REGULATORY UPDATE - ZAGREB APRIL 2020
Policy note drafted by the Eurofi Secretariat

Enhancing transparency in EU securities markets

1. Assessments underway regarding MiFID II / MiFIR transparency measures

Improving the transparency of equity and non-equity markets is one of the key objectives of MiFID II / MiFIR. Transparency is considered as a key driver of the efficiency and integrity of equity and non-equity markets and also of its resilience in times of stress, in a context where the number of venues and venue types has significantly increased in the EU. Appropriate trading data supports price formation processes, which are essential for informing investor decisions and allowing an efficient allocation of assets. Transparency also helps to narrow bid-ask spreads and enhances liquidity. Furthermore, appropriate post-trade market data is essential for market participants to comply with MiFID II provisions such as best execution.

MiFID II and MiFIR mandate that ESMA should submit a report on the impact of the transparency obligations put in place since 2018, as an input to the upcoming review of these legislations by the European Commission (EC). ESMA is currently leading several consultations, aiming to assess how transparency has evolved in EU securities and derivative markets and whether MiFID II / MiFIR provisions need adjusting or completing. The implications of Brexit in this area also need to be considered, since many of the requirements and thresholds in the current framework (including the double volume cap[1] (DVC) or requirements applying to systematic internalisers[2] (SIs)) were calibrated to include UK data. ESMA's objective is to send final recommendations to the Commission in Q3 2020. One general improvement that has been observed, is that MiFID II / MiFIR have enabled to improve the data at the disposal of the public authorities to monitor market developments.

Regarding equity instruments and other related instruments such as ETFs, ESMA published in December 2019 a report on the development in prices for pre- and post-trade data and on the objective of setting up a consolidated tape for equity and launched a consultation in January 2020 on MiFID II / MiFIR transparency measures for equity and equity-like instruments[3]. For non-equity instruments a first consultation was launched in January 2020 on SIs (systematic internalisers) in non-equity instruments[4]. A second consultation paper on the transparency regime for non-equity instruments and the trading obligation for derivatives was also published in March 2020[5]. In these consultation papers ESMA assesses the impacts of MiFID II / MiFIR so far in terms of transparency and proposes a certain number of recalibrations or amendments to the existing requirements.

2. Equity and equity-like instruments: issues under review and proposals

2.1. Transparency regime of equity instruments

MiFIR mandates ESMA to submit a report on the impact of the newly established pre-trade transparency obligations and waivers of MiFIR and in particular the double volume cap[6] (DVC) for equities and equity-like instruments. ESMA has decided to broaden the assessment and include other key transparency provisions such as the share trading obligation and the transparency provisions applicable to SIs. The objective of the review is indeed to simplify the current complex trade reporting regime while trying to improve the overall trade transparency available to market participants. Initial assessments generally show that MiFIR requirements are complex and have not yet achieved their objectives.

ESMA's data analysis since 2018 has revealed that a significant margin for improvement remains in many areas:

- There has not been a significant change in the share of trading volume executed OTC for equity and equity-like instruments, which still represents around 1/3 of the overall volume
- A majority of trading is not subject to pre-trade transparency (between 50 and 70% of trading in turnover). This includes on-venue execution for which a large share of the total turnover is traded under pre-trade transparency waivers (approximately 30% of turnover for shares and 50% for ETFs[7])
- The use of waivers from pre-trade transparency has changed due to the application of the double volume cap (DVC), which limits the amount of trading under the reference price (RP) and negotiated transaction (NT) waivers[8], resulting in a significant increase in the percentage of trading under the LIS waiver (+56%)[9].

[1] The purpose of the DVC is to ensure that the use of certain waivers does not unduly harm price formation by limiting the trading under the RP waiver and the NT waiver for liquid instruments. In particular, Article 5 of MiFIR provides that the trading volume under the waivers against the total volume traded on EU trading venues over the last 12 months for a specific instrument should not be higher than 4% at the level of a single trading venue, or higher than 8% for all the venues combined. In such cases NCAs have to suspend the use of the authorised waivers for the relevant instruments for a period of 6 months.

