27 requirements. We agree with the Commission that investors essentially do not consume these reports, demonstrated by a very low number of downloads. Hence, we must assume that investors cannot or do not make any meaningful comparisons between firms on the basis of RTS 28 data. In fact, in a forthcoming review we propose that both the **RTS 27 and RTS 28 reports are deleted** from the MiFID framework.

Finally, we understand that there have been some supervisory concerns regarding the "**payment for order flow**" practice. We would like to underline that financial intermediaries are subject to strict conflict of interest rules and inducement rules. Those payments are used to enhance the quality of financial services and are reported to clients. This market practice should not be considered as an impediment to compliance with these rules.

*****

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

www.ebf.eu @EBFeu

For more information contact:

Pauline Guérin
Senior Policy Advisor
p.guerin@ebf.eu
+32 2 508 37 32