# FESE Response to German Ministry of Finance Consultation on MiFID II/MiFIR

15th March 2019

**Introductory remarks**

FESE welcomes the opportunity to respond to this consultation as we consider it timely for policymakers to assess the impact of MiFID II/MiFIR one year after application. While some changes in the market took place immediately (e.g. trading in broker crossing networks stopped as these were banned), in other cases adjustment to the new regulatory framework is likely still ongoing. In this consultation response, FESE highlights views in relation to the impact of MiFID II/MiFIR on the following areas: equity markets, derivatives markets, primary markets, market data and data reporting.

## 1. Equity markets

SI regime

**Application of tick size regime**

One key objective of MIFID II / MiFIR is to strengthen the price formation process on transparent multilateral trading venues and it therefore includes a share trading mandate and caps on dark trading. However, following application of MiFID II/MiFIR, market analyses showed that volumes previously traded in the dark only to a limited extent moved to lit venues and that the main shift was to systematic internalisers, block or large in scale venues and to a small extent to periodic auctions.

Given the clear contradiction between the policy intention and result, FESE supported regulatory amendments to the SI regime and efforts by regulators to ensure compliance with the single rulebook to deliver upon MiFID II/MiFIR's objectives. Notably, SIs have been benefitting from an unlevel playing field compared to trading venues as they have not been subject to the tick size regime and therefore been able to offer meaningless but marginally better prices. In conjunction with the MiFID II/MiFIR best execution provisions, this meant that SIs could drive significant trading flows towards them, a trend which was accentuated by the extensive use of smart order routers, which 'ping' multiple venues and SIs for prices and give priority to - even marginally - better prices.

FESE therefore warmly welcomes the political agreement on application of tick sizes for SIs which was reached in February 2019 on the Investment Firm Review since this file will amend MiFID II/MiFIR to correct the unlevel playing field by ensuring that tick sizes apply to SI quotes, price improvement on those quotes, and execution prices. Moreover, the rules agreed under IFR will provide an exemption for both SIs and trading venues when it comes to tick size application for midpoint trades above LIS. While the intention of these provisions is to provide for the same conditions for SIs and trading venues, it should be noted that while the exemption for SIs will apply at the same time as the tick size regime becomes fully applicable to SIs (normally in the course of 2019), the exemption for midpoint trades above LIS for trading venues, will only apply once implemented by Member States. This is due to the fact that the changes to trading venues' requirements are made in MiFID II that, as a directive, requires implementation before becoming applicable. Following application,

supervision and enforcement will be crucial to ensure that the unlevel playing field is indeed corrected.

Moreover, FESE would like to point out that at this stage the proposed amendment in COMMISSION DELEGATED REGULATION (EU) 2017/587 of 14 July 2016 (RTS 1) that includes provisions to require SIs to apply the common tick size regime up to standard market size, should not be endorsed by the co-legislator as this would contradict the Level 1 change that was decided upon in the Investment Firm Review as referred to above.

**Compliance with restrictions on riskless principal trading**

MiFID II/MiFIR provides that SIs benefit from less transparency requirements as they trade on risk. It also specifies that SIs should not be allowed to bring together third party buying and selling interests in functionally the same way as operators of regulated markets and MTFs.

While every trade in an SI must take place against the proprietary account of the operator, FESE has consistently highlighted inconsistencies in the MiFID II/MiFIR framework in respect of the potential deployment of riskless back-to-back transactions within SIs. Recognising the potential for this to be used by banks to enable broker crossing network (BCN) type models to be operated within SIs, ESMA sought to clarify the situation by initially providing guidance through Level 3 Q&A. This ultimately led the European Commission to amend one of the Level 2 Delegated Acts.[1] This Level 2 amendment prohibits investment firms, when dealing on their own account, from entering into matching arrangements with entities outside their group with the objective of carrying out de facto riskless back-to-back transactions in financial instruments outside trading venues. This is an important legislative amendment to ensure that investment firms cannot simply use SIs to accommodate BCN models and thereby transform SIs into a hybrid trading model. These changes were subsequently complemented by a further ESMA Q&A on back-to-back trading across asset classes.[2]

Notwithstanding these initiatives, we believe that regulators should continue to be alert to the potential for investment firms to develop models by which third party proprietary traders are enabled to provide liquidity to the customers of SIs. Furthermore, these models may rely on swap agreements and/or transactions with entities based in third countries. While the legislative framework is in place, it is now important to ensure regulators supervise to ensure correct application.

FESE would therefore strongly encourage regulators to carefully assess investment firms' application of Article 16a of Commission Delegated Regulation (EU) 2017/565 on SIs and riskless back-to-back transactions. To facilitate such an assessment of SI workflows and order execution practices, FESE has prepared a list of issues regulators might wish to look into. This list is included in annex.