[2] SIs, as defined in MiFID II, are investment firms which on an organised, frequent, systematic and substantial basis, deal on own account when executing client orders outside a trading venue (i.e. a regulated market, a multilateral trading facility or an organised trading facility) without operating a multilateral system. In other words, a SI is an investment firm which is a counterparty dealing with its proprietary capital and is not a trading venue.

[3] With a deadline for feedback postponed to 14 April 2020.

[4] Weadline for feedback14 April.

[5] With a deadline for feedback postponed to 14 June 2020.

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[7] See Eurofi Views Magazine article – V. Ross "Less complexity, more transparency" – April 2020.

[8] The reference price (RP) waiver: for systems that match orders based on a trading methodology by which the price of the financial instrument referred is derived from the trading venue where that financial instrument was first admitted to trading or the most relevant market in terms of liquidity. Negotiated transactions (NT) are made within the current volume weighted spread reflected on the order book or the quotes of the market makers of the trading venue operating that system (liquid equity instruments); dealt within a percentage of a suitable reference price (illiquid equity instruments); or, subject to conditions other than the current market price of that financial instrument.

[9] The LIS waiver is for orders that are large in scale compared with normal market size and aims to protect investors from market impact.

ESMA proposes to reduce the complexity of the regime and further clarify it:

- The DVC mechanism – if maintained, ESMA is proposing to simplify the DVC regime, using a single cap (e.g. eliminating the 4% threshold concerning the use of waivers at a single trading venue) and the applicable liquidity tests and also to apply DVC in a wider and stricter way to further curb dark trading (e.g. applying thresholds even if there is not a period of 12 months of available data);
- Pre-trade transparency and waivers – to address the ongoing high volume of dark trading ESMA proposes to either reduce the number of waivers available to market participants (suppressing the RP and NT waivers) or to make the use of waivers, notably the RP waiver, subject to stricter requirements in terms of size (on the grounds that there seems to be little justification for trading small orders via reference price facilities and there may be scope for increasing the LIS threshold);
- The trading obligation for shares – ESMA is proposing to clarify the scope of the trading obligation specifically in relation to third-country shares (i.e. those for which the main pool of liquidity is located outside the EU), given the current challenges in this area (i.e. the low liquidity of these shares on EU exchanges, the overlap with equivalent trading obligations applicable in third countries and the difficulty of implementing an equivalence regime in this area).

2.2. Prices of pre-and post-trade transparency data for equity and equity-like instruments

MiFID II / MiFIR provide obligations to make pre and post-trade data available separately, on a reasonable commercial basis (RCB)[10], to ensure non-discriminatory access to that data and to make it available free of charge 15 minutes after publication and also an obligation for systematic internalisers (SI) to make quotes public to other market participants on a RCB.

Following a consultation led during the second semester of 2019 notably on the variation of data prices, ESMA considered that the input provided by market participants shows that MiFID II has so far not delivered on its objective to reduce the price of market data. In their replies to the ESMA consultation, data users generally considered that market data prices have on the contrary increased significantly since the application of MiFID II / MiFIR, albeit with some variations across trading venues, based on observations of costs paid by individual companies. These increases concern notably the price of data for non-display usage or data used by SIs and are also due to the introduction of fees for some services that were previously provided free of charge. Data providers such as trading venues and approved publication arrangements[11] (APA) disagreed with these observations, arguing that the overall prices of market data have been stable since the application of MiFID II / MiFIR. According to them, while the price of some services has increased (e.g. data for non-display usage), others have gone down and the application of disaggregated prices means that users can select the data they purchase.

A second question was whether market data is provided on a reasonable commercial basis (RCB). When considering how RCB could be enforced, ESMA advised on choosing a "transparency-plus" approach aiming to enhance the public transparency of the policies related to pricing and market data[12], rather than other possible systems such as imposing a revenue share limitation or applying a cost-plus methodology. Evidence gathered during the consultation showed that while trade information is generally made available with respect to the RCB provisions, data users feel that there are significant shortcomings regarding the quality, comparability and usability of the information provided and the current RCB information provided does not enable users to understand how data prices are set or to compare the information provided. This has led ESMA to propose measures to improve the current "transparency-plus" approach: development of standards to further specify RCB requirements[13], move to Level 1 of the requirement that market data should be provided on the basis of costs[14] and additional requirements for venues and APAs to share information on the actual costs for producing and disseminating market data. These assessments and proposals were however not supported by regulated markets who consider that much progress has been made towards delivering good quality information and that further significant clarifications are not needed.

