ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS

FINANCIAL MARKET PROFESSIONALS

AMAFI / 22-58
5 September 2022

MiFIR REVIEW

AMAFI POSITION PAPER

The sanitary crisis, Brexit and the conflict in Ukraine have underlined the necessity for the Union to develop and strengthen its open strategic autonomy globally, especially in the financial sector area where financial markets have a major role to play.

The Covid-19 health crisis has severely impacted the EU-27 economy and caused debt to surge, increasing the need for the EU to bolster its market-based financing capacity, not just to support the economic recovery but also to regain some autonomy in sectors the crisis has led to be identified as strategically important.

Besides, with Brexit, the City is no longer the Union's main financial centre. The EU must rethink how its markets operate so that it can maintain control over the ecosystem that is vital to financing its economy.

The Union is facing an unprecedented challenge where for the first time it has such a strong competitor at its door which is very agile from a legislative/regulatory perspective and has already shown concrete proof of its willingness (i) to diverge as per the Wholesale Markets Review (*e.g.* end of STO and DVC, lighter transparency constraints for non-equity market) as well as (ii) to create a more competitive UK financial sector which features as a core objective in the Financial Services and Markets Bill[1] published in July.

This situation has very concrete implications for both (a) EU market actors' competitiveness and for (b) the attractiveness of the EU regulatory framework:

(a) In the short term, we can fear that the competitiveness of UK branches of EU Firms will significantly drop as they will de facto be subject to the stricter regime *i.e.* the EU one;

(b) In the medium to long term, we have reasons to believe that the EU regulatory framework will become less attractive than the UK one.

In this context, we consider the relaunching and deepening of the CMU project is key to enable financial markets to play a bigger role in light of the EU-27 financing challenges.

As part of the CMU project, the MiFIR review proposal presented by the European Commission in November 2021 is of critical importance to increase the competitiveness of financial market actors operating in the EU-27 and the attractiveness of the Union's regulatory framework. Two goals that feature prominently in D. Hubner's draft report on the MiFIR review[2]. It should also aim to ensure that the financing of the Union's economy can build on robust domestic financial markets and does not need to rely too extensively on resources located in third countries, hence outside its control, be it in terms of expertise, capital or liquidity. More proportionality should also be introduced, to prioritise actions relating to the wholesale market for which a better integration at EU level is critical.

[1] https://bills.parliament.uk/bills/3326
[2] https://www.europarl.europa.eu/doceo/document/ECON-PR-731644_EN.pdf

With these objectives in mind, based on AMAFI's previous note on the MiFIR review (*AMAFI / 22-11*) this position paper takes stock of (i) the European Parliament's (EP) Economic and Monetary Affairs (ECON) Committee draft report as well as (ii) the latest Council compromise text under the FR Presidency and aims to highlight AMAFI's core and medium priorities in order to contribute to ongoing negotiations[3].

I. Core priorities in the MiFIR review

a. Establishing a European pre/post trade consolidated tape for equities & post trade for bonds

AMAFI members are supportive of the creation of European Consolidated Tapes (CT) for equities and bonds (not for derivatives) as they consider it has a central role to play in the building up of EU financial markets.

For equity, most AMAFI Members believe it is critical to introduce pre trade data from the launch of the CT[4], to take into account (i) the strong interconnexion between pre and post trade data (ESMA 2019 report on the creation of a CT), (ii) most use cases featuring in the Market Structure Partners report and (iii) the benefits that, in case of market outage, only a pre and post trade CT could deliver to least sophisticated market participants willing to manage their portfolio and associated risks.

In light of current difficulties in the Council to reach a compromise with several Member States against the creation of a pre trade CT for equity from inception, most AMAFI members support the proposal featuring in Danuta Hubner's report, as well as in the last FR Presidency compromise text, which would exempt "small markets" to contribute to the CT while leaving them the possibility to opt-in. With regards to the criteria proposed in the ECON draft report to define small markets, while we support the first one i.e. the average daily trading volume of shares should represent less than 1% of the EU average, we consider the additional criteria for the exemption above the 1% should be carefully assessed as it risks to exclude many individual shares (including SMEs) and regulated markets.

Another issue we consider critical to ensure the sustainability of a CT and for which the approaches both from the Council and from the EP still lack precisions concerns the revenue sharing mechanism.

It should be adequately tailored and clearly framed at the legislative level. As a core principle, we consider that small markets which contribute to the CT should benefit from the revenue sharing mechanism in a way that would overcompensate their loss. Most AMAFI members[5] consider the features of the revenue sharing mechanism should be defined by ESMA through level 2 provisions:

(a) A maximum amount per user of the CT should be determined, it would take into account (i) the profit sharing of contributors to the success of the CT, (ii) attractive prices for users and (iii) the viability of the CT. The targeted amount per user to remunerate contributors could be regressive in time in order to encourage contributors to limit their dependence to revenues coming from the selling of data.

(b) The modalities of allocation of revenues, one could consider an allocation by pool, with for instance (i) a first pool remunerating each contributor in the same way reflecting fixed costs linked to their contribution (*e.g.* connexion costs), (ii) a second pool targeting smaller exchanges, (iii) a last pool allocated to the volumetry of data contributed.

[3] This paper reflects the position of a large majority of AMAFI's members. "We" and "us" should therefore be read as the opinion of the vast majority of AMAFI's members.
[4] Some AMAFI members do not believe that a real-time pre-trade CT should be pursued due to concerns that such a tape would advertise a misleading sense of liquidity creating a flawed and easily gameable benchmark to the detriment of less sophisticated investors.
[5] Some AMAFI members do not share the views outlined below in relation to the revenue sharing mechanism.

Besides, most AMAFI members consider that the creation of a CT will not solve the issue of increasing market data costs. Most AMAFI members[6] support the EC proposal to convert ESMA guidelines on market data into a legal text, the empowerment of ESMA to specify how the Reasonable Commercial Basis (RCB) principle should be applied as well as the European Parliament's proposal to draft an RTS to specify RCB obligations.

Moreover, most AMAFI members also consider as a positive step forward the proposal from the EP to outline in the level 1 text that the price of market data should be based on the cost of producing and disseminating, with reasonable margin as foreseen in the recommendations featuring in ESMA 2019 December report[7].

b. Preserving the delicate balance between transparency and liquidity for non-equity instruments

We consider it is of paramount importance to take into account the specificities of the bonds and derivatives markets to enable market makers to (i) hedge their risks as well as (ii) to unwind their positions and hence their ability and willingness to enter into transactions of significant sizes or on illiquid instruments.

Considering pre-trade transparency regime, most AMAFI members support the deletion of the SSTI threshold and the removal of pre-trade transparency requirement for RFQ and voice systems as proposed in the ECON draft report, since these mechanisms do not bring any clear value, while increasing the operational complexity for market participants. We also consider that the deletion of the pre-trade requirement should apply equally to multilateral venues and Systematic Internalisers.

With regards to post-trade transparency, considering the different dynamics at stake in the Council with on the one hand some Member States keen to tighten the deferral regimes[8] and "bigger" Member States sceptical towards such approach, we support for euro-denominated instruments the approach featuring both in the last FR Presidency compromise text and in the ECON draft report which introduces five categories to differentiate deferral lengths, for corporate bonds and derivatives, on the basis of transaction size and liquidity. We also welcome the four week maximum deferrals permitted for trades in the "very large" category and ESMA to calibrate the deferral buckets at level 2. Finally, we would also recommend to add a notion that ESMA calibration should be based on liquidity and risk offset (trade out time) data analysis.

With regards to instruments denominated in other European currencies, we consider the calibration could be left at the discretion of NCAs in charge of the material market in terms of liquidity according to Article 1 paragraphs b) and c) of Commission Delegated Regulation 2017/570[9].

Ultimately, AMAFI supports real-time transparency for liquid instruments and trades of small sizes, for which hedging, and risk management are straightforward.

Given that, on their side, UK authorities and other third country jurisdictions show no intention to reinforce the constraints imposed on market makers, it is critical that the EU proposal, everything else being equal, does not result in dealers preferring to provide liquidity at a better price in the UK/other third country markets, rather than in the Union. Ultimately, this would result in a transfer of liquidity from the EU to the UK/other third country markets, and in a loss of attractiveness of the Union's markets.

c. DTO targeted exemption provision

While we support the proposal from co-legislators for the suspension of the DTO requested by a NCA for its investment firms and granted by the EC to also beneficiate automatically to other concerned entities of the Union as long as they respect the set criteria, we have specific concerns with the date of entry into force of the MiFIR review.

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[6] Some AMAFI members would underline that the market is currently adjusting to much awaited guidelines from ESMA on MiFID II/MIFIR Market Data obligations and that in light of this no further action should be taken prior to the ESMA peer review in 2023.
[7] ESMA Final Report on market data costs, points 58-65, page 26-27.
[8] Sweden in its May 2022 non paper (i) argues against the separation of prices and volumes deferrals, (ii) proposes the introduction of T+2 deferrals for large transactions in illiquid instruments and (iii) suggests longer volume deferrals of two weeks only for certain very large transactions.
[9] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R0570&from=EN

Indeed, taking into account the expected length of the EU legislative process and given the urgency to enable EU firms not to apply anymore the EU DTO when trading with non-EU clients, we are calling for a fast implementation of this provision. It is critical for the proposal to enter into force as quickly as possible as once a client has moved to another dealer to get liquidity, it is extremely difficult to establish or re-establish a trading relationship for EU market makers.

We would therefore call for ESMA to issue a non-action letter to suspend the DTO until the level 1 text of the MiFIR review is implemented.

Moreover, we would support the proposal of the EP to enable ESMA to decide on a standalone temporary suspension. However, we believe that 3 months is too short and would call for at least a year, renewable based on ESMA's assessment.

This issue is all the more important given that ESMA proposes as part of its ongoing consultation[10] to broaden the list of instruments eligible to the DTO.

d. Payment for order flow: defining precisely scoped in practices

We are in favour of a ban of payment for order flow for shares only[11]. Indeed, PFOF practices on shares raise issues with regards to:

- the compliance with best execution rules, especially as the payment from the platform to the entity aggregating and sending orders from its retail clients may contribute to lower fees charged to the latter, but with no ability to assess the materiality and to quantify such benefit ;
- the price formation process, as they divert retail orders from order books that primarily contribute to this process.

We also consider that many of the poor practices that rightly worry the EC could be avoided by a stricter implementation of existing rules in terms of best execution, suitability and appropriateness tests when it comes to retail orders executed under a PFOF scheme and call for a level playing field in terms of supervisory practices in this area, regardless of the decision finally made on a ban on PFOF. The creation of a CT pre trade for equity would facilitate the control of best execution by supervisors.

In any case, this ban should only affect financial instruments which involve retail clients' flows, for which the price formation process is order driven, and where there is no clear benefit of the payment for the retail clients. The approach should not be extended to other financial instruments, for which the price formation process is linked to other parameters that are not influenced by the modalities of orders execution (the price of warrants for instance is based on the price of the underlying instrument, its volatility and the maturity of the warrant), especially when there is a clear link between potential retrocessions and benefits granted to the retail clients (typically gratuity of order passing).

e. Modification of the transaction reporting regime

AMAFI is strongly against the proposal of the EP draft report to add AIFM/UCITS firms to the scope of entities obligated to report transactions to NCAs. As highlighted in AMAFI's answer to ESMA 2020 consultation on the obligations to report transactions and reference data[12], we consider this would have huge detrimental impact on the current regime of the reporting mechanism for investment firms.

AIFMD and UCITS firms will face the same challenge to analyse, implement, maintain and manage the reporting rules as the investment firms. This implies the solely transmission of the report but also to comply with the provisions of article 15 of Delegated Regulation (DR) 2017/590.

Moreover, it would have a huge impact on the current regime of the reporting mechanism for investment firms. Indeed:

[10] https://www.esma.europa.eu/sites/default/files/library/esma70-446-369_consultation_paper_on_co_and_dto_referencing_estr.pdf
[11] Some AMAFI members do not share the view that a ban of PFOF should be limited to shares only and that it would make sense for instruments in asset classes other than shares to also be in scope of the ban.
[12] For further details, please see AMAFI/AFTI answer to ESMA consultation, *AMAFI / 20-67*.

- Either the AIFMD/UCIT firm chooses to make its own reporting and in this case the new regime is neutral for the current investment firms (mainly brokers or market makers).

- Or the AIFMD/UCIT firm chooses to "transmit" the order according to article 4 of DR 2017/590.

In the latter case and having in mind that AIFMD/UCIT firms generally transmit global orders for retail or collective schemes clients, it would be impossible to transmit all the required information in the order (considering that even for single orders, current electronic order transmission systems are not adapted to transmit the required information). This means that AIFMD/UCIT companies and the brokers will have to put in place ex-post arrangements to allocate each relevant information for any given transaction which would be very burdensome. Besides that, the broker will have to put in place arrangement to comply with GDPR rules when receiving and transmitting personal information such as CONCAT.

Moreover, and as explained in AMAFI response to ESMA consultation, we consider that the ECON proposal to include a transaction identification code generated by the trading venue within the reports would, in reality be very difficult to put in place and would demand huge investment for investment firms with no actual benefits for regulatory purposes.

On these topics, which do not feature in the EC's MiFIR proposal and have not been discussed at Council level, AMAFI considers that a sound cost-benefits analysis should be carried out before envisaging any modification of the current regime.

II. Medium priorities in the MiFIR review proposal

a. Reforming the transparency regime for equity in a pragmatic way

Most AMAFI members are supportive of the approach taken in the ECON draft report which (i) empowers ESMA to calibrate the minimum size threshold for the use of the Reference Price Waver (also proposed in the last FR Presidency compromise text), (ii) proposes the suspension for five years of the Double Volume Cap and (iii) gives a mandate to ESMA to calibrate minimum quoting size for equity SIs (also proposed in the last FR Presidency compromise text).

Such approach is all the more pragmatic given the length of the EU legislative process which makes any swift correction of the regulatory regime extremely difficult at a time where the UK is considering reforms to its financial markets' regulatory framework.

One can already observe very concrete implications of EU-UK regulatory divergence on the volumes of dark trading in EU shares following up from the decision of the UK FCA to qualify EEE shares as illiquid in early 2021 (for further details please see in Appendix).

Moreover, concerning the SI regime, it is important to bear in mind that divergence between the EU and UK frameworks would be detrimental for EU SIs and EU clients. As the main clients of EU SIs are located outside the EU (mainly in the UK), should the EU implement a more restrictive regime (*e.g.* constraints on mid-point trading) then those clients would be less incline to trade with an EU SI. Besides, EU investors which can only trade with EU trading venues would have access to a less liquid market.

b. STO : extending the derogation based on currency used to all non-EU currencies

With regards to the share trading obligation (STO), we support the transposition in the level 1 text of the transitional measures adopted by ESMA in October 2020.

However, we consider the derogation based on the currency used for the transaction should be extended to all non-EU currencies instead of the domestic currency of the market where the transaction takes place. This is the case for instance of AMS AG, lastminute.com, COSMO PHARMACEUTICALS N.V.CMN et PIERER Mobility AG, whose transactions are mainly in CHF both in the Swiss and UK markets.

We also believe that the derogation in Article 23 of MiFIR on a *non-systematic*, *ad-hoc, irregular and infrequent basis* is extremely important and should not be deleted to continue covering exceptions from normal business activities.

c. Alleviating investment firms' best-execution reporting constraints

We are in favour of deleting both Article 27(3) and 27(6) of MiFID II, related to "RTS 27" and "RTS 28" best execution reports as proposed in the ECON draft report. They represent an important burden to produce and are not read by investors while many buy-side investment firms can receive all the relevant information via other means (*e.g.* brokerage meetings).

This seems all the most relevant as the UK already removed them entirely in December 2021.

d. Modification of the existing reporting regime

We support the creation of the status of designated reporting entities, as proposed in the EP draft report, which should remove the uncertainty of the existing SIs reporting regime and has led to duplicative reporting and higher costs for small investment firms in particular. We believe the creation of a register managed by ESMA should result in a more realistic view of market participants.

e. Preserving open access provisions

Most AMAFI members are against the deletion of open access provisions[13]. They question the argumentation of the EC which considers that it would improve competition and innovation. Indeed, those are the very benefits the provisions were introduced for and will deliver if commercial opportunity and regulatory support secure adherence. There is no reason to introduce in a level 1 text provisions that would pre-empt the possibility to put in place open access for ETDs for instance through the use of new technologies. The same issue was previously raised for cash markets while in the end it has become successful, if incomplete, change of the clearing arrangements to the benefit of market participants. Open access for ETDs could lead to lowering the clearing costs.

[13] Some AMAFI members welcome the proposal to remove the open access provisions for ETDs underlining that this removal would eliminate the prospect of liquidity fragmentation (at the trading level) and of the increase of systemic risk (at the clearing level).

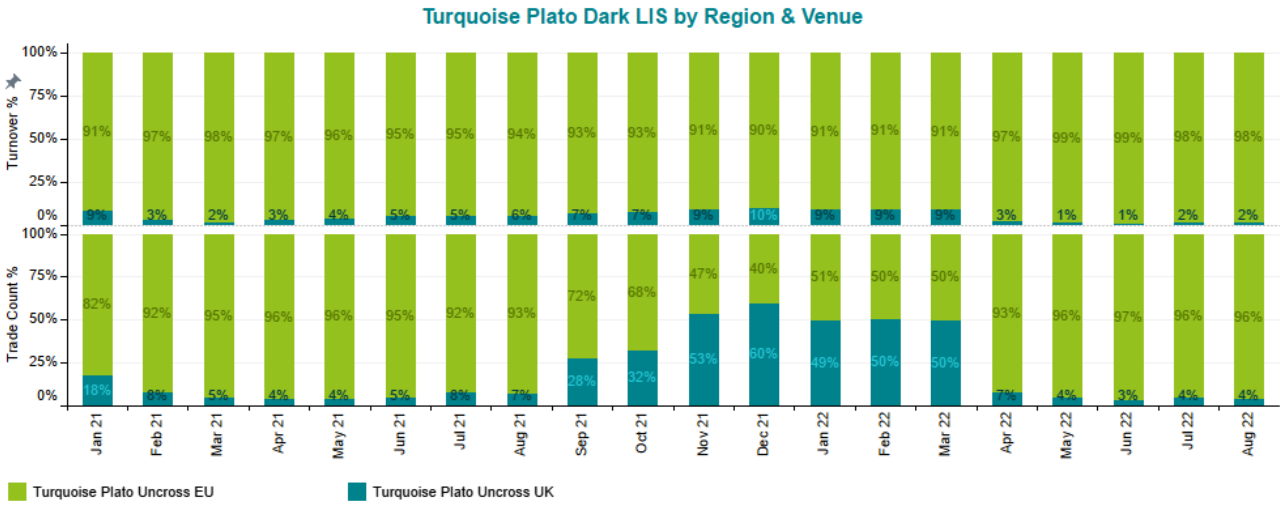
Appendix - Dark Trading in EU shares: an illustration of the impact of EU-UK regulatory divergence

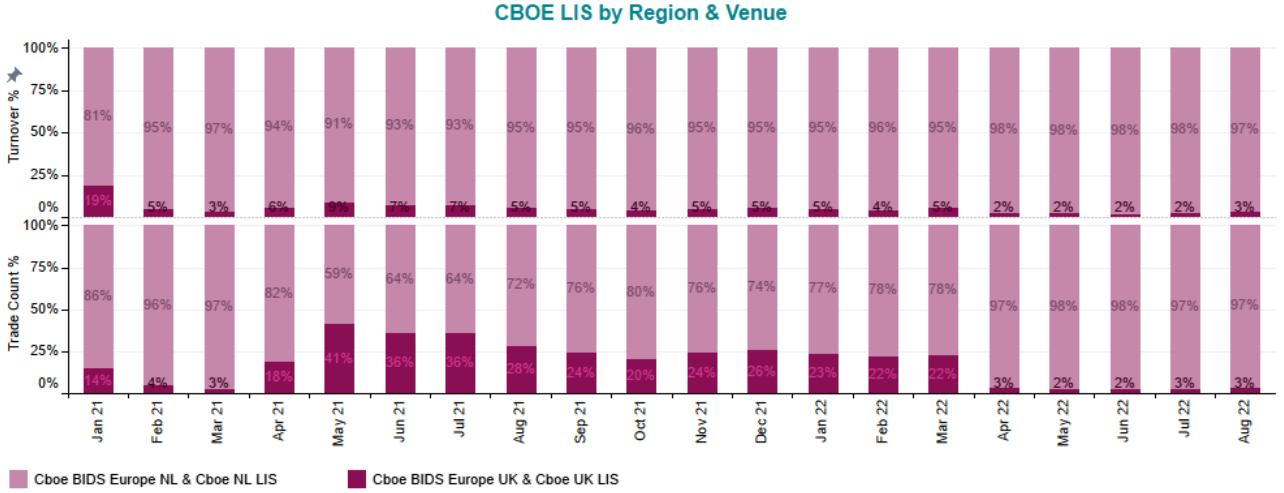
Beginning of 2021, the FCA qualified all EEE shares as illiquid. The main impact of that move was to move the UK Large In Scale (LIS) threshold for these shares to EUR 15k, while the threshold remained set at EUR 650k for the most liquid of these shares in the EU. As a consequence, transactions above EUR 15k were eligible to dark trading in the UK any case, since the Double Volume Cap designed to limit the market share of dark trading applies only to transactions below the LIS.

CBOE and Turquoise implemented the FCA threshold for their UK dark pools in April 2021 and September 2021 respectively. This resulted in a significant transfer of liquidity from their EU dark pool to their UK dark pool.

Since the 1st of April 2022, the FCA has applied the results of liquidity calculations performed on the ground of 2021 volumes, that resulted in the qualification of a significant number of EU shares as "liquid". As a consequence, the UK LIS threshold for these EU shares moved back to the EU levels, and the market share of UK dark pools on EU shares moved back to the levels observed beg. 2021.

Even though it was on limited scale, and was based on parameters, rather than on regulation differences, this case illustrates the way EU-UK regulatory divergence can translate into shifts of liquidity on EU instruments between the EU and the UK.





Source: BNP Paribas, CBOE, Turquoise.