EU CONSOLIDATED TAPE: MAIN CHARACTERISTICS AND IMPLEMENTATION MODALITIES

1. Objectives and potential benefits of the EU Consolidated Tape (CT)

The Chair stated that while the emergence of consolidated tapes (CT) was one of the expectations of MiFID II, none have emerged so far. The MiFID II review is a timely opportunity to revisit this issue. The potential usefulness of the CT now seems to be a given. The issues remaining to be discussed are more of an operational nature, concerning the content of the CT, the instruments to be covered, the type of information to be provided and the timetable of implementation. There are also questions around the institutional setting of the CT and the type of business model and governance needed for an efficient and useful CT.

Several panellists emphasized the benefits that a CT could provide in terms of data transparency and consolidation and the potential impacts on the effectiveness of EU capital markets. The role that a CT could play in supporting best execution was also stressed by certain panellists.

An industry representative noted that the objective of setting up a CT is closely linked to the Capital Markets Union (CMU) initiative, for which a liquid and transparent capital market is vital. Financial markets in Europe are still not as accessible with respect to price transparency as, for example, the US. A CT would support the CMU by offering better price transparency, which should in turn facilitate the improvement of capital market allocations. Market participants, investors and issuers want to have a timely view on how assets are priced and where assets are traded and the CT should help to improve this information, which currently is not optimal in Europe.

A second industry representative suggested that timely access to comprehensive data about market activity, specifically the price and size of trades in equities, bonds and derivatives, is critical to healthy markets, helping to lower the cost of capital both for the public and private sectors. Such information empowers investors, both large and small, to accurately assess execution quality and facilitates the achievement of best execution. This information also removes information asymmetries, allowing all liquidity providers to better manage risk and, in turn, more confidently quote prices, commit capital and warehouse risk across all market conditions. Transparency also makes markets more resilient, especially in times of stress, by ensuring that new information is efficiently assimilated and reflected in current price levels. Finally a European CT would help to further integrate EU capital markets in line with CMU objectives.

A third industry representative emphasized that a CT would support fair and efficient capital markets in different ways including by lowering data costs. Little has changed in terms of data transparency since the first MiFID II discussions in 2014 and there are possible failings, particularly in the pre-trade transparency of the fixed income markets, which need to be fixed. Very sophisticated and large entities will always go to the most comprehensive data source for their modelling and will pay the money for it, but many smaller players in the marketplace cannot afford that. There needs to be a price point at which people can come in and participate in this CT data. A CT also has broader implications in terms of research and innovation, since access to a wider set of data will support innovation in the European capital markets. Democratising data via a CT therefore has potential benefits beyond the current market participants.

A regulator observed that momentum is building around the CT initiative and it is now time to move forward with it, because it is a key part of the CMU. The speaker's institution is supportive of the priority put on the CT within the MiFID II review by the European Commission and it is working on different proofs of concept to help accelerate the implementation of a CT. The absence of a consolidated, standardised and reliable overview of transactions executed on EU financial markets is a major obstacle to the development of EU capital markets and needs to be addressed. Price and market information also need to be more integrated in Europe and price discovery has to be facilitated with the availability of EU-wide reference prices across different asset classes.

A regulator considered that the CT is primarily about the data consolidation, which is essential to facilitate the meeting of supply and demand. There is a great deal of fragmentation of trades in Europe, so a CT should be useful, although it is not a silver bullet for the CMU. According to ESMA, there are 400 trading venues in the EU27 and 200 systematic internalisers (SIs) and Brexit is bringing further fragmentation, therefore data consolidation is essential. Concerning best execution, the regulator noted that while a CT can be useful for best execution as a reference it is not sufficient to achieve best execution.

