BPFI POSITION PAPER ON MIFIR REVIEW

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INTRODUCTION

Banking and Payments Federation Ireland (BPFI) warmly welcomes the European Commission (EC) proposal amending the Markets in Financial Instruments Regulation (MiFIR), which is of critical importance for the competitiveness and attractiveness of EU financial markets.

As the EU looks to develop a robust and well-integrated capital markets, we believe the proposed changes to MiFIR can support this political priority, while helping to deliver on the EU's other key objectives, such as the transition to a digital and sustainable economy where financial markets have a major role to play through the diversification of funding sources.

Against this backdrop, the overarching objectives of the review should be to enable EU markets to further contribute to the economic recovery by allowing them to support the financing needs for EU companies. In our opinion, the proposal goes some way to ensuring that these objectives are delivered upon, particularly with the introduction of a real-time comprehensive consolidated tape, which can bring significant added value to the development of EU markets.

We also support certain targeted changes that seek to make the existing regime more effective and proportionate, like the adjustments to the EU STO and DTO. In our view, ensuring the regulatory framework remains flexible is critical to the overall attractiveness of EU markets considering the changes being introduced by the UK through its Wholesale Markets Review. To avoid unnecessary fragmentation of markets, EU policymakers need to take into consideration the wider regulatory developments taking place globally.

At the same time, we also think certain aspects of the proposal could be improved through targeted changes to ensure that the framework is appropriately calibrated. In particular, it is our firm belief that the EU needs to retain the diversity of its trading landscape, including the role Systematic Internalisers (SIs) play. Below we have set out a number of recommendations on how to ensure the key objectives of the review are delivered upon.

i. IDENTIFIED CORE TOPICS

A. CREATING A REAL-TIME CONSOLIDATED TAPE

We fully support the ECs proposal to develop a real-time Consolidated Tape (CT) in equities, ETFs, and liquid bonds[1] as a first step. This can be a "golden source" for investors and smaller firms and help create an easily accessible and comprehensive picture of the trading landscape in the EU, which is currently dispersed across numerous competing trading venues and systematic internalizers (SIs). Alongside this, we see concrete benefits that a CT can provide to firms, small trading venues and regulators such as;

- supporting best execution for investors by having close to real-time pricing and volume data
- democratising access to comprehensive and standardized market data for retail investors and supporting their participation in EU capital markets

[1] Some BPFI members would support the creation of a real-time CT for the most liquid derivatives, but others see this as challenging until such time as complexities with using ISINs as identifiers have been addressed.

- supporting liquidity risk management for buy-side participants through having a consolidated overview of the market, while also helping regulators monitor any emerging stresses in the capital markets
- Strengthening the resilience of EU markets in the face of market outages by providing instant communication to investors that a problem exists
- Enhancing the ability of compliance managers to monitor and react to any detected market abuse practices through the use of real-time market data and AI tools
- Helping smaller exchanges gain visibility with buy-side participants who do not have a full overview of the EU trading landscape through a post-trade CT.

As proposed by the EC, we support having separate CTs per asset class, each with only one CT provider. In addition, we welcome the proposal for a comprehensive CT for both pre-trade and post-trade data for equities. We do recognize that for practical reasons a staged approach to the development of a CT may be required and in such a scenario, we believe the focus of EU policymakers should be on the creation of a CT for post-trade data as a first step, with pre-trade to follow with minimal delay. However, we would welcome further clarity as to the timing of when the CT for all the asset classes and pre-trade CT for equities will commence in the Level 1 text. In the initial draft, the wording of Art 27 (as well as the recital 20) suggests that a post-trade CT for equities will be developed initially, and after a period of time, assess whether there is a need to develop a pre-trade CT. In our view, there is already a confirmed need for a pre-trade CT for equities and the proposed delay for delivery is too long.
In light of this, we see the following as essential features for the development and usefulness of a CT:

- Mandatory contribution to the CT for all operators and firms as proposed by the EC. This should include trading venues, APAs and SIs.

- The CT should be close to real-time as possible as proposed by the EC. Given the technical sophistication of existing market data providers, we do not envisage any challenges to such a CT.

- There should be no mandatory consumption of the CT, as this would simply increase the cost of market data rather than help address the challenges posed by rising market data costs.