FESE believes that there would also be merit in the Commission examining, with other relevant authorities, the case for SI trading to be included within regular and ongoing stress tests of the EU banking sector. Such an initiative would reflect the significant scale of this business and the need to monitor risks in the system.

Finally, FESE is currently assessing the impact of the definition and transparency requirements applicable to SIs, so as to ensure a well-functioning price formation process. The results of this assessment will be shared with regulators once it is finalised.

[1] Commission Delegated Regulation (EU) 2017/565
[2] ESMA MiFID II Q&A on Market Structure, Question 22



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## Share trading obligation

According to the share trading obligation (STO), EU investment firms can only undertake trades in shares admitted to trading in the EU on EU trading venues or equivalent third country trading venues.

Ahead of MIFID II/MiFIR application, the STO provision was highlighted by FESE and others to policy makers as one which would likely generate unintended consequences due to its extraterritorial reach. This assessment was made since, if equivalence is not granted, shares traded on third country non-equivalent venues also admitted to trading in the EU would have to be traded in the EU by EU investment firms. These provisions would apply regardless of the liquidity of non-EU shares on EU markets, meaning that shares that are highly liquid on third country venues but for which liquidity on EU markets is low would also have to be traded in the EU.

To date, only a handful equivalence decisions have been adopted, while the Commission and ESMA have limited application of the STO by interpreting the scope in a narrow way. Both regulators have indicated that equivalence decisions will only be adopted for countries where the EU trading in the shares is of a certain magnitude and that the absence of an equivalence decision therefore does not prevent EU investment firms from trading shares admitted to trading in the EU on non-EU venues.[3]

While the extraterritoriality has been de facto limited this way, the approach does not provide certainty to the industry as the regulation's requirement exempting 'non-systematic, ad hoc, irregular and infrequent' trading has not been clarified in a conclusive way.

In the medium to long-term, FESE would therefore recommend a review of the application of the STO to limit its scope to EU shares only or to focus more on the liquidity in the EU.

## Periodic auctions

Considering the rise of market share of frequent batch auctions, following application of MiFID II/MiFIR, ESMA, in their call for evidence on periodic auctions, observed that the trend seems to be to a large extent driven by instruments that have been suspended under the double volume cap (DVC) and that this development should therefore be further assessed.[4] FESE overall shares ESMA's assessment but while we recognise many of the observations in ESMA's analysis of frequent batch auctions, it should be kept in mind that the market share of periodic auctions is still only around 2 percent for European markets.

As rightly noted by ESMA, trading venues operating auctions is nothing new, on the contrary, auctions are widely used to orderly open and close trading sessions and many venues also organise intra-day auctions. FESE welcomed ESMA seeking advice on the functioning of frequent batch auction systems as this will result in a better understanding of market developments and enable correctly distinguishing between conventional auctions and new frequent batch auctions[5]. Moreover, we consider that any consideration of regulatory measures should be based on a thorough analysis of the overall market structure.

[3] European Commission, Press Release, 21 December 2017, 'MiFID II: Commission adopts equivalence decision on Swiss share trading venues', available here & ESMA, Press Release, 'ESMA clarifies trading obligation for shares under MiFID II', 13 November 2017, available here.

[4] ESMA, 'Call for evidence periodic auctions for equity instruments', 9th November 2018, available here

[5] Our full reply to the ESMA consultation, is available here.



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## 2. Derivative markets

### Non-discriminatory access

MIFIR provides for non-discriminatory access to clearing, specifically with provisions requiring "two-way" access between CCPs and trading venues in respect of transferable securities, money market instruments and exchange-traded derivatives. That is, CCPs must provide access to all trading venues, and trading venues must provide access to all CCPs. Critically, the access provisions also require fungibility or margin offsets where multiple trading venues are clearing similar products at the same CCP. In addition, MIFIR requires entities with proprietary rights to benchmarks (such as an equity index) to provide non-discriminatory access to any trading venue and/or CCP which wishes to offer products based on the benchmark.

However, ahead of application of MiFID II/MiFIR, regulators granted transitional periods for, inter alia, ICE, London Metal Exchange, Eurex and Euronext[6] from these provisions. This transitional period applies until 3 July 2020.

FESE believes that for exchange traded derivatives (ETDs), application of these requirements would undermine the stability and liquidity of European derivative markets and therefore considers that ETDs should be removed from the scope of the MiFIR 'non-discriminatory access' provisions.

Non-discriminatory access for ETDs would create unresolvable issues for both trading venues and CCPs and introduce operational inefficiencies that could prove detrimental to financial stability as well as liquidity, especially in times of stressed market conditions. It is therefore critical that policymakers acknowledge the distinct characteristics of ETD contracts and review again whether an open access policy is desirable.

