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AFME response to the consultation of the German Federal Ministry of Finance on the experience and possible need for amendment with regard to MiFID2/R.

15th March 2019

Introduction

MiFID2/R

The Association for Financial Markets in Europe (AFME) is grateful for the opportunity to respond to this consultation.

MiFID2/R is one of the cornerstones of EU financial services law setting out which investment services and activities should be licensed across the EU and the organisational and conduct standards that those providing such services should comply with. Given the scale and scope of the MiFID2/R (MiFID 2 and MiFIR) regime, this response is only a high-level illustration of the key issues raised by our members and is intended as a precursor to further engagement.

AFME supports the MiFID2/R review process being driven by fact-based analysis of the effects of the MiFID2/R regime in advance of any amendments being made. Our overall assessment is that MiFID 2/R has been costly to implement for all segments of the financial sector and remains so on an ongoing basis. Specific examples of areas we recommend for review, including drafting contradictions, are detailed in this document such as the share trading obligation and best execution requirements.

AFME shares the overarching objective of the European Commission's review of MiFID2/R, specifically, to improve market transparency and enhance investor protection. However, we believe that many of the provisions of the regime need recalibration to avoid damage to markets, liquidity and investor choice. By engaging with the European Commission as well as with the European Parliament and Council, AFME is seeking to contribute to the MiFID2/R Review.

The MiFID2/R Level 1 rules, in conjunction with the Level 2 and Level 3 rules adopted at European level, have brought about major changes for the financial sector. The European Commission's report on various aspects of the regime, to be submitted in accordance with MiFID Article 90 by March 2020, provides a starting point for reviewing its ramifications for investors and financial market participants. Below we highlight some general observations and key issues and welcome the opportunity for ongoing dialogue.

Brexit

The United Kingdom's prospective withdrawal from the EU adds further context to considerations on revisions to MiFID2/R. We have not sought to address in this response the various matters that relate to the MiFID2/R framework in the context of a "no deal" Brexit, on which AFME has produced separate analysis, or the future EU-UK relationship in financial services. As acknowledged by several European authorities, it will be necessary to consider MiFID2/R provisions and calibrations designed for the EU28 in the context of the future bilateral relationship with the UK. We look forward to engaging with the BMF and other authorities on these issues as they are considered.

Capital Markets Union

The future of the EU capital markets is highly dependent on the advancement of Capital Markets Union (CMU) project. As the primary rulebook for EU financial markets, the MiFID2/R framework is central to advancing CMU objectives to strengthen the capacity of EU capital markets, reduce fragmentation and improve efficiency and investor choice. We welcome that the European Commission recently launched

two studies focused on the functioning of primary and secondary equity markets in the EU and on the feasibility for the creation of a CMU equity market index family. We look forward to engaging with these studies and their conclusions as they feed into the MiFID2/R reviews.

Executive summary

In this AFME response we lay out our members' priorities in a thematic fashion.

Market structure

The impact of the regime on market structure is highlighted first in this response as a particular area where the new rules have, as noted in the BMF's consultation, brought about major changes for end investors, investment firms and market infrastructures. AFME supports evidence-based regulation and would encourage policymakers to carry out a robust analysis of the European trading landscape and then consult on possible changes to the share trading obligation, the double volume cap and tick size regimes. As currently defined, for example, the share trading obligation results in detrimental outcomes for end-investors in certain circumstances and limits the ability of firms to deliver best execution to their clients.

Transparency and reporting

A primary policy object of the MiFID2/R review was to improve the transparency of financial and commodities markets, mitigate systemic risk, and protect against market abuse. This objective has been pursued through a strengthening of the transparency framework within the regime. In this response AFME highlights the problematic linkages between the transparency requirements and the excessive breadth of the concept of "traded on a trading venue" in some circumstances.

