Consolidated Tape: prospects for delivery

1. Objectives of the EU consolidated tape (CT) project and related opportunities

An industry representative was in favour of the MiFIR[1] review proposal to set up an EU consolidated tape (CT). The aim is to make European securities markets more attractive for investors and to increase liquidity, which should support the financing of the EU economy and make European markets more resilient. The CT should provide investors with the data they need to make investment decisions with a consolidated view of all EU markets. The objective should also be to make this data available as widely and as cheaply as possible, in order to attract more investors to the market.

Another industry representative agreed on the benefit of setting up a CT providing a view across transactions executed on- and off-venue in the EU, including systematic internalisers (SI) and over-the-counter (OTC).

An investor representative also supported the CT initiative, which should help to enhance costs and competition in the market by providing institutional and retail investors with a consolidated view on the pricing of transactions. This should also facilitate the access of companies to capital market financing and support the green transition. European markets indeed remain fragmented despite the implementation of the MiFID[2] and MiFIR legislations. Transaction data also continues to be relatively opaque and best execution is not delivered, with retail investors in particular paying the price for this market dysfunction in terms of spreads being unnecessarily wide. Systemic internalisation is widespread and loopholes from best execution are not serving the market well.

A regulator emphasised that beyond serving the interests of investors by addressing the present fragmentation, cost and difficulty of accessing adequate transaction data, the tape will also support the activities of regulators and supervisors analysing the market and working on the improvement of regulation. Another regulator stressed the potential contribution of the CT to building a single European capital market and addressing the current fragmentation, by making data available to investors across the Union.

2. Main characteristics and content of the CT

2.1. Type of data available on the CT

An industry representative stated that the CT project, which proposes the setting up of a unique CT providing close to real time data for equity shares and bonds is moving in the right direction. Some aspects however need to be reconsidered from an investor perspective. Only post trade data will be available in the first phase of implementation, but this should be extended to pre-trade data for equities because equity markets work with an order book, the visibility on which is necessary to make investment decisions. While a phased implementation starting with post-trade data is understandable, it should not be limited to this for equities because the use case of the CT will be insufficient.

A second industry representative was on the contrary in favour of a post trade delayed tape and not a pre-trade tape. A pre-trade tape is not feasible due to the latency issues that will be seen across the geography of Europe. In addition, it may lead to the creation of a two-tier market with some financial firms able to afford low latency services and others only using the CT where part of the liquidity will no longer be available, thus creating a false reference point. A phased approach is therefore needed, starting with a delayed 15 minute tape. Since data provided by the exchanges is free after 15 minutes, this would also solve remuneration issues. Once this has been done, an impact assessment of introducing a real-time post-trade CT can be conducted to plan possible further steps of the CT.

An investor representative agreed that the post-trade CT should be the primary objective, as it is timestamped, traceable and includes information on the market venue on which the transaction was executed. It would allow the tackling of the main data fragmentation issues. Although a real-time CT would normally be the ultimate goal, this might lead to a potential increase in trading costs due to the investments required for collecting, consolidating and distributing the data in real-time, which does not seem worthwhile at present. In addition, retail investors who are not able to engage in price arbitrage between a variety of markets, unlike high frequency traders, will probably not benefit that much from a real-time CT. In the initial implementation a 15 second delay could be an acceptable compromise for the equity CT, since this would still allow the validation of best execution without disrupting current market practices.

A third industry representative explained that for fixed income the focus should be on post-trade data because of the nature of the product. Post-trade data will have more value than pre-trade data in this case. The majority of bonds are trading via the RFQ (Request for Quote) negotiation protocol, which means that the pre-trade price and the post-trade price actually print very close to each other. Someone would rather wait for the certainty

1. Markets in Financial Instruments Regulation
2. Markets in Financial Instruments Directive

of the post-trade price than bank on pre-trade prices, which may not have actually executed.