A third issue covered during the ESMA consultation was the MiFIR provision on data disaggregation aiming at ensuring that users only pay for data they are interested in, rather than being forced to buy bundled data. So far only limited demand has appeared for data disaggregation, which has not contributed to reducing the cost of market data so far, according to the feedback generally received. ESMA however considered that further guidance on the provision of market data on an RCB basis combined with a stronger focus on the enforcement of data disaggregation requirements should address these concerns.

Finally the ESMA consultation noted some improvements in terms of access to data regarding the MiFID II / MiFIR objective of making data available free of charge 15 minutes after publication by the trading venues and APAs. However, data users complain that data is often not provided in a user-friendly way or in a machine-readable format and also that accessing it may require agreeing to restrictive terms of use. Trading venues and APAs for their part disagree with the requirement to provide data free of charge to all users, notably commercial users who may be competing with the business of venues. At this stage ESMA recommended clarifying in legislation the obligation for trading venues to provide market data in easily accessible and usable formats in order to remove any doubt about this requirement.

2.3. Implementation of an EU wide consolidated tape for equity and equity-like instruments

MiFID II sets out the regulatory framework for DRSPs (Data Reporting Service Providers), which include APAs (Approved Publication Arrangements) and CTPs (Consolidated Tape Providers). CTPs are entities authorized to collect post-trade

[10] The RCB concept requires that prices for market data should be fair and non-discriminatory i.e. prices should be based on costs of producing and disseminating data including a "reasonable" margin and should be charged according to the use made by the individual end-user, data should be offered on a non-discriminatory basis to all clients and should be available without being bundled with other services.

[11] Approved Publication Arrangements (APAs) are entities created by MiFID II / MiFIR responsible for publishing details of executed trades to the market on behalf of firms as close to real time as possible, on a reasonable commercial basis. The data should be made available free of charge 15 minutes after publication. APAs must disseminate information in a manner that ensures fast market-wide access on a non-discriminatory basis. They must also check a firm's trade messages for accuracy and completeness (requesting the resubmission of any identified erroneous messages).

[12] The objective of this solution is to provide more information on the pricing of market data, which should enable data users and supervisors to effectively compare the offerings, spot best practices as well as monitor compliance.

[13] Standardised publication format to be used by all providers, standardization of the key terminology used.

[14] And delete articles allowing trading venues and APAs to charge for market data proportionate to the value it represents to users.

reports for equity and non-equity financial instruments and consolidate them in a continuous electronic live data stream (the CT) providing price and volume data per financial instrument. The objective of a CT is to contribute to remedying the fragmentation of markets by providing a reliable view of liquidity and trading data across the EU; support the creation of a single market for equity trading; ensure the provision of real-time data at a fair cost and help to establish a level playing field among users of data; and supplement best execution policies notably for retail investors.

While MiFID II defines the requirements applicable to CTPs, potentially established on a commercial and voluntary basis, it does not mandate the establishment of a CT in the EU and does not oblige trading venues and APAs to submit transaction data to a CTP for consolidation, as is the case in the US. MiFID II nevertheless indicates that a CT for equity and equity-like instruments may be appointed through a public procurement process if the initial commercial solution does not lead to an effective and comprehensive CT. Nearly two years following the application of MiFID II a CTP for equities is yet to emerge. While post-trade information is available from trading venues and APAs and also offered by data vendors, there is currently no data source consolidating 100% of the market.