Having a fixed reporting hierarchy within which systematic internaliser status attracts reporting responsibilities, coupled with the decisions by some buyside firms not to build reporting infrastructure (and therefore only deal with systematic internalisers) has resulted in potentially unforeseen consequences, such as a larger number of firms deciding to be systematic internalisers. AFME members consider that it would be beneficial if the current reporting hierarchy were to be supplemented with the ability (not the obligation) of parties to agree who reports.

Golden source for reference data

This report also highlights the need for a "golden source" for reference data. AFME suggests that as ESMA is responsible for collection and warehousing of reference data, it is only reasonable that its databases should be considered a "golden source" which firms could use to ascertain, for example, which instruments are considered as traded on a trading venue.

Market data costs

Market data costs have increased significantly since MiFID2 and data licenses are complex for investment firms consuming this primary input. MiFID2/R requires trading platforms to make pre- and post-trade market data available on a "reasonable commercial basis". Notwithstanding this requirement, consumers of market data report significant price increases most notably from the primary exchanges. AFME urges policymakers to address these concerns as a priority.

Investor protection

AFME supports the transparent communication of cost and charge information to end clients but considers that further thought should be given to the utility and content of the mandatory costs and charges provisions for wholesale clients. Since those clients in the main actively negotiate their costs and charges, AFME would support the introduction of the ability for them to opt out of receiving the mandatory standardise information on costs and charges.

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AFME also considers that the current best execution reporting regime is not functioning optimally for professional end investors and supports a considered and rigorous consultation process in advance of a review of this aspect of the regime. Additionally, the paper examines the regimes' product governance interlinkages to the PRIIPs regulation. The uncertainty about its scope and concerns about its requirements have had a serious negative impact on the availability of plain vanilla financial products which AFME suggests requires further examination.

Other priorities

Other key areas of concern addressed in this paper include inducements; open access to market infrastructure; commodities; product identifiers and instrument classifications and non-equity product calibration thresholds.

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Market Structure

1. STO (share trading obligation)

Overview

Under the STO (share trading obligation) for investment firms in Article 23 of MiFIR, an investment firm must ensure the trades it undertakes in shares admitted to trading on a Regulated Market (RM) or traded on a trading venue take place on a RM, MTF, systematic internaliser or a third country trading venue assessed as equivalent in accordance with Article 25(4)(a) of MiFID2 unless the trades:

(a) are non-systematic, ad-hoc, irregular and infrequent (the "de minimis exclusion"); or

(b) are carried out between eligible and/or professional counterparties and do not contribute to the price discovery process (the "price discovery exclusion").

Shortcomings

A primary shortcoming of the STO regime is the apparent scope of the STO which captures all shares traded on a trading venue (ToTV) within the EU, regardless of liquidity. The application of the ToTV is binary in nature and does not make any calibration with respect to the levels of liquidity within the EU. This is likely to result in less optimal outcomes for end-investors, as EU firms subject to an STO which is comprehensive in scope are less able to deliver best execution in its truest form.

In a speech by Robert Ophèle, AMF chairman, at the AFME Annual European Compliance and Legal Conference on 01.10.2018[1] he made the following comments:

"...based on the experience accumulated with platform equivalence last year and with the UK withdrawal in mind, it may be time to consider amending Article 23 MiFIR by narrowing down the scope of the share trading obligation..."

AFME members would welcome the opportunity for further engagement on the subject and can provide appropriate drafting suggestions that achieve the STO's aims, in line with M. Ophèle's understanding of the legislative intent, which would not lead to the harmful execution outcomes for investors caused by the current drafting and balances this with other policy priorities including the Capital Markets Union and maintaining the EU's attractiveness as a listing location for issuers.

STO equivalence determinations

The STO as drafted compels EU investment firms to trade in the EU or on equivalent third country venues even when to do so would deny end investors access to material pools of liquidity. The deficiencies of this proposition became apparent in the run up to the MiFID2/R go live date of 03.01.2018 and were partially mitigated by the ESMA 13.11.2017 press release which noted that "...the absence of the