A public representative considered that the CT has many potential benefits. It can be a useful supervisory tool for ESMA and the national competent authorities (NCAs) to acquire the full picture of what goes on in the market at the cross-border level, which is not possible at present. All market participants should also be able to have access to a high-quality data stream provided on a reasonable cost basis thanks to the CT. That will be particularly beneficial for smaller market participants. Having a full picture of transactions should also enhance the price formation mechanism, particularly in markets where much trading happens off-exchange, which is quite widespread in the EU. The key precondition for these benefits to be possible is however that market participants contribute to the CT and that the data being consolidated is of the highest quality.

An industry representative explained that fixed income instruments are much more numerous than equity instruments and often trade with significant gaps between each transaction for a given instrument, so order book protocols used for equities are simply not sustainable for bonds because there are not enough concurrent bids and offers. In the absence of frequent transactions and the visibility of pricing afforded by order book execution, the fixed income market routinely employs pre-trade predictive models and post-trade review models. CT data would be of immense benefit for optimizing these models in the fixed-income space, thus improving price formation and best execution. In addition, although a CT will not replace exchange data, it is likely to reduce market data costs.

Another industry representative however considered that there is a broader issue of market structure and transparency that needs to be dealt with before embarking on the CT project. Generally speaking MiFID's transparency objective has failed especially on the equity side where there is a proliferation of trading venues and dark trading and the reliability of reference prices has worsened with MiFID. While some observers emphasize the level of competition that has been achieved in the market with MiFID, the reality is that the EU's capital markets are significantly behind the curve across all proxies. The EU had 7% of all initial public offerings (IPOs) globally last year, while 60% went to Asia and the US. The EU had about 9% of the total share in trading, which is also far behind the curve and the same is true for total market capitalisation. A recent study by the French AMF shows that while SIs were initially introduced in the market for handling large institutional orders, the average size of orders is relatively limited, particularly for ELP SIs (Electronic Liquidity Providers) and there is only a 1.4% contribution to the transparency of markets in terms of total volume. In the bonds market the level of non-transparency is particularly high with a structural problem in the design of the market. At the beginning of 2020 only 3.1% of bonds were liquid and transparent. ESMA's work in this area needs to move forward possibly with more radical thinking on the waiver regime for example. Overall, it should be recognised that exchanges (regulated markets) are already providing their high quality data for free on a 15 minutes post-trade basis, while all other trading and execution venues would not do so. As such, it was important to recognise the market failure around much needed high quality data from the OTC, dark pool and SI segments. Once this data quality is ensured, one would likely see the emergence of private sector CT offers.

Concerning retail investors, the industry representative considered that there is not much benefit to expect from the CT in terms of costs, because if someone goes to their broker there are completely different pricing factors that play into the bill and therefore increasing retail investment requires a different set of actions. Therefore, and before conceptualising the CT in more detail, it is key to be clear about the use case and the concrete objective so as to avoid a costly and lengthy project that may ultimately be limited in actual application and overall added value. Another industry representative agreed that there are other barriers for retail investors in Europe if they want to trade, but equities are usually liquid enough for retail investors and there is good pre-trade transparency.

2. Priorities in terms of asset class, type of data and venue coverage

2.1 Priorities in terms of asset class and type of data

Some panellists were in favour of giving the first priority to a fixed income CT.

A regulator preferred a post-trade CT aimed at fixed income as a priority, as there is a bigger asymmetric information gap that can be filled relatively quickly in this market. Fixed income should therefore proceed first and market participants should be incentivised to improve data quality and respect delays in transaction reporting.

An industry representative considered that price transparency in equities is relatively good whereas in fixed income instruments it needs improvement. Pre-trade transparency is a difficult concept for bonds because the notion of liquidity differs depending on which types of investors are involved. Liquidity requirements are indeed different for institutional and retail investors. While more data is generally better, there can be misleading data that can result in the wrong conclusions and beyond a certain level, transparency can actually hurt markets.

A second industry representative noted that there is support both on the buy and sell sides for a CT particularly in fixed income instruments. Good CT post-trade data in fixed income could be a proxy for pre-market information, which is considered to be very poor at present. That is in itself a reason to pursue a CT. The difference between instruments, e.g. between equity and fixed income, however needs to be taken into account. There has to be care to construct a CT that is appropriate for each of the asset classes, rather than a one-size-fits-all approach.