The main obstacles to the implementation of a CT identified by ESMA are: the limited commercial rewards for operating an equity CT; strict regulatory requirements for providing an equity CT; competition by non-regulated entities such as data vendors ; and the lack of sufficient data quality in particular for OTC and SI-transactions. In their input to the consultation some market stakeholders also highlighted significant shortcomings associated with a CT (such as the negative cost/benefit of setting up a CT, the lack of funding of the project) and pre-requisites (e.g. improvement of the quality and consistency of data notably for non-trading venues such as SIs and OTC). The difficulty and cost of implementing a real-time CT was also stressed due to the challenge of consolidating data feeds provided by about 170 trading venues in the EU.

Following the consultation, ESMA nevertheless recommended the implementation of a real-time CT for equity instruments, while recognizing that this would be a complex and long process that may take at least 5 years to go live. Several key factors of success to the implementation of a CT were identified, as well as conditions including a further specification of requirements that would require Level 1 amendments and Level 2 measures in most cases, in addition to supervisory guidance (e.g. concerning the area of data quality):

- A high level of data quality;
- Mandatory contribution of post-trade data to the CT by trading venues and APAs free of charge;
- Contribution of the users to funding of the CT e.g. via mandatory consumption and possibly with a proportionate fee key depending on the extent of consumption;
- Full coverage with a CT consolidating 100% of transactions across all equity and equity-like instruments, except in certain pre-specified conditions;
- Publication in real-time;
- Operation of the CT on a exclusive basis providing the most cost efficient solution. ESMA recommended the appointment of the provider for 5 to 7 years following a structured and fully competitive appointment process;
- Strong governance framework in order to ensure the neutrality of the CTP, a high level of transparency and accountability and provisions ensuring the continuity of service.

In addition some stakeholders have questioned the scope of the CT: whether it should include pre-trade as well as post-trade data[15] and whether the project of developing a CT for non-equities (and notably bonds) should be conducted in parallel with the equity CT, rather than sequentially, given that it may not be suitable to use the equity CT as a template for a bond or derivative CT[16]. MiFID II indeed provides an additional 21 month delay for the implementation of a non-equity CT, recognizing the greater difficulty of establishing it. The parallel is often made with the US also, where post-trade consolidated tapes exist in each of the corporate bond, municipal bond, mortgage-backed securities, and OTC derivatives markets. These CTs are each comprehensive, require mandatory contribution, disseminate information immediately upon receipt (both freely to the public via websites and via real-time data feeds at a reasonable cost), and feature targeted and limited deferral regimes for larger size block trades.

2.4. Review of the SI regime for equities and equity-like instruments

ESMA is also consulting on the review of the SI regime for equities. The objective of this review is to address concerns about the SI regime and perceived lower transparency requirements compared to other venues.

The number of SIs and their share of equity trading has significantly grown since the implementation of MiFID II / MiFIR with above 70 SIs operating in the EU and a share of turnover between 20 and 25%. ESMA's assessments show that most of SI trading is not subject to pre-trade transparency requirements for two main reasons: the absence of requirements for illiquid instruments (which represent the vast majority of shares[17]) and transparency requirements only apply to transactions below the standard market size (SMS), which is equal to 10,000€ for most shares[18]. ESMA proposes an increase of minimum quoting obligations related to SMS subject to pre-trade transparency, a revised methodology for determining quoting sizes and/or an extension of the SI obligations to illiquid instruments.

3. Non-equities: issues under review and proposals

In response to the financial crisis and the weaknesses identified regarding the provision of information on non-equity transactions and positions to market participants, MiFIR and MiFID II introduced a pre-trade and a post-trade trade transparency regime for non-equity instruments (bonds, structured finance products, emission allowances and derivatives). MiFiD II /MiFIR also introduced a new trading venue category of OTFs (Organised Trading Facilities), that complements regulated markets and Multilateral Trading Facilities (MTFs) for non-equity trading with the purpose of having more non-equity trading taking place on trading venues and therefore being subject to pre-trade transparency.

In line with MiFIR review requirements, ESMA has undertaken a technical review of the effects of the MiFIR transparency regime for non-equity instruments since January 2018 with the aim of (i) assessing whether the provisions have delivered on their objectives and (ii) where possible, proposing legislative amendments to ensure a more effective application of the rules while simplifying a regime that has proved to be rather complex to apply and supervise in practice.

