EDMA Europe

Position paper

Necessary amendments and revisions to secondary market provisions in MiFID/MiFIR

General remarks

EDMA members believe that any amendments or revisions to the transparency of non-equity instruments under MiFIR should be consistent with the underlying principles and obligations of MiFID and MiFIR; specifically, the objective of enhancing transparency, improving cross-border harmonisation and encouraging competition while delivering a level playing field for all market participants.

Generally, we believe the industry should be allowed more time to fully integrate and bed down the current MiFID II requirements before too many new changes are made. That said, EDMA are of the view that several requirements require revision.

1. Level playing field issues

1.1 Market structure: trading venues/other unregulated system providers

Issue: Nearly two and a half years into the implementation of the MiFID II/R framework, several system providers (otherwise referring to themselves as fintech firms or technology providers) are effectively operating multilateral systems that bring together multiple buying and selling interests which result in legally binding trades outside of the regulatory perimeter, largely in reliance on the argument that execution occurs bilaterally. To all intents and purposes, these trades are executed using these systems without those same systems being subject to regulatory scrutiny or having appropriate regulatory status as venues (Regulated Markets, Multilateral Trading Facilities or Organised Trading Facilities). This not only undermines the efforts of legitimate system operators to receive and maintain their venue licenses but also undermines the regulatory framework as a whole in facilitating off-venue trading, reducing transparency of financial markets and reducing investor protection.

EDMA: The current MiFID II/R review provides the European Commission and ESMA with the appropriate and very timely opportunity to address the discriminating status quo. MiFID II Article 1(7) requires that multilateral systems be regulated as trading venues. We therefore look forward to supporting the European Commission in their work to remind and to compel member states, ESMA and the national competent authorities to properly apply and enforce the current rules. Ensuring that multilateral systems are regulated as trading venues will bolster the intended goal of MiFID II/R and enhance investor protection by avoiding the unregulated activities of non-compliant system operators.

Another area of focus should be on *either* levelling the playing field between pure OTC (non-venue, non-SI) trading activity and activity conducted on venue or via a systematic internaliser (SI); *or* ensuring completely non-regulated entities cannot provide equivalent trading services. There could also be a combination of both approaches.

1.2 Market structure: trading venues/OTC

Issue: The lack of a level playing field between trading venues and OTC trading.

EDMA: Trading venues are required under Article 26(5) to report to their NCAs any transactions and associated client allocations on their venues by non-MiFID firms. There is

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no comparable reporting requirement when non-MiFID firms trade off-venue (OTC), even with MiFID firms. Non-MiFID firms therefore face both an entry barrier to trading on-venue as well as additional costs to provide and maintain the information required by trading venues when compared to OTC trading.

EDMA believes that there should be a level playing field between trading venues and OTC trading. We suggest that trading venues should only be required to report the market side of a transaction and not the client side (i.e. individual allocations).

1.3 Market structure: regulated multilateral trading facilities/systematic internalisers

Issue: The lack of a level playing field between regulated multilateral trading facilities (MTFs) and systematic internalisers (SIs). Under Article 26(5) MTFs must collect sensitive, confidential and restricted client information from non-MiFID firms in order to complete venue reporting obligations. SIs do not have this obligation nor do venues outside the EU. This differential requirement to provide detailed and often confidential personal data has discouraged firms not authorised under MiFID from transacting on MTF trading venues. This has in turn undermined the aims of MiFID II, reducing liquidity available to EU firms and investors making the capital raising process more expensive and reducing the set of trading information reportable to regulators. Those counterparties have reverted to bilateral voice trading with EU firms or such firms have moved their trading activities to venues outside of Europe.

EDMA: Given the above issues these requirements should be re-assessed. In addition, with Article 26(5) continuing, market-side reporting only should be applied for non-MiFID investment firms trading on-venue in order to level the playing field when trading with an SI. This could be achieved by trading venues only being required to report the market side of a transaction and not being required to report the client side (individual allocations).

1.4 Market structure: approach to new trading systems

Issue: Regulatory Authorities appear to be considering changes to how they approve new trading systems.