A third industry representative agreed that the focus should be on a post-trade fixed income CT. While in isolation there are strong arguments for implementing a CT for equities in order to increase transparency and reduce costs, comparatively to fixed income, equities already have an abundance of transparency thanks to exchange data and order-book execution.. Moreover there are two reasons for aiming for a post-trade CT. First is that fixed-income instruments trade with much less frequency than equities. When looking at trading an instrument today that traded a month ago, the real data point is what it traded at and not necessarily the surrounding pre-trade quotes. Also, the implementation effort for a pre-trade consolidated tape and post-trade consolidated tape collection is probably identical, but the much larger return on investment (ROI) is in the post-trade space.

A fourth industry representative stated that in the EU CTs can and should be both tailored to and phased in by asset classes. The equities and the fixed income markets are different, but tailoring and phasing in a CT that is appropriate for each of the different instrument categories is possible. There is no reason to prioritise or delay the development of a CT for one asset class versus another, they can proceed in parallel. The US has separate CTs for different categories of financial instruments. The US capital markets benefit from pre and post-trade CTs in the equities and options markets, as well as post-trade only CTs in the corporate bond markets, municipal bond markets, mortgage-backed security markets and over-the-counter (OTC) derivatives markets. Starting with post-trade transparency in each of the asset classes is the logical starting point and in the fixed income space, a post-trade CT is likely all there will be, judging by the example of the US where the TRACE system for corporate bonds is a post-trade only CT.

The third industry speaker considered that developing CTs in parallel would be feasible if there were parallel regulations driving the projects, but there is the risk of having a single regulation which does not respect the differences between the asset classes, which would present a problem for parallel delivery.

The Chair suggested that for a parallel implementation and regulation of different CTs to be possible the issue of the business model of the CT also needs to be considered, whether this will involve public or private participation and whether there are natural monopolies per instrument or category of instrument. In addition there is also the question of the availability of data for non-equities. With the current transparency requirements there would almost be no relevant information in a non-equity CT to start off with.

A public representative suggested that priorities need to be defined in terms of instruments. The benefits will probably be greatest for the bond markets where, generally, transparency levels are much lower than the equities markets. However, given the existing solutions in the equities markets, beginning with equities would probably be sensible. Other asset classes could then come at a later stage. Given the failure of the first attempt to implement a CT with MiFID II, a cautious, step-by-step approach seems more prudent than attempting to implement a CT for all asset classes at once. A regulator agreed with the idea of a cautious approach and added that for equity and non-equity instruments the correct approach is to be pragmatic and to start with post-trade data. There are different data demands from different kinds of investors and this should also be considered. In any case data quality and machine readability are essential, as well as cost-benefit analyses, legal analyses of property rights and defining the connection with APAs (approved publication arrangements). Everyone hopes that a private solution will emerge, but private consolidators need incentives and there needs to be an adequate regulation in terms of pricing.

An industry speaker disagreed that an equity CT would be easier to implement than a fixed income one. Current functional fixed income APAs are testament to the fact that a fixed income CT can be produced as easily as an equity one, because the operational delta between running an APA and a CT is not that significant. The issue is more about agreeing the common data standard for the CTP to actually consume. However there is a need to have one common voice setting that data standard.

2.2 Coverage in terms of venues and instruments

An industry representative stated that the CT should provide 100% coverage of venues and instruments, otherwise it will not have enough added value compared to the data which is already made available by exchanges freely on a 15 minute post-trade basis. There is further work to do requiring all execution venues, including SIs for example, to actually send and deliver a daily file on what has happened in their systems. If a 100% picture is achieved across all venues then there must also be a conversation on the accessibility to all of the venues for retail and institutional investors, because many alternative execution venues, such as the SIs, are not accessible on a non-discriminatory basis to all market participants.