According to ESMA, these assessments show that generally the level of pre and post-trade transparency for non-equity transactions remains limited, which means that one of the main objectives of MiFIR following the G20 commitments is not yet fulfilled. This is due in part to market structures but also to the way the MiFIR transparency provisions are designed, which results in the exemption

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[15] Some have pointed out that pre- and post-trade data may correspond to different needs i.e. trading information for the former and mainly compliance on best execution for the latter

[16] While equity and bond markets share a few challenges such as the fragmentation of infrastructure and an unlevel playing field in the access to data, the bond and equity market ecosystems are largely different. The drivers of a CT in these markets also differ due to differing market structures (e.g. the presence of equity exchanges). A CT for equities addresses speed and the prevention of arbitrage opportunities, while in fixed income a CT would provide transparency and an overview of the market. Source ICMA Quarterly review – October 2019.

through waivers and deferrals of many OTC derivatives from the MiFIR transparency and transaction reporting requirements.

3.1. Pre-trade transparency of non-equity transactions

According to ESMA's assessments, the overall level of pre-trade transparency appears to be limited due to the high share of financial instruments benefitting from a waiver, in particular the illiquidity (ILQ) waiver[19], which means that real time transparency is the exception rather than the norm. While most waiver notifications received by ESMA were for large in scale (LIS) waivers, more than 75% of the notional trading volume concluded under a waiver benefitted from an illiquidity waiver. In addition, there is a high proportion of transactions concluded OTC or on SIs (in particular in terms of notional amount, close to 30%). However the situation varies across asset classes. For commodity derivatives or interest rate derivatives for example, a significant amount of trading is executed on trading venues, whereas for other asset classes such as bonds and credit derivatives, the trading activity on trading venues is limited.

In terms of possible improvements, ESMA mentions several options in its consultation paper that need to be further assessed. One is deleting the SSTI (size specific to the financial instrument) waiver, which is only marginally used (6% of waiver requests) and lowering the pre-trade LIS threshold in order to simplify the pre-trade transparency regime. A second option is clarifying the use of the hedging exemption, mainly used for commodity derivatives. A third proposal relates to the calibration of pre-trading requirements applying to different types of trading venues. A fourth improvement area concerns the quality, consistency and completeness of the pre-trade transparency information published, which varies significantly across venues and the availability of real-time data on an RCB basis which is not always ensured.

3.2. Post-trade transparency of non-equity transactions

The overall level of real-time post-trade transparency also appears to be very limited according to ESMA[20], due in particular to the available deferral options used notably for bonds and illiquid instruments and also the complexity of the deferral regime that is subject to national discretion. ESMA's assessments show that an excessive amount of transactions benefit from waivers and the 4-week deferral period from public reporting which is relatively frequently used[21] means that the information provided is of very limited use. The reporting environment is also very fragmented and complex with more than 279 trading venues and APAs operating in the EU, which hinders the emergence of a consolidated tape provider (CTP) for non-equity transactions, due to the high cost of implementation with different rules and post-trade transparency regimes across the EU. Moreover some market participants stress that in many cases post-trade transparency data is not published free of charge 15 minutes after, as is required.

ESMA therefore proposes in its consultation paper that more real-time post-trade transparency should be made available to enhance competition among market participants, reduce asymmetries of information and deliver high quality information to market users. A first option would be to simplify waivers, deleting the SSTI concept for the deferral regime (as for pre-trade requirements) and lowering the post-trade LIS threshold, possibly to different levels depending on the asset class. This would leave two main waivers for real-time publication: LIS and illiquid instruments. In addition, ESMA proposes to create one single regime for post-trade deferrals across the EU, removing the current discretionary regime, in order to avoid the current patchwork of rules. This new regime would require that for transactions benefitting from the LIS or the illiquidity waiver, post-trade information would be published as close to real time as possible but with the volume being masked.