EDMA: With respect to the type of system and the related information to be made public in accordance with Article 2 in Annex I of Commission Delegated Regulation (EU) 2017/583 ("RTS 2"), EDMA do not believe there is any need to change the way different trading systems (also known as protocols) are assessed and made subject to transparency requirements. The introduction of more formal processes would constrain innovation of on-venue trading methods disallowing the market's ability to adopt new methods quickly that assist venue users conducting their business in a safe and efficient manner on-venue.

2. Consolidated tape

Issue: There is currently no Consolidated Tape (CT) for equities or non-equities in the EU or the UK.

EDMA: Should the authorities wish to accelerate and make certain the existence of a Bond CT through legislative proposals, then a Bond CT should be developed and provided in collaboration with the trading venue and APA communities and broader industry and not merely implemented as an extension to the work being conducted on an Equity CT. The market structure and trading protocols of Bonds differs greatly given the absence of centralised exchanges in bond markets.

To ensure a successful implementation, special attention should be given to the creation of a dataset that is relevant and valuable to end users of the tape. To achieve this result, we believe ESMA should work with the industry to address data quality issues. This will also allow ESMA to be in a better position to perform its liquidity and threshold calibrations based on appropriate

analysis of the data. There are different interpretations of data standards in several areas - they should be identified with an objective to agree on simplified standards.

We believe there should be a single solution provider appointed to operate a Bond CT within an appropriate commercial model and subject to safeguards to make it available at a reasonable cost. Market participants should then be mandated to provide accurate data on a close to real-time basis to this single selected bond consolidated tape provider.

The CT solution provider should be selected by the regulators, using a competitive process from market infrastructure providers who have the relevant experience in data management, operating regulated business and expertise in bond markets. A standardisation effort will be needed to address the provision of data to the Bond CT from multiple APAs/trading venues in a standardised way. These contribution standards will both speed adoption/implementation and improve quality/consistency longer term.

The objective of a Bond CT should be to provide a good quality and at least an 80% view of trading activity across all bond asset classes. A European or UK Bond CT should aim to encompass all cash bond instrument classes traded on European or UK venues, in so far as that is possible.

A Bond CT should focus on post trade data only. A Bond CT pre-trade involves much greater technical challenges. It is impractical, with known latency issues, for a venue to advise a CT provider before a trade is executed. Also, the inclusion of pre-trade data could create significant gaming risks harmful to price and liquidity formation and reduce incentives to show the best price.

Like TRACE, a European or UK Bond CT should be introduced or phased in over a multiple year period between now and 2025; and can be implemented independently from an Equity CT.

The introduction of a Bond CT should have regard for the newness and potential inherent limitations of the bond dataset following MiFID II go live in January 2018. A Bond CT should be introduced on a timescale that allows the business models of critical market infrastructure to adapt and change without causing inappropriate disruption. A Bond CT should, where possible, be future-proofed, e.g.:

- To take into account the emergence of so called ‘golden’ sources of data particularly with regard to alternative identifiers
- To accommodate any future planned or predictable changes to the liquidity thresholds

A Bond CT should look to collaborate with standards work undertaken by a variety of industry groups including FIX, ICMA and others.

Issues with regard to timestamping will need to be addressed in constructing a Bond CT including granularity, precision, differences in national deferral regimes, inconsistent transaction times and inconsistent time of publication. The Bond CT should be used as an additional source of data to drive the regulators’ liquidity and threshold calculations.

3. Market making agreements issues

Issue: Investment firms are required to enter into market making agreements with trading venues under Article 17(3)(b) of MiFID II and RTS 8, which trading venues are required to have in place under Article 48(2)(a). Article 1 of RTS 8 implies that the obligation would not relate to venues that operate by way of a request-for-quote trading system.

These obligations duplicate the monitoring and reporting requirements of Primary Dealers (investment firms for the purpose of MiFID) who engage in market making on “designated platforms” (as specified by the various national Debt Management Offices (DMOs) or sovereign issuers), with no discernible benefit for any party involved and the consequent waste of

resources. Further, this causes confusion amongst Primary Dealers, who often do not understand the distinction between the demands of the DMO and the MiFID II-mandated market making agreement.

A trading venue's market making agreement should not be more demanding or restrictive than a DMO's market making requirements. In practice, platforms are not always fully informed on the details of a DMO's quoting requirements and evaluation criteria. Article 48(3) requires that the trading venue monitor and enforce compliance by investment firms with the requirements of the market making agreements and, as such, Primary Dealers may be subject to enforcement by trading venues for breach of their market making agreement, despite those Primary Dealers being satisfactory performers according to the market making requirements of the DMO.