Looking more concretely at the reporting pools, machinery is needed to build a list of SI data per instrument that needs to be disclosed the industry speaker suggested. On the bonds end, there seems to be a structural problem in the design of the overall transparency system. There is also a broader discussion to have on the need to change some of the existing Q&As into actual guidelines and to apply them. What is put into law has to be enforced. It cannot be the case, for example, that there are still netting offers out there for what are supposed to be bilateral setups. That is a breach of the law in terms of MiFID Article 16A.

A second industry representative disagreed about a 100% coverage for the CT. Such a requirement would probably lead to the failure of the CT project, because there is always some activity at the fringes that is hard to capture and is not necessarily vital for the performance of the CT.

A third industry representative suggested that for equities and exchange-traded markets it is important to consider separately the consolidation of pre-trade quotes and post-trade executions. In the US 100% of post-trade equity executions are covered, whether they are on or off-exchange, but the rate is effectively lower on a pre-trade basis because only displayed quotes on exchanges are included (and not non-displayed quotes on exchanges or off-exchange trading). It is essential to have a post-trade CT because, whether on-exchange or off-exchange, the post-trade CT brings 100% of market activity together in a transparent fashion. Not every instrument across the entire financial market has to be covered but every instrument within a given asset class should be.

3. Data quality and waiver issues

The Chair highlighted the need to further discuss the issue of data quality and whether it should be a prerequisite for a CT or whether developing a CT will help to improve data quality. There is also the issue of lacking data mainly for non-equity markets.

An industry representative emphasised that data quality is a pre-requisite for the CT, and what is needed in terms of data quality needs to be defined first. This is one of the lessons of the 2008 financial crisis. Appropriate market data is the starting point for any investor decision but it is also a key component for ensuring financial stability and defining monetary policy. More transparency is needed and the required overall market structure has to be constantly monitored. All of the deferrals and waivers that are used in the market need to be reviewed. In terms of data quality, there is also a significant problem around reference data in the EU. Harmonisation is needed, not only of the terminology but also of the overall classification across all member states. The use of NRCF I-codes is needed.

A regulator suggested that it is time to start rationalising the deferrals and reducing the number of waivers. This could help to make more data available and ensure that the CT has a better business case. The Chair noted that if the current set of waivers and requirements for bond transparency is maintained then that will considerably limit the interest of a bond CT.

An industry representative stated that CTs are only as valuable as the quality of the data that they collect and disseminate. That is why it is essential to address the current deficiencies that the European Commission and ESMA have already identified with respect to the scarcity, quality, timeliness and accessibility of post-trade transparency data, particularly in the bonds and OTC derivatives markets. In addition to ensuring that all on-venue and off-venue transactions are covered, particularly in the fixed income space, rationalising the current inconsistent and excessive deferral regimes must be a priority. In the US setting a maximum 15-minute deferral for larger sized block trades in corporate bonds and in OTC derivatives has been sufficient to maximise the benefits of transparency.

A public representative stressed that the main requirement for a CT is getting data quality up to a certain standard. Data quality is a pre-requisite for a CT before thinking about the governance structure and the business case of the CT. If poor-quality data is consolidated there will be a poor-quality CT. Part of the data quality issue can be fixed by working on the deal data reporting and the actual reporting templates of MiFID II. Currently, those templates still leave too much room for inconsistencies.

Another equally important factor is enforcement. For a CT to work, increasing and maintaining data quality has to become a priority for supervisors, who should be in charge of safeguarding data quality. Currently, most regulated markets deliver useful data in line with MiFID II requirements. The same is unfortunately not true for many smaller trading venues, especially SIs or dark pools. A solution may ultimately be to impose fines on the firms delivering poor-quality data.

The Chair concluded by saying that the legislative proposal by the Commission is awaited on this subject, and that there will perhaps be an opportunity to foster this project under the upcoming French presidency of the European Union – in close consultation with all stakeholders.