With the post-Brexit capital markets in mind, Europe needs to consider what type of capital market to construct and what its fundamental architecture should be. For efficient and liquid hedging and risk transfer markets of ETDs, non-discriminatory access provides no added value in that architecture. Non-discriminatory access would impose a fragmented structure on EU ETD markets, causing problems for price formation, oversight and systemic risk that cannot be adequately addressed.

A re-think of the MiFIR provisions on non-discriminatory access to CCPs and trading venues is thus warranted. It is important that policymakers acknowledge the distinct characteristics of ETD contracts and review the trading and clearing of derivatives. Given that the political and regulatory agenda is now more than ever determined to preserve and further enhance stability of financial markets: central clearing has become even more important for the evolution of the post-trading landscape in the EU as well as globally. Brexit also underlines the need to ensure effective supervision of financial markets infrastructures and enforcement of rules across jurisdictions.

Given that MiFIR's non-discriminatory access provisions for ETDs are not workable, contradict CCPs mandate to manage risks and impair exchanges' ability to foster liquidity in ETDs, FESE calls on EU policymakers to consider Level 1 amendments to remove ETDs from the scope of open access provisions in MiFIR (Article 35 – 38 MiFIR).

[6] Euronext Amsterdam, Euronext Brussels, Euronext Lisbon and Euronext Paris



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## Position limits

The intention behind the MiFID II/MiFIR position limits is to support liquidity, prevent market abuse and support orderly pricing and settlement conditions. However, even before MiFID II/MiFIR application, FESE members applied similar regimes, adapted to the respective markets and tailored to the specific needs of the commodity type, whereas, unfortunately, the current position limit regime has several shortcomings.

The MiFID II/MiFIR position limits regime has so far been able to function in a reasonable manner for a number of well-developed benchmark contracts. These highly developed markets are characterised by a large number of different types of active trading firms and an overall substantial amount of open interest. However, for the development of new products and further growth of the existing illiquid commodity derivative markets, the position limits regime has proven to be a substantial barrier. Fast growing markets in particular have suffered from an increasingly restrictive standard limit of 2500 lots as open interest in a market classed as illiquid increases, an inflexible treatment in terms of their categorization under the position limits framework and an inaccurate reflection of the underlying physical markets.

Coupled with an immediate availability of OTC or third-country venue commodity derivatives as well as cumbersome regulatory requirements for ETDs, there is a serious risk of contracts moving from EU trading venues into the OTC space and to other jurisdictions. The EU position limits regime may thus hinder the development and growth of new products, as well as the on-venue trading of commodity derivatives, in the EU. For example, in the US, only benchmark products are included in the position limit regime, while the EU regime covers all commodity derivatives traded on EU trading venues regardless of their liquidity profile, size of open interest and underlying market characteristics.

Whilst the policy objective of MiFID II as expressed in its implementing RTS 21 clearly states that: “Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately“, in practice it has proven to be impossible for NCAs to reclassify markets and recalibrate the applicable position limits in a manner that would prevent a negative impact on the development of fast growing markets.

FESE therefore believes that position limits for new and less liquid contracts i.e. contracts with an open interest up to 20.000 lots should be temporarily suspended in order for these contracts to be able to develop. However, should such a change not be immediately possible, FESE recommends that the current provisions are nonetheless adjusted in order to mitigate their adverse negative impact on the development of markets in commodity derivatives.

FESE proposes that the current de minimis limit for illiquid markets i.e. contracts with an open interest up to 10.000 lots is increased to 5 000 lots to better accommodate the nature of fast growing contracts. Such an approach would ensure that (1) the development of contracts is not curbed by an overly restrictive limit once open interest grows closer to the 10.0000 lots upper range of the illiquid markets category and (2) the overall framework becomes less dependent on unreasonably high levels of flexibility required from NCAs in terms of re-classifying markets and re-calibrating applicable limits on a near real-time basis.

For contracts between 10.000 lots and 20.000 lots or “less liquid contracts” FESE proposes that the current derogation for the position limit should go up to 50% and be transformed into a default approach from which derogations could be envisaged if needed.

FESE members furthermore have extensive experience with operating a position management system based on hedging exemptions. Under its regime, exchanges can grant such exemptions to any market participant, regardless of their legal status, provided that the hedging intention is adequately documented and demonstrated. This ensures that the



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genuine hedging activity is not restricted and allows commodity market participants to manage their risks efficiently.

FESE proposes that an analogous regime is introduced within the context of MiFID II/MiFIR package.