The comparable size requirement is also problematic because: (i) DMOs only demand a minimum size, (ii) materially divergent quantities in 2-way quotes reflect specific trading interests being actively managed whilst performing a market making strategy, and (iii) conforming to the comparable size requirement usually results in the reduction of the larger quantity quoted rather than the increase of the smaller quantity, thus damaging market liquidity.

In some countries, Primary Dealers have the right to choose their preferred designated platform and can do so from one day to another. The fact that MiFID II mandates participants to comply with a market making agreement with the trading venue(s) limits this freedom.

EDMA: A reasonable solution could be to allow platforms and investment firms to be considered as compliant with RTS 8, where those platforms are considered "designated platforms" by the relevant DMO/sovereign issuer and the relevant investment firms that are Primary Dealers have agreed to satisfy their quoting obligations on those platforms (and not have to enter into a corresponding market making agreement with the platform).

Whilst an amendment to RTS 8 is unlikely and would in any event require a long time to achieve, an ESMA guideline to this effect is conceivable.

4. Pre-trade SSTI waiver

Issue: Regulatory Authorities appear to be considering changes to the pre-trade SSTI waiver regime.

EDMA: Recommend that the pre-trade SSTI waiver should be retained "as is" and that ESMA changes the liquidity thresholds first and keeps the pre-trade SSTI waiver as a back-up tool until the impact of changing liquidity thresholds has played out. There is always the annual option to move the SSTI levels up if it proves necessary.

If the pre-trade SSTI waivers are deleted thresholds should also be adjusted for SI trading.

5. Pre-trade LIS thresholds

Issue: Regulatory Authorities appear to be considering changes to pre-trade LIS thresholds.

EDMA: Adjustments to LIS should only be made if, taken in the whole, they continue to level, rather than further unlevel, the playing field between trading venues on one hand and OTC or SI trading on the other.

6. Standardising pre-trade transparency information

Issue: Regulatory Authorities appear to be considering mandating more standardisation of pre-trade transparency information.

EDMA: Do not see value in changes to the standard for pre-trade transparency information. Such information has been made available by certain venues for decades and well-established standards have already been developed.

7. Post-trade deferral harmonisation

Issue: Article 21(3) and (4) MiFIR grant NCAs various options regarding deferred post-trade publication of non-equity instruments. As a result, the deferred post-trade publication regimes of non-equity instruments vary widely across the EU and lack consistency.

EDMA: Believe the NCA options in Article 21 MiFIR should therefore be harmonised so as to achieve greater consistency in deferred publication.

8. Quality of post-trade data

Issue: The quality of post-trade non-equity data has been called into question by some market participants and regulatory authorities.

EDMA: There are no material quality problems with MTF-derived post-trade data. Issues may exist with off venue / OTC post-trade data and EDMA believe that ESMA should engage and work with the industry to resolve any data quality issues. EDMA do not believe there are any legislative measures necessary to improve the quality of post-trade data derived from Regulated Markets and MTFs.

9. Quarterly liquidity calculation / liquidity determination for bonds – Stage 2

Issue: Regulatory Authorities are consulting on the appropriateness of moving to Stage 2 for the liquidity calculation / liquidity determination for bonds and other non-equity instruments.

EDMA: The quarterly quantitate IBIA test for bond liquidity determination is appropriate. Trading venues and APAs have made significant contributions to improving the data quality submitted to ESMA's FITRS system. For example, ESMA's 1st May 2020 publication of completeness indicators demonstrates that the top 20 trading venues (out of 172) covering 75% of the total 32.5 million bond reporting periods of 1Q 2020 have an average completeness ratio of 98.5%.

However, the intermediate liquidity determination of newly issued bonds under the COFIA approach (and solely focussing on the bond's issue size) tends to occasionally produce 'false positives'. Subsequent quarterly assessment of these COFIA liquid new issues (and potential reversion to illiquid determination) contribute to the perceived "instability" of the liquid bond scope.