B. ADDRESSING DATA QUALITY CHALLENGES

In order for the CT to be successful, it is paramount that current data quality challenges are overcome. Creating an effective CT will therefore depend on simplifying and harmonising data standards, which providers will need to adopt. Currently, the calibration of data is not streamlined, while the quality of the data differs across the various vendors who supply data to the market. The problem mostly arises with how the data source is defined. If this situation persists when a CTP is appointed, it will make the creation of a CT more difficult, resulting in increased costs and complications. To avoid that from happening, harmonization of data sources should be prioritised before the CT goes live.

As a post-trade real time CT will support investors in understanding the wider EU trading landscape such as market liquidity, while helping to support best execution, without quality data then the objective of democratising data and growing EU capital markets could be undermined. Phasing of implementation of a CT should therefore ensure sufficient time is embedded in overall timelines to allow for this harmonization, including any necessary further consultation and technical rulemaking by ESMA, rather than setting a fixed launch date which could compromise the quality of the outcome.

One benefit of better and more granular data quality would be to identify what is addressable liquidity within the consolidated tape. Given the breadth and scope of transparency, a huge amount of data is published which is not addressable in nature and if mandated effectively, industry driven standards could help deliver more efficient and clear data. This would be of benefit for identifying and assessing market structural changes

In particular, the implementation of the post-trade transparency regimes under MiFID II identified a number of data quality issues relating to SI and OTC post-trade reporting. Therefore, having better quality and more granular data can help identify what is addressable liquidity within the CT. To help iron out these challenges we would recommend:

- Data quality of the inputs into the CT need to be simple and standardized in order to make the tape useful. We therefore welcome the EC's proposal to create a data standards group under EU law.

- Mandating the use of an open common industry standard such as FIX, in order that the data is cheaper, better quality and more effective. In particular the work on Market Model Typology (MMT) standard can help improve the consistency and comparability of data, as recognized by ESMA in its report on a CT.

- Exclude non-addressable/non price forming trades for the purposes of post-trade transparency

C. SHARE TRADING OBLIGATION (STO) & DERIVATIVE TRADING OBLIGATION (DTO)

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. We believe this is a sensible approach and provides further legal clarity in respect to the application of the STO to EU ISINs. However, we have concerns around the removal of the existing derogation in Art 23 MiFIR on a non-systematic, ad-hoc, irregular and infrequent basis, particularly given its linkages to the ESMA position with respect to its interpretation of the application of the STO.

When it comes to the DTO, we welcome the EC proposal to align the scope with the changes introduced through EMIR Refit, such that only trades subject to the Clearing Obligation can be subject to the DTO. We also support the EC proposal to suspend the mechanism upon member state request for EU market participants, under certain circumstances when trading with non-EU clients. This measure could help address the unfortunate impact conflicting DTOs have on branches of EU firms located in non-EU jurisdictions, like the UK, and should come into force as soon as possible. However, in our view, to avoid market fragmentation, we consider that any exemption requested by a NCA for its investment firms and granted by the EC should apply automatically to other concerned entities as long as they respect the set criteria laid down by the EC. We would therefore make the following recommendations:

STO

- Retain the existing Art 23 exemption for *non-systematic*, *ad-hoc*, *irregular and infrequent* trades.

- Extend the derogation based on the currency of the non-EU jurisdiction to all non-EU currencies instead of the domestic currency of the market where the transaction takes place. This would ensure that EU firms can continue to trade a small number of shares that are dual-listed and non-EU.

DTO

- In our view, the fixes agreed to the application of the DTO should be enter into force as soon as possible and be fast tracked. This will remove existing legal misalignment with EMIR and help solve the conflicting DTOs faced by EU entities in the UK for example.

D. TRANSPARENCY REQUIREMENTS

We fully support the objective of MiFID II/MiFIR to contribute greater transparency in the equity and non-equity markets. In fact, MiFID/R established the most ambitious regime globally, covering many asset classes and products.

Having been in place now over 2 years, it is understandable that a review and possible re-calibration should be assessed. However, **any overhaul of the regime needs to be carefully examined** due to its relative infancy. Only adequately calibrated regimes can achieve the objective of delivering transparency to the market. As such, **we do not believe further changes to pre-trade transparency rules are required at this time, rather there should be a strong focus on improving the quality and timeliness of post-trade transparency.**

Looking at fixed income, derivatives and equities, we would like to highlight:

1. Fixed income

Given that non-equity markets do not function in the same manner as equity markets, we believe **the focus on achieving a level of transparency based on a significant number or proportion of bonds being reported should be reconsidered.**

For example, there can be differences depending on the non-equity underlying and the liquidity of individual bonds varies over time. As such, an appropriate calibration of transparency and accuracy of reporting is a vital pre-cursor to the success of a Consolidated Tape Provider in both fixed income and equities.