A regulator stated that a staggered approach leaving the possibility to adjust the project if needed is the best way forward, because such a project is difficult to plan upfront entirely. The MiFIR review proposal is right to start with a post-trade CT for bonds and equities, before considering going to pre-trade data. The implications of a pre-trade CT for equities, i.e. the delays, its purpose, and the cost and complexity of implementation, need to be further clarified, because views vary on these issues.

The first industry representative observed that a further element that needs to be considered is the phasing in of deferrals. At the moment the Commission wants to reduce deferrals significantly and build the CT at the same time, however waiting for the CT to be built and fine-tuned before addressing data deferrals would seem more appropriate. This would allow a better definition of transparency needs based on an assessment of the market structure, the liquidity in the market and current transaction flows, before deferrals are adjusted. The regulator suggested that regarding deferrals, there should be one single regime in Europe, because harmonising the existing patchwork of national specificities will be very complicated.

2.2. Priorities in terms of coverage of instruments

An industry representative pointed out the breadth of the range of asset classes due to be included in the CT according to the current proposal and the need to establish priorities. Implementing 4 CTs in 12 months in a big bang type approach seems very ambitious. Previously the introduction of MiFID transparency requirements in January 2018 for example faced major data quality issues resulting in significant delays. The priority should be given to equities and bonds, as they are simple instruments for which clear use cases have been established, which is less the case for ETFs and derivatives. The CT for other asset classes could come later if clear use cases are defined.

An investor representative agreed that priorities should be established. It would be costly to go for the full 4 CTs at once, as it would mean imposing many requirements concerning the provision and analysis of the data in order to ensure best execution. Bond markets should be a priority, because of the lack of data. Only a quarter of bond transactions take place on lit markets. It is necessary to ensure that the different trading venues including SIs and the approved publication arrangements (APA) are required to provide the trading data to the consolidated tape provider (CTP) free of charge, and in highly harmonised, high-quality formats to have the most cost-efficient way of distributing the data.

A regulator suggested that a staggered approach should also be used for rolling out the different CTs. It is possible to start with one asset class, learn from that, and then move to a more complex one. This would give enough time to ESMA to stop and correct things if needed. The CT should first be implemented in the markets where fragmentation is highest and where the data is the most difficult to gather. That is both bonds and equities, for different reasons, in the first case because of the market structure and the way fixed income markets function, and in the other case because of the proliferation of equity trading venues.

A regulator stressed that it is important to keep the momentum. Four years were given to see whether a CTP would emerge, and it has not. It is important to be ambitious but at the same time pragmatic and thus a staged approach would be beneficial.

The Chair observed that a challenge with the staged approach is that while it allows progressive learning and adjustments to the CT in terms of functioning and business model, it will make it more difficult to establish clear rules up front and therefore market players may not know what point they are moving towards. One idea would be to provide ESMA with more discretionary powers so that rules can be tweaked at a later stage if needed.

3. Data quality and availability issues

The Chair emphasized the importance of data quality for the CT and the related challenges to be considered including deferrals, waivers, and data publication delays.

An industry representative considered that data quality issues should be fixed before the CT is put in place. While good quality transaction data is easily available from the exchanges, this is not the case for SIs and OTC transactions, which should be first required to meet their publication obligations in the right format.

A second industry representative stated that data quality depends on the asset class, and is simpler to accomplish for equity and bonds than for derivatives. Achieving sufficient data quality requires constant work on the part of financial institutions and also of the APAs, who check the transactions reported in their systems, identify potential outlier trades and correct errors. Solving certain issues also requires a collective effort of the whole ecosystem. SIs have an obligation of post-trade transparency and already publish on APAs. There are only a few APAs on equity, and one of those is preponderant. That data is available and it is as real time as possible, since SIs have the obligation to send it in less than one minute. It is up to the APAs to make it more accessible.

A third industry representative considered that data quality is a slight misnomer when it comes to fixed income. There is not a data quality issue as such in these markets, but an issue around the clarity of existing regulatory standards and the way they are interpreted, which ESMA could contribute to fix.