### Trading obligation for derivatives combined with the EMIR clearing obligation

Responding to the financial crisis, at the 2009 Pittsburgh meeting, G20 leaders agreed to improve transparency of OTC derivatives and that standardised OTC derivative contracts should be centrally cleared through CCPs and traded on electronic platforms, by 2012. Central clearing for OTC derivatives has been mandated in the EU via EMIR, which was adopted in 2012.

However, 10 years after the financial crisis, the clearing and trading mandates for OTC derivatives have still not yet been fully implemented in the EU, with some categories of counterparties still being exempt. In addition, the obligations only apply in respect of certain interest rate and credit OTC derivatives. Since the trading obligation for OTC derivatives (mandated by MiFIR) is linked to the clearing obligation for OTC derivatives (mandated by EMIR), only those OTC derivatives subject to the clearing obligation can be realistically subject to the trading obligation.

In contrast to the OTC space, all ETDs are automatically subject to central clearing (mandated by MiFIR), regardless of the counterparties involved in the transaction and regardless of the asset class. While all derivatives traded on a regulated market are subject to an obligation to centrally clear, look-alike contracts traded OTC (i.e. those contracts that mimic the economic value of the ETDs but are traded OTC as defined in EMIR) are only subject to the requirements if ESMA mandates the products for clearing. By extension, these contracts are also not subject to the trading obligation under MiFIR.

There is therefore a loophole in the interplay between the divergent clearing rules under EMIR for OTC derivatives and under MiFIR for ETDs, as well as the trading obligation under MiFIR, that creates incentives to move ETD volumes to OTC venues and to pure bilateral trading that is not centrally cleared. In addition, contracts that are traded bilaterally are not subject to MiFIR transparency requirements or even certain reporting requirements.

In order to close this loophole, and ensure transparent and orderly markets, we would recommend extending the EMIR clearing obligation to all standardised contracts, in particular standardised equity derivatives.

### Product intervention measures

MiFIR gave ESMA powers of product intervention to introduce measures on a three-monthly basis. Throughout 2018, ESMA made use of these new powers to ban marketing, distribution and the sale of contracts for difference (CFDs) and binary options to retail clients. These measures have now been renewed a number of times.

FESE agrees with these measures as the products in question are not suitable for retail clients. However, it is important that the scope is clearly defined so as not unintentionally capture other types of instruments, in particular securitised derivatives. FESE therefore welcomed the ESMA Q&A from 30 July 2018 clarifying that turbo certificates are not within the scope of the measures. However, the Q&A states that regulators will assess whether to include these in future measures.

FESE would therefore wish to highlight a number of elements specific to securitised derivatives that should be considered:

- Securitised derivatives are traded on regulated trading venues with the associated levels of supervision and market surveillance, in contrast with CFDs which are generally traded on OTC basis;



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- In contrast with CFDs, securitised derivatives are issued only after publication of a prospectus;
- Securitised derivatives are subject to the PRIIPS Regulation and the publication of a key information document for investors which highlights the level of risk and the cost associated with these products;
- To comply with their risk management processes and their supervision, banks proposing securitised derivatives, notably in the case of warrants and certificates, hedge the risk created by these instruments – in contrast with CFDs issuers where hedging is not systematic;
- Furthermore, due to non-hedging of client positions, the CFD-Provider may directly benefit from a losing trade which would be a conflict of interests that issuers of securitised derivatives never face;
- Issuer default risk is therefore considerably higher for investors when investing in CFDs than when investing in securitised derivatives, creating a different credit risk profile between these two products.

## 3. Primary markets

### Equity research for SMEs

MiFID II's inducement rules requires research to be paid separately from other types of fees, whereas previously the cost of research used to be bundled with execution fees. The intention is to provide more clarity and transparency around costs, but feedback indicates that the rules may have unintended negative consequences for the provision of research on smaller companies. The new disclosure rules regarding research will make it difficult for small and medium-sized enterprises to access and exist on capital markets. The new rules will increase the costs and administrative burden of going and being public for SMEs and thus thwart the aim of the Capital Market Union to create optimal regulatory framework conditions, especially for the European growth markets.

FESE considers that the inducement rules require reassessment, particularly their impact on equity research conducted on SMEs as there is some evidence[7] that coverage is diminishing as a result of the regulatory requirements.

In this regard, we welcome the European Commission's call for tenders for a study[8] on the effects of MiFID II/MiFIR research payment rules on SME research and fixed-income investment research and in particular the impact on the amount and quality of research. We believe this study could be an important first step towards reviewing these rules.

In parallel, there are also issues arising from the prohibition on investment advice providers to accept monetary incentives from issuers to promote investment in IPOs or other equity investments.