EDMA's specific views on the appropriateness of moving to stage 2 for the various determinations are set out below:

9.1. The liquidity assessment for bonds.

EDMA believe it would be appropriate to move to stage 2 for the determination of the liquidity assessment for bonds.

9.2. The pre-trade SSTI thresholds for all non-equity instruments except bonds (specifically fixed income derivatives)

EDMA believe it would not be appropriate to move to stage 2 for the determination of the pre-trade SSTI thresholds for fixed income derivatives products because moving to stage 2 would incur more market disruption than appropriate.

9.3. The pre-trade SSTI thresholds for bonds (except ETCs and ETNs)

EDMA believe it is appropriate to move to stage 2 for the determination of the pre-trade SSTI thresholds for bonds.

10. Best Execution (RTS 27/28) Reports

Issue: The existing MiFID II framework includes reporting obligations on data relating to the quality of execution of transactions whose content, format and periodicity are detailed in Delegated Regulation 2017/575 (also known as 'RTS 27'). The best execution framework also includes reporting obligations for investment firms on the top five execution venues in terms of trading volumes where they executed client orders and information on the quality of information. Delegated regulation 2017/576 (also known as 'RTS 28') specifies the content and format of that information.

EDMA believes these best execution reports are not of sufficiently good quality to provide investors with useful information on the quality of execution of their transactions.

It remains unclear what purpose best execution reports aim to achieve. Market participants/investors rarely cite RTS27 reports as being useful or influential in making trading decisions. EDMA members observe that in general these reports are only rarely downloaded from their respective websites. There also remains a lack of coherence in listing the appropriate execution venue in RTS 28 reports. Furthermore, NCAs place varying degrees of importance on best execution reports which further heightens the lack of coherence in these reports as well as any useful information they could be providing as mandated under the MiFID II regulatory framework.

Few market participants/investors appear to be accessing RTS27 reports citing lack of useful information. This appears to confirm that best execution reports do not provide useful information for market participants/investors wishing to execute trades on trading venues.

EDMA: Do not agree that best execution reports provide sufficient benefits to investors to justify the cost of producing these reports and therefore the balance in terms of costs between generating these best execution reports and benefits for investors is not correct. This is evidenced by few market participants/investors accessing RTS 27 reports citing lack of useful information which raises the question of the use of the exercise in generating these reports. EDMA believe the required resources would be better spent focusing on other efforts that would be more constructive in helping market participants/investors.

In order to improve the quality of best execution reports issued by Investment Firms EDMA recommend certainly that the format is amended, and the quality of data is improved. Perhaps also the comprehensiveness of the reports needs to be extended. Further clarification on what execution venue should be listed in RTS28 reports would also help.

11. Alignment of TOTV for transparency and transaction reporting

Issue: Regulatory Authorities appear to be considering changing the current alignment of TOTV within both transparency and transaction reporting

EDMA: It is important that the interpretation of TOTV remains aligned for both transparency and transaction reporting.

12. Regulators ability to temporarily suspend transparency provisions.

Issue: Regulatory Authorities appear to be considering removing their ability to temporarily suspend transparency provisions

EDMA: ESMA should retain their ability to suspend transparency provisions to be able to react quickly to market developments. Possible changes to the transparency regime stemming from recent consultations may increase the need for this capability.

13. Central Bank exemptions

Issue: Article 1(6) MiFIR exempts the members of the European System of Central Banks (ESCB) from pre-trade and post-trade transparency requirements where they act to pursue their monetary policy mandate. In practice, the delineation of exempted tasks and other, non-exempted tasks of central banks proves difficult.

EDMA: Believe that, to facilitate such delineation, Article 1(6) MiFIR should refer to the tasks under Title IV of the ECB/ESCB Statute. In addition, the application of the transaction reporting requirement in Article 26 MiFIR to trading venues as regards transactions involving ESCB members is not appropriate because central banks are not “firms” in the sense of Article 26(5) MiFIR. It should therefore be clarified that trading venues do not have to report transactions involving central banks.

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About EDMA Europe

Electronic Debt Markets Association represents the interests of companies whose primary business is the operation of regulated electronic fixed income multilateral trading facilities in Europe (regulated markets and/or trading venues) and act as a source of consultation between the members in their roles as operators of such venues in order to project collective views on regulatory, compliance and market structure topics for the benefit of the electronic fixed income markets.

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