A regulator noted that for data quality there is a need to have appropriate preparation and definitions ex ante in the Level 1 and 2 texts and in the regulatory standards before the process of data collection is started, otherwise the risk of failure is high. The Commission has done excellent work with its proposals on data quality and data standards, but there is some confusion with the multiplicity of consultative committees currently working on data. These assessments should be coordinated by ESMA, which would then be able to advise the Commission on these issues or propose changes in the delegated acts.

Another regulator highlighted the importance of collective work on the improvement of data quality. It is essential that this work takes place across all the asset classes and venues, not just regulated markets, and that all trades are reflected on the CT. ESMA is reviewing the relevant Regulatory Technical Standards (RTS), and also working on a day-to-day basis with the national competent authorities (NCAs) and financial firms on the improvement of data completeness and quality, considering however that perfect quality is difficult to achieve. The CT will be an incentive to further improve data. It makes sense to keep data quality requirements as technical standards and not change them into a delegated act.

4. Implementation challenges

A regulator stated that one of the first challenges in terms of implementation of the CT is in having a process with realistic timings. The selection procedure of the CTPs is due to be run by ESMA for the four different CTs. It is important to define high level criteria on which decisions will be based in order to ensure that the process is transparent and clear for all candidates that come forward. There is an issue of timing however, because the criteria will need to take into account the data that the CTPs will be providing and that will be specified in Level 2 measures. Those Level 2 measures will therefore be needed before ESMA can decide the criteria on which it will judge who will be selected. The three months that is currently envisaged for managing the selection and the authorisation process would be problematic both for ESMA who will be running the process and also for the candidates who will be applying. An industry representative agreed that it is vital to be careful with the selection criteria, as shown by the first iteration of the US tapes which was a failure.

A second issue, the regulator felt, is the current combination of the selection and authorisation process. The selection process is about assessing who best meets the selection criteria, and the authorisation process is about making sure that the entity retained actually complies with the requirements to run the tape. By merging the two there is a risk that applicants will have to make significant investments which could be lost if they are not selected, or that ESMA may have to make a decision without all the elements of information needed. Splitting the selection and authorisation processes would therefore be beneficial, as well as separating and phasing the selection procedures for the four CTs.

An industry representative sympathised with the challenges faced by ESMA in the implementation of the CTP. The current timelines are incredibly tight and may lead to a bad outcome if they are maintained. Any potential applicant to be a CTP would likely need to make significant investment and run the risk of not actually winning the tender itself, leading to sunk costs. Another issue concerns APAs. Incumbent APAs are the main players in the market who could provide a CT in a relatively short timeframe, as their technology stack performs very similar tasks to a CTP and their commercial model is up and running. In addition APAs are already regulated by ESMA. However in the explanatory notes of the MiFIR review it is clearly stated that ESMA should consider independent providers, potentially outside the incumbent providers such as APAs, which reduces their probability of being selected. There is nevertheless a good chance of getting a CTP due to the fallback option, whereby the Commission would request ESMA to interject and create a CTP. But to allow a commercial solution to emerge the observations made previously concerning non-equity instruments need to be addressed, requiring a different approach for equities and fixed income in particular.

A regulator was concerned about the fallback option mentioned by the previous speaker. If no commercial provider with all the necessary experience emerges then it will not be easy for ESMA to take on the responsibility of developing the CT. More time is needed before declaring that no commercial CTP solution is viable. Another regulator stressed the importance of appropriately planning the development of the CT, taking into account the time needed to move from the Level 1 text to data standards and detailed specifications.

The Chair agreed that sufficient time and effort needs to be spent in the market to see whether there is a possibility to make the CT commercially viable in a reasonable timeframe before there is any discussion of a fallback.

5. Governance and business model issues

An industry representative stated that further clarity is needed regarding the governance and commercial viability of the CT. In terms of governance, a precise definition of who conducts the oversight of the CT is needed, as well as who is in charge of data quality and ensuring that SIs and firms executing OTC transactions are meeting their publication requirements in the proper format.