Specifically, MiFID II/MiFIR's stricter rules on inducements are also likely to have a disproportionate impact on the way equities are currently distributed to investors. In the past, blue chip issuers raising capital via an IPO with a retail tranche – i.e. initial public offerings by large companies which directly targeted individual investors as part of their future shareholder base – frequently resorted to inducements to encourage investment firms in their target countries to promote their shares with retail clients. This model is an efficient

[7] See CFA Institute 'MiFID II One year on' (2019) for the drawbacks with the MiFID II regime for investment research
[8] FISMA/2017/117(06)/C



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tool to promote retail investment in equities and was, for example, a feature of the privatisation campaign in France in the late 1980s.

With the introduction of MiFID II/MiFIR's inducements rules, we believe investment firms will likely focus on promoting other types of investments, for example their own investment funds or life insurance products, to their retail clients. This will only reinforce current trends in shifting investment away from equities to the benefit of other asset classes.

## The framework for SME Growth Markets

MiFID II/MiFIR introduced the concept of the SME growth market as an MTF dedicated to SMEs. The purpose was to facilitate access to capital for SMEs by designating a capital market where SMEs would face lighter regulatory requirements. Nevertheless, while MiFID II/MiFIR defined SME Growth Markets, many of the substantive provisions regarding their governance are not found in the MIFID, but in the Prospectus and Market Abuse Regulations. In May 2018, the Commission proposed an initiative to promote SME growth markets by making amendment to the Market Abuse Regulation, the Prospectus Regulation and MiFID II Level II.

SMEs are critical to accomplishing the EU's goals of job creation, competitiveness and growth. As the basis for these goals, SMEs require a favourable environment, which allows them to meet their financing needs, in particular when accessing markets.

Many FESE Members organise specialised markets that allow SMEs across Europe to access capital markets. We encourage policy makers to create more tangible benefits to be listed on EU growth markets. On these markets, there is a continuous dialogue among various participants in the ecosystem about improving the rules tailored to local needs. This is done with the aim of finding the best balance between maintaining a liquid and trusted market with reduced burdens for issuers and adequate levels of investor protection. These markets, for those reasons, should retain a certain level of flexibility to ensure efficient functioning and the integrity of the market. Any policy on trading should be judged on how it affects the diversity of the financial services that exist to serve companies, other issuers and investors.

FESE fully endorses both the Level I measures presented by the Commission to encourage SMEs listings and the Level II amendments to the Delegated Regulation under MiFID II. In particular, FESE members welcome the proposal to establish a less burdensome 'transfer prospectus' for SME growth market issuers seeking a graduation to regulated markets. We believe this measure will be beneficial for companies wanting to 'up-list' and will reduce some of the administrative barriers to do so.[9]

Furthermore, a new definition of SME is highly appreciated, especially for non-equity issuer. The criteria of overall balance and annual net turnover are not suitable for qualifying SMEs issuing debt instruments. Instead, the total volume placed should be used as the sole criterion.

[9] Our full position, is available here.



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## 4. Market data

### Consolidated tape

MiFID II/MiFIR introduces the concept of a consolidated tape provider (CTP). However, since application, no 'MiFID authorized' CTPs have been registered in Europe. This is primarily because this type of services (aggregation/consolidation of data) are already provided by market data vendors. However, in contrast to market data vendors, 'MiFID authorized' CTP providers are subject to the full set of MIFID II provisions, including the provisions on reasonable commercial basis (RCB).

While no 'MiFID authorized' CTP has so far emerged, the fundamental problem in Europe is actually the **lack of data quality and consistency**, in particular with respect to SIs and OTC transactions, as opposed to the absence of a 'MiFID authorized' CTP.

It is important to note that data quality and consistency problems are aggravated by fragmentation. Indeed, alongside more than 60 equity trading venues, MiFID II / MiFIR has brought an increase of additional data sources such as SIs and Approved Publication Arrangement (APAs). While data from trading venues generally is of the highest quality (as regards availability and reliability), data originating from OTC trade reporting still lacks quality from the source. On the one hand, APAs and data vendors add to market efficiencies as well as data aggregation and publication. However, on the other, data consistency, quality and reliability needs to be addressed including with respect to the source of the information – i.e. the investment firm.

In this respect, the implementation of MiFID/MiFIR II has been challenging. The very flexible reporting rules under MiFIR (where either seller or buyer reports, except if one of them is an SI) create high uncertainties. While current trade flags for on-venue executions are fully consistent, issues arise from trade categorisation of OTC/SI trade reports as well as duplicates of OTC/SI reports. In this context, there still seems to be uncertainty across investment firms in the EU on how to adequately flag executed transactions before submitting their trade reports to APAs. Some of those concerns have already been addressed to ESMA, including by investment firms.