In order to increase the transparency of OTC derivative transactions, ESMA is also assessing how transparency requirements may apply to derivative contracts traded OTC but that share many characteristics with those traded on trading venues such as MTFs or OTFs, either using a broader approach to the present concept of TOTV[22] (traded on a trading venue, which currently means that MiFIR transparency requirements apply to instruments that are traded on-venue), or abandoning the concept of TOTV, which would mean that any OTC-derivative would be subject to post-trade transparency and transaction reporting, whether executed on-venue or OTC. This second option would be closer to the situation in the US where real-time reporting and public dissemination requirements apply to all publicly reportable swap transactions (interest rate, credit, equity, foreign exchange, and other commodity), including swaps executed on-venue as well as OTC. Finally ESMA proposes removing the possibility for a National Competent Authority (NCA) to temporarily suspend transparency obligations where the liquidity of a class of financial instruments falls below a certain threshold, which has never been used so far, or alternatively to put in place a mechanism whereby the suspension would apply across the EU temporarily, if a threshold is met.

3.3. Monitoring of the application of pre-trade transparency obligations to SIs for non-equities

SIs are subject to the obligation to make firm quotes public under certain conditions for equity and non-equity instruments. While for equity instruments this obligation is specified in MiFIR delegated acts, there are no equivalent Level 2 measures for non-equity instruments. ESMA and the NCAs are however responsible for monitoring the application of these pre-trade transparency obligations[23]. The focus of the monitoring is on the sizes at which quotes are made available to clients of an investment firm and to other market participants relative to other trading activity of the firm, and the degree to which the quotes reflect prevailing market conditions. Based on this monitoring, ESMA is due to submit a report to the European Commission by July 2020.

In its preliminary recommendations, ESMA proposes several measures aiming to improve the effectiveness of SI requirements and their consistent application. These include simplifying certain requirements for SI quotes in liquid and illiquid instruments, clarifying the definition of exceptional market circumstances under which SIs may withdraw quotes and further specifying the content and format of pre-trade transparency information that should be made public. ●

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[17] The latest transparency calculations resulted in just over 1,500 liquid shares in the EU and over 20,000 illiquid instruments

[18] MiFIR requires SIs to comply with pre-trade transparency requirements when dealing in sizes up to the SMS and to make public quotes for sizes of at least 10% of the SMS for equity instruments for which they are SIs. Statistics gathered by ESMA show that 70% of shares have a SMS equal to 10,000€.

[19] The non-equity transparency regime allows Competent Authorities to waive the obligation for trading venues to make pre-trade information public in certain instances including: Illiquidity (instruments which are not deemed to have a liquid market by ESMA); LIS (orders that are large in scale compared with normal market size); SSTI (actionable indications of interest in request-for-quote and voice trading systems that are above a size specific to the financial instrument, which would expose liquidity providers to undue risk and takes into account whether the relevant market participants are retail or wholesale investors); OMF (orders in an orders management facility of a trading venue pending disclosure as per MiFIR Article 9(1a), such as iceberg orders); Package orders (specific orders that meet certain conditions).

[20] It is estimated that approximately only 5% of off-venue trading activity in OTC derivatives is currently subject to post-trade transparency requirements.

[21] This is mainly due to inaccurate liquidity assessments or excessively low size thresholds for trade deferrals – see article by S. Berger, Citadel in Eurofi Views Magazine – April 2020.

[22] The concept of 'traded on a trading venue (TOTV) applies to a number of provisions in MiFID II and MiFIR, and in particular the pre- and post-trade transparency requirements for trading venues and investment firms (including SIs) trading OTC, the obligations to report transaction data and the requirement to submit reference data. MiFIR does not provide for a definition of TOTV.

[23] MiFIR SI pre-trade transparency requirements for non-equities differ substantially from those to be met by SIs in respect of equity instruments. investment firms have to make public firm quotes in respect of non-equity instruments traded on a trading venue for which they are SIs and for which there is a liquid market when they are prompted for a quote by the client of the systematic internaliser; and they agree to provide a quote. When the non-equity instrument does not have a liquid market, SIs are required to disclose quotes to their clients on request if they agree to provide a quote, unless the SI can benefit from a waiver for this obligation.