

MARKET STRUCTURE AND MiFID

In the Covid-19 environment it seems that investor protection and the nitty gritty on daily process has come to the fore and everything around market structure is less in focus. Markets have been working well, no major outages or issues have occurred. The Commission highlighted that feedback from its recent consultation on the Review of MiFID II/R seems to indicate that, in the immediate future, most respondents would rather focus on: the retail end, investor protection, product governance, IPOs and primary markets. Major changes to the market infrastructure should be tackled subsequently.

There is a vigorous on-going debate on whether an immediate recovery package (Autumn/Winter 2020) on investor protection and the retail end is required or whether a more holistic review further down the line (2021) that looks at retail issues along with market infrastructure would be more appropriate.

However, it was suggested by one member of the panel that the 'no brainer' issues should be tackled first (i.e. SI issues) and more controversial ones separately. Although, ensuring the most appropriate market infrastructure would require more certainty and an evaluation on market trends assessing the impact of Brexit. A decision is needed between the emergency fix (two step approach) or a more holistic approach (one step approach) since time is running out if anything is to be done before the end of the year. The outcomes of the negotiations between the EU and the UK will be needed before a view is taken on how to structure various trading obligations.

The crisis has shown that EU market infrastructure is resilient. Regulated Markets play a big part in that. At times of high uncertainty, more trading volumes go to the Regulated Market as a safe trading venue where core price formation takes place. These periods have also demonstrated that transparency is highly appreciated by all market participants, as it offers financial stability, integrity and fairness. The economy cannot be built on debt alone, building equity buffers will be key. Market structure, the liquidity available on markets, the functioning of markets is very important for market structure. The design of the market structure has to be the main goal. Existing rules, i.e. the regulatory framework for SIs should be fully enforced. This is also of particular importance during the Brexit transition, to ensure that the EU27 remains competitive. MiFID I was all about creating competition in trading venues. MiFID II is all about creating transparency in trading to improve transparency and price formation. We see that SIs which were initially conceded as a flexibility tool has been rebranded as a dark and OTC tool. A bottom up analysis conducted by the AMF concludes that SIs represent 15 to 20 % of total value in all French equities and have a limited contribution to transparency. This well documented issue is also a core MiFID II issue because it prevents the delivery of the MiFID II objectives.

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When reflecting on what ambition there is for the outcome of the Review?

- (i) simplification of market models,
- (ii) how to create more inclusive markets and
- (iii) how can we enhance offers to investors for them to better interact with transparent venues?

The share of lit has decreased to the detriment of issuers and investors. The intention of policymakers with MiFID II was not to give new life to SIs but that BCNs be transferred to MTFs. One possible avenue to solve this would be to limit SI trading to above LIS. The LIS threshold would be used as a main tool to delineate lit and dark trading. This would also mean that there is little need for a DVC mechanism which does not work well anyway. It is important to make the waiver regime easier to comprehend.

There is a need to first think about simplification of market models, reducing the complexity of the various layers. Simplification is warranted and would be very much appreciated by market participants. Limiting SI trading in equities to above LIS only would be an effective solution.

It was confirmed that ESMA is currently in the process of finalising the MiFIR review report on the equity transparency regime, the double volume cap mechanism and the trading obligation for shares and aims for submission to the Commission and publication in July 2020. Stakeholders can expect to see our recommendations on this after the ESMA Board of Supervisors on the 8th of July.

ESMA is also in the process of finalising the MiFIR reports on SIs in non-equity instruments and aims for submission to the Commission and publication in July 2020. The ESA confirmed its planning to perform the annual review of RTS2 ahead of 30th July 2020. A more comprehensive Level 1 review report on non-equity transparency can then be expected to come in September.

On commodity markets, the MiFID II/MiFIR objective to 'improve the functioning and transparency of commodity markets and address excessive commodity price volatility' has not materialised. The establishment of, and compliance with, MiFID II has proven to be a burdensome and costly process for both commodity derivatives exchanges and market participants. Commodity markets have specific characteristics and hence often suffer from a 'one-size-fits-all' regulatory approach.

The discussion highlighted that, while the position limits regime has been able to function for a number of well-developed benchmark contracts, it has proven to be a substantial barrier for the development of new and illiquid products and further growth of the existing non-benchmark liquid commodity derivative markets.

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To solve these issues, it was suggested that the scope of the regime should be reviewed with the aim of moving towards a more proportionate and efficient position limit regime. This can be achieved by focusing its application to 'critical' contracts only, similarly to the US regime. The Commission is considering whether to limit position limits to mature markets in the areas of energy, oil, natural gas and metals. Nascent (no position limits) and mature markets (position limits are maintained) could be defined by using the 300.000 lot borderline. The issues deriving from the position limits regime could be addressed in a possible 'quick fix', if this tool will materialise.

ESMA would also favour a review of the position limit regime in line with the US system, i.e. to reduce its scope of application to critical contracts only.

How to define 'critical' contracts is however still to be discussed. ESMA would be open to introduce changes at Level 2 while waiting for the legislative process to review the Level 1 text to be completed.

Furthermore, Brexit will have an impact on

- (i) the weekly position reports, hence need to adjust the conditions to ensure we have meaningful transparency; and
- (ii) on the ancillary activity test.

Co-legislators should look into how to review this latter. It was confirmed that the Commission would be willing to add this last issue in a potential 'quick-fix'. The Commission should provide more evidence to support any proposed change.

In conclusion, it was mentioned that there was some disappointment with the lack of progress of the Brexit negotiations, in particular as financial markets do not seem to be part of the discussion. Market structure is key and its improvement is essential to achieve an effective capital markets union.

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