**At the same time, the assumption that a CTP will solve data quality and consistency problems is a clear misconception**. Crucially, without any improvements to data quality at source, the 'MiFID authorized' CTP (or APA) will not be in a position to fully deliver on data quality and consistency in this particular respect. Neither an APA nor a 'MiFID authorized' CTP is in a position to solve data quality and consistency issues downstream which originate from inconsistent trade reporting at source.

Furthermore, the fact that market data vendors already provide consolidation services (and normalise data), while CTPs would obviously not be able to correct data quality and consistency shortcomings from the source, the rationale underpinning the introduction of a 'MiFID authorized' CTP can clearly be questioned.

### Reasonable commercial basis (RCB)

MiFiD II/MiFIR strengthened the requirements applicable to the provision of transparency data, notably via the reasonable commercial basis (RCB) and introduction of disaggregation rules. Market data provided by exchanges is a small element of a much longer value chain, in a broader market data industry that is large and growing. Stock exchange market data is often aggregated and complemented by other sources of data and value-added services, **with stock exchange data revenues accounting for around 15% of the total value chain**

However, since application, some stakeholders have argued that these provisions have not been effectively implemented and that additional price regulation measures should be taken. Arguments brought forward to introduce price regulation in respect of market data



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are often not fact-based and we would like to take this opportunity to provide some evidence to address some of the statements occasionally put forward by some market participants:

***"There is a regulatory requirement to purchase market data"***

Unlike in the US, a requirement for firms to obtain real-time market data does not exist under MiFID II/ MiFIR and, in case market data is obtained, the relevant fees must comply with the RCB framework. In addition, 15-minute delayed market data is made available for end-users of exchange market data free of charge.

***"Stock exchanges increase market data fees to compensate revenue losses at trade execution services"***

There is no evidence to support this. However, there is evidence of price adaptations, including reductions for some products. Furthermore, in case of structural changes in the market, such as a significant substitution of human data users through electronic usage of data, exchanges should naturally adapt pricing structures accordingly. Market data revenues are also necessary to fund enhanced quality and reliability of the price formation process through continuous investment in a safe and reliable infrastructure that is available to market participants at any time even during challenging market situations and crises. Extensive monitoring activities of the price formation process by exchanges also contribute to such an environment. However, it makes sense to look at the ratio of market data revenues to the sum of market data and trading revenues. Evidence from our members show that, during the last years, the ratio in question has on average remained broadly stable.

***"Stock exchanges are monopolies that exploit their market power which leads to market failure"***

MiFID I brought in new competition for stock exchanges and led to the arrival of new entrants in the market. These trading venues brought competition and are now also able to charge market data fees and compete based upon both trading fees and market data fees, just like the previous incumbents.

***"Provision of data is a simple and cheap undertaking"***

FESE considers this narrative to be based on an incorrect understanding of the functioning of equity markets and the core functions of a stock exchange. In fact, for exchanges, price formation on exchange is inextricably linked to the market data business as the cost incurred by exchanges to provide price formation is recovered from the fees for trade execution services and market data services. Any evaluation of the MIFID II/MiFIR provisions on market data needs to be based on a full understanding of the value of transparent markets, the investments involved in producing high quality market data on exchange and the commercial value derived from its exploitation by third parties, as well as overall market data costs and the place of exchanges in the market data value chain.

**In order to fully grasp market data costs facing end users, there is a need for a detailed understanding of the complete market data value chain, taking into account all relevant parties and how they interact with each other as exchanges are part of a larger market data value chain, e.g. including data vendors.** This is particularly important in light of the fact that stock exchange data revenues account for only around 15% of the total value chain.

In addition, given the fact that exchanges' business models have been extensively impacted by the MiFID framework, notably in terms of transaction fees, as well as from a market policy perspective, the price of market data has to be seen in the broader context of the overall costs of transacting and holding securities.

When assessing the impact of MiFID II/MiFIR on the market data landscape, policymakers should consider that impairing the commercial incentives to organise transparent markets will inevitably result in adverse consequences for investors, be they retail or professional,



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and beyond the financing of the economy, economic growth and employment. This is crucial to ensure consistency with the aims of CMU and the EU's desire to promote public capital markets financing.

Requests for a stricter price regulation of market data are unsubstantiated and such measures would run counter to the right businesses have, in a free-market economy, to define their fees based on the services they offer and wold prevent exchanges from fulfilling their core function of financing the real economy.