The business case and the conditions for ensuring the commercial viability of the CT also need to be more precisely specified, the industry speaker suggested. Making a CT function correctly for the market cannot be done cheaply and requires a significant amount of work. It is important to have more detail on remuneration and how it will be ensured that data providers are rightly compensated and that small exchanges do not lose a vital revenue stream. A business case where exchanges are mandated to furnish their data and users have no obligation to use it would not work. Moreover, a badly designed tape could harm the smaller exchanges and the capital markets in which they operate. For example, the three exchanges in the Baltics heavily rely on their revenue from data because their activities are not very diversified and data revenues finance their other listing and trading operations. Removing data revenue would reduce the contribution of those exchanges to the development of the capital markets in which they operate. The impacts however depend on the choices made for the tape. A post-trade delayed tape would not significantly affect the main exchanges that have diversified revenue sources, but will impact the smaller exchanges like the Baltics, whereas a real-time post-trade tape would also affect the revenues of the larger exchanges. This depends also on the position that exchanges have on different instruments.

A second industry representative considered that the revenue redistribution aspects of the CT proposal need to be reconsidered, because at this stage it adopts a mechanism that maximises profits from market data instead of focusing on getting the data available as cheaply as possible for investors. The speaker also noted that professional investors and market makers will continue to pay direct fees to every single exchange in every market, because quick access is needed when trading electronically. The tape will therefore probably result in a loss of revenue for exchanges and an increase of the direct fees paid by professional investors and market makers. A participant in the audience confirmed that fees paid by market-makers keep rising. There is hope that volumes will increase in European markets when pre and post-trade transparency reach the desired level, but it is uncertain.

A third industry representative emphasized the potential impacts of the CTP proposal on APAs. A CTP will consolidate data from APAs and trading venues into a publishable format and then publish it for consumption. Suggestions have been made that APAs should give their data to the CTP for free, but if this is the case their revenue will likely be cut in half, which could lead some of them to exiting the market. The industry speaker moreover emphasized some commercial challenges associated with the CTP for APAs. Operating a CTP is not a technical challenge since nine major APAs already exist in the EU conducting similar activities, but a commercial challenge, which is impacted by the regulatory requirements applying to the CTP. One issue that CTPs could be facing is the responsibility for the appropriate implementation of waivers and deferrals. Bringing that upstream to the CTPs, rather than leaving it with trading venues will result in a duplication of effort and another commercial burden for the CTPs.

The industry speaker was also concerned by the viability of the bond and derivative CTs. Many of the regulatory requirements applying to fixed income CTs were initially defined for the equity CT and do not fit the fixed income market. This explains why no CT has emerged for fixed income for the time being. The current proposal corrects some of the challenges that existed in the incumbent legislation for equities, but this is less the case for fixed income. As for derivatives, the industry representative considered that a CTP is not viable until the International Securities Identification Number (ISIN) challenge is solved. For example, if someone wants to use a derivative CT for comparing a 10-year swap over 250 business days of the year that will require dealing with 250 ISINs, which is impossible. Until this issue is solved, there is no use case for a derivative CTP. A regulator agreed that this ISIN problem has to be fixed for derivatives. A derivative CT can make sense, but these feasibility issues need to be addressed first.

An investor representative was also worried by potential impact of the cost of implementing the CTs on retail investors. The anticipated annual revenues for equity and bond CTPs are about €100-$150 million per annum; it should be ensured that this does not translate into price increases for investors. This should be taken into account in the assessments conducted by ESMA.

The Chair summarised that there is broad support for the CT, which is a concrete project which can drive EU capital markets and the CMU forward. It is important to keep momentum, but a sensible way forward needs to be defined, according to the panellists, which could possibly be a staggered approach, allowing learning over time. It is also important to delve into the details and make sure that the CTP is viable, because it is a highly technical subject. In particular, unnecessarily wrecking existing business models which have positive externalities in smaller exchanges should be avoided.