In addition, our members find that **within the professional Fixed Income markets there seems to be no demand for MiFIR-mandated pre-trade transparency**. The main purpose of transparency is to provide potential investors with necessary information on price formation and to enable them to make informed decisions on investments.

However, if changes are required for fixed income markets, **a re-calibration exercise could be explored**, considering the appropriateness of the current classes of instrument. The objective should be to achieve optimal transparency by providing data that is useful to end investor decisions, whilst not being compromised by unnecessary data which clouds the useful information or exposing market makers to undue risk by including instruments that are not truly liquid. In determining these mechanics, consideration should also be given both to the accuracy of the transparent population and to the need to create a framework that is workable and sustainable from a maintenance perspective.

- **PROPOSAL**

We recommend redesigning the framework to ensure the focus is on enhancing transparency for the universe of "liquid" bonds trading in sizes which do not expose market makers to undue risk. Sufficient waivers and deferrals must be retained for transactions in illiquid instruments or that are large in scale (LIS). The "size specific to the instrument" threshold should not be removed unless it is compensated for by an appropriate recalibration and lowering of the LIS threshold based on a thorough analysis of the potential impact to liquidity and risk to market makers.

2. OTC derivatives

Since the introduction of MiFID/R, it has led to a significant amount of additional data being made available to the market. However, **market participants have highlighted that the data does not always provide meaningful transparency or added benefits to end-users that would justify the complexity or costs associated to it**, particularly in the case of certain derivatives.

As highlighted above, non-equity markets are fundamentally different from equity markets, while there are significant differences across derivatives asset classes. Our members therefore consider that **transparency requirements must be balanced to avoid damaging liquidity or undermining price discovery processes**.

For example, pre-trade transparency for certain OTC derivatives can be of a different nature because a majority of these products do not operate with a direct interaction between buying and selling orders. In addition, there are some OTC derivatives instruments that are not liquid. Therefore, the general benefits of pre-trade transparency in these markets are far less compared to much more liquid markets such as equities.

As such, **derivative transparency should be focused on the most truly liquid derivatives** – those subject to the derivative trading obligation (DTO) or the clearing obligation. When it comes to the DTO it includes an assessment by ESMA of a range of factors (including, as a result of the required clearing obligation consideration), product standardisation, availability to trade on venue, liquidity and number and type of active market participants.

The defined parameters for DTO products are clear and well understood by market participants and avoid many of the pitfalls and complexities of an ISIN based approach.

- **PROPOSAL**

Define the scope of the transparency regime to only include liquid bonds and OTC derivatives. This will allow for the relaxation and simplification of deferrals, subject to retaining a suitably calibrated deferral for trades in large size. For both Bonds and OTC derivatives, importantly these changes would entail a move away from the concept of "Traded on a Trading Venue" (TOTV) as a determinant of the scope of transparency, in order to adopt to more suitable means of defining the range. This will be a significant change, but the current TOTV scope has proven to be too broad and unworkable in practice to deliver meaningful transparency.

3. Equities

From a post-trade transparency perspective, the “seller reports” rule has created a number of unintended consequences that have led to duplicate reporting or investment firms’ inability to ascertain whether a trade is required to be reported by themselves or another counterparty in the trade chain.

- **PROPOSAL**

The accuracy and granularity of flagging in post-trade reports should be improved, through suppression of double reporting, addressing the divergence of interpretation, and providing for explicit categorisation of technical transactions which do not indicate a trading interest so these can be excluded. To retain protection for firms from undue risk when taking significant risk positions (multiple times LIS levels) through provision of liquidity, longer transparency deferrals should continue to be provided as under the current regime.

E. BAN ON PAYMENT FOR ORDER FLOW (PFOF)

We would like to underline that although PFOF for retail clients is an active practice within EU, it is limited to only a few jurisdictions, while we are unaware of any ETF Liquidity Provider (ELP) SIs that are engaged in PFOF. As such, we believe the current legislative drafting is misaligned.

More broadly, we consider PFOF to be a level playing field issue in the EU as the majority (but not all) NCAs have a ban of direct PFOF in place, with BaFIN the only NCA widely accepting the practice (subject to certain conditions being met). Also, the market models implemented to facilitate PFOF are non-competitive and of questionable benefit to retail investors, for example, where trading firms pay the retail order flow providers by establishing themselves as the single market maker on a trading venue.

Under this model, a retail broker enters into an agreement to receive PFOF when it routes orders to a specific trading venue (or segment of such). This is a ‘closed’ trading venue model, operating on a multilateral trading venue, where no other market maker is permitted to provide liquidity and the market maker has complete control over execution (including in some cases “last look”). Alongside this, the retail brokers release themselves from best execution obligations by stating in customer agreements something along the following:

> *The customer must instruct [*the broker*] at which of the execution venues offered its order is to be executed. This is true due to the restricted selection of execution venues described above, even if only one Execution venue is offered. ......As a result, [*the broker*] is not obliged to comply with this Execution Policy to achieve the best possible result (best execution).*

In our opinion a) there needs to be a harmonized approach to retail PFOF enforced across all EU jurisdictions, b) single market maker models masked as multilateral trading venues should be prohibited and c), if elected to be adopted, the ban needs to be expanded to encompass the current practices of retail PFOF being seen in the EU. We would suggest for instance that the text is re-drafted as follows:

Article 39a ***Ban on payment for retail client order flow ~~forwarding client orders for execution~~***

Investment firms acting on behalf of ***retail*** *clients shall not receive any fee or commission or non-monetary benefits from any third party for forwarding* ***or routing retail*** *client orders to such third* *party**, either directly or via a particular trading venue,** for their execution **or executing client orders with such third party.***

ii. OTHER KEY ISSUES

E. MARKET RESILIENCE

Repeat outages at major EU venues over recent years has had significant negative impact on EU equity trading. As witnessed last year, trading volumes do not redeploy smoothly to alternative venues even where they are available and unimpacted by the outage. These outages have seen market-wide trading in instruments listed on EU exchanges significantly reduce. This has been particularly frustrating for market participants and end users given the presence of alternative pan-European trading venues that compete with Market of Listing Venues (ML) during continuous trading hours and support trading in the affected instruments even during ML outages. This situation weakens the overall resilience of European markets and makes them vulnerable to single point of entry attacks. **In order to address the clear weaknesses in the system, a range of fixes should be deployed, including:**

- Require all venues to have in place a fully tested back up relationship with an alternative provider to allow for timely cut-over – including in the case of primary venues for critical market services such as opening/closing auctions

- Enhanced requirements for clear, consistent, timely, realistic and regularly updated communications by venues to market participants on outages, progress and timing to resolve.

- Removal of various MiFID requirements mandating firms have reference to “most relevant market”, as this embeds unfair and harmful dependencies on primary markets.

F. DOUBLE VOLUME CAP

Operation of the DVC is cumbersome, has not achieved goal to transfer more volumes onto lit markets and hampers predictability in process of determination of best possible execution. We support the concept of moving towards a single cap but we do question the 7% level of the cap considering the Commission did not present a quantified cost-benefit analysis outlining the rationale of this change.

G. COST OF MARKET DATA

Market data costs have risen considerably since 2017. This is due to a market structure whereby firms are compelled to purchase data from venues, but there is no competition as to where the data can be bought from due to the uniqueness of data obtained by the venues.

Venues are currently subject to a “transparency plus” model, which is intended to moderate the venues’ monopolistic advantage, but the evidence indicates that this is not currently working. **The significant increase in market data costs creates a barrier to entry for firms, and raises costs throughout the system, ultimately to the detriment of EU end investors.**

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

While we welcome the recently finalised ESMA Guidelines[2] on market data, early feedback from our members suggests that in the short term some market data providers have in fact used aspects of the Guidelines to justify yet further increases in costs, despite providing no incremental increase in the quality of services. **We hence urge ESMA and NCAs to consider as a priority whether further Guidelines are necessary, and to ensure data providers are applying** practices fully aligned to both the letter and the legislative intent of MiFID expectations and the ESMA Guidelines in order to curb and reverse the increases in costs. We note that the consolidated tape proposals, whilst a useful project in itself, would not solve for the problems of excessive market data costs.

[2] ESMA guidelines on the MiFID II/MiFIR obligations on market data, June 2021.

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