## 5. Data reporting issues

MiFID II/MiFIR extended the data reporting requirements for financial market institutions significantly. In fact, the legislation, which was initially due to become applicable from 3 January 2017 had to be postponed for one year to allow regulators sufficient time to build the necessary data infrastructure to handle the reporting.[10]

However, following application, some of the challenges around data reporting have remained. In January 2018, ESMA had to postpone publication of the double volume cap until March 2018, stating insufficient data quality and completeness of data as the reason.[11] In September 2018, ESMA announced that they would start publishing data completeness ratios for trading venues to incentivise trading venues to increase their efforts to provide timely and complete data.[12]

FESE fully agrees that data quality and completeness it essential for the correct functioning of the legislative requirements as these are highly data dependent. However, we would like to highlight that there is room for improvement also on the regulators' side, in terms of: clarity of requirements, consistency of approach between regulators and numbering agencies, system functioning and timeliness of publications. FESE have therefore continuously been in contact with ESMA to provide feedback on issues observed in relation to the functioning of the system and suggested solutions.

While certain areas related to data reporting have improved since MiFID II/MiFIR application, there are some that would require further attention. Please find below a high-level overview of some key issues. FESE will continue to provide more detailed feedback to ESMA and NCAs to advice on technical solutions to issues encountered.

**Most relevant market**

The concept of most relevant market (MRM) is important for a number of other requirements, including tick sizes. However, there is currently a lack of clarity and consistency regarding how the requirements related to MRM determination are implemented.

For new securities, FESE is of the understanding that until the MRM in terms of liquidity is determined, the MRM should be the trading venue where the financial instrument is first admitted to trading or first traded. However, it is not clear how ESMA is currently determining which venue is the relevant one in this instance. FESE has repeatedly raised concerns with ESMA regarding cases where a security is admitted to more than one market on the same day.

[10] Commission, Press Release, 'Commission extends by one year the application date for the MiFID II package', 10th February 2016, available here.
[11] ESMA, Press Release, 'ESMA delays publication of double volume cap', 9th January 2018, available here
[12] ESMA, Press Release, 'ESMA to publish new data completeness indicators for trading venues', 27th September 2018, available here



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Inconsistencies appear due to process, as the first trading venue that submits the data is considered the correct one determining the MRM, which may not be correct. This results in many warnings on inconsistent data being sent to trading venues on a daily basis which is extremely resource intensive and manual. In many cases this relates to free text fields which are unlikely to ever be consistent across different trading venues.

In this context, FESE members have observed cases where the first venue to report trading is deemed the MRM, even where it is not the listing venue and the date reported is prior to the IPO. There have also been cases where an SI has been deemed the MRM, whereas only a trading venue can be the MRM according to the relevant provisions. While this is a technical point related to the functioning of the IT system, designating an incorrect MRM for the first weeks of trading is harming newly listed instruments' market liquidity. FESE therefore considers that the designation of MRM should instead be based on an administrative criterion i.e. country of incorporation of the issuer.

**CFI code attribution and matching with MiFIR identifiers**

Classification of financial instruments (CFI) codes are crucial for the implementation of MiFID II/MiFIR as these determine the type of instrument applicable requirements. However, FESE members' experience is that CFI codes are not attributed consistently across instruments and member states classify differently the same instrument. For instance, one member state will classify a given instrument as a bond whereas another will classify it as a structured product. Often times the CFI assigned does not correspond with the exchange's classification of the security.

Moreover, the CFI codes do not clearly map across MiFIR identifiers and bond types and there are still many securities that do not have CFI / FISN codes assigned by the numbering agency. The rules for the assignment of CFI codes need to be clear-cut to ensure that CFIs are exhaustive and univocal. CFI codes can currently be updated by numbering agencies at any time and trading venues would not be notified of this, even when it could impact the data required.

These issues regarding CFI classification have implications for the data submitted to ESMA as the CFI determines the reference data required. It therefore leads to many rejections in relation to the FITRS trading data and can impact the MiFIR identifier and bond type codes as ESMA is reconciling all databases. For example, there are cases where an incorrect CFI has been assigned by a venue or by a number agency whereby reference data submitted by other venues are rejected as being incomplete because certain fields has not been supplied.

Technical improvements to processes for classification of financial instruments and the functioning of the ESMA database are therefore essential to deliver upon the political objectives of MiFID II/MiFIR.

**Legal entity identifiers**

Requirements for FESE members in relation to legal entity identifiers (LEIs) were introduced with the application of MiFID II/MiFIR, as trading venues are required to identify each issuer of financial instruments traded on their system with an LEI and provide this information to ESMA and/or their national competent authority.

However, FESE would like to highlight that for non-EU issuers, FESE members encountered some difficulties in reporting LEIs, as there is no obligation for issuers to obtain LEIs. As a consequence, not all non-EU issuers have LEIs but trading venues are nonetheless required to report these for all tradable instruments. Trading venues have been reaching out to non-EU issuers to encourage these to adopt LEIs but these efforts have not always been successful as, in the absence of a legal obligation in their jurisdiction, they may not see the added value.



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In addition, there does not appear to be a consistent approach to the application of LEIs to certain entities. For example, the application of LEIs to investment funds varies as some funds have LEIs at umbrella level, while others have LEIs at the sub-fund level. We would urge regulators and policy makers to clarify this and ensure a consistent approach is taken.

In this context, we would like to remind regulators and policymakers to always keep the international dimension in mind when producing and evaluating new regulation. Regulatory convergence on global commitments facilitate companies' compliance and support competitiveness and growth. However, when requirements in one jurisdiction (in this case LEI reporting) do not easily link up with those in others, implementation is more challenging. It should be noted that, despite G20 endorsement, many jurisdictions have not yet implemented requirements in relation to LEI.

FESE fully supports the idea of the global LEI system and its members are committed to encourage firms to obtain LEIs, to promote transparency of the global financial system and facilitate regulatory supervision. FESE therefore supports FSB's efforts[13] to promote exchange of best practices on LEI implementation, through collaboration and dialogue. Moreover, FESE would support FSB action to further encourage their members to take measures to promote or require LEI adoption on a global scale.

**Tick sizes**

FESE considers that the MiFID II/MiFIR tick size regime will need to be further assessed over time before clear conclusions regarding its impact can be drawn. The impact of the tick size regime is likely to differ between markets and effects should therefore be analysed both at a European and local level. While an AMF study for the French market showed positive effect in terms of liquidity, some of our members have conducted their own assessment which shows that the tick size regime had a rather negative impact on liquidity, as it triggered an overall increase in implicit trading costs. FESE therefore considers it important to conduct a market study for all EU trading venues over the same time period and with the same methodology in order to evaluate the tick size regime's impact across the EU.

Regarding implementation of the tick size regime, FESE considers that there are several issues related to information, corrections and publication that should be addressed as they are currently preventing the goal of achieving a harmonised tick size regime. In addition, we see issues with regard to setting average daily number of transactions (ADNT) for new listing and corporate actions as there are no information channels to communicate liquidity bands and changes to these between regulators and trading venues once trading has started. To correct this, FESE would suggest that regulators develop a standard procedure for trading venues to submit data to either NCAs or ESMA allowing for automatic calculations.

Finally, FESE is currently assessing whether the tick size regime should apply to all equity ETFs. The results of this assessment would be shared with regulators once finalised.

[13] Financial Stability Board, Press Release, 16th August 2018, 'FSB launches thematic peer review on implementation of the Legal Entity Identifier and invites feedback from stakeholders', available here.



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## ANNEX – Questions for assessing SIs' compliance with Article 16a

- Does the investment firm operating the SI have a proprietary trading desk? If yes, is this proprietary trading desk responsible for providing liquidity onto Regulated Markets and MTFs?

- Which entity within the investment firm is in charge of providing liquidity to the SI? What is its role? Are the algorithms used for providing quotes and executions on the SI developed, monitored and maintained internally or is there an intervention from a third party?

- Does the investment firm engage its own capital to supply liquidity on the SI? Are other entities within the investment firm's group involved? Does the SI operator enter into swaps activity with external entities?

- What is the nature of the collateral used within the Central Risk Book at the heart of the SI to hedge its activity?

- What is the investment firm's commercial policy for the execution of client orders on its SI? What is the pricing policy? Are clients charged fees for order execution on the SI? Where does the SI sit in the workflow of order execution within the bank and how does it sit with the bank's best execution policy?

- Are clients of the SI treated in the same fashion and do they have access to the same quotes on an equivalent basis?

- Are open positions resulting from the SI activity commingled with the rest of the investment firm's activity? For example, could an SI short position be offset by another existing position within the investment firm?

- What policies does the investment firm have in place to ensure compliance with Article 16a of Commission Delegated Regulation (EU) 2017/565?

- Within orders executed by the investment firm's SI, what are the relevant percentages of high touch vs. low touch execution? 'High touch' being understood as orders necessitating human intervention to facilitate execution, and 'low touch' as executed via an algorithm without human intervention.

- What is the percentage of orders received by the investment bank which are routed to its own SI? Routed to an external SI provider?

- How are trades executed in the SI reported[1]?

- Why are non-price forming trades (as categorised in RTS 1) performed within an SI structure when they are exempt from any trading obligation in the first place?

Finally, FESE believes that there would also be merit in the Commission examining, with other relevant authorities, the case for SI trading to be included within regular and ongoing stress tests of the EU banking sector. Such an initiative would reflect the significant scale of this business and the need to monitor risks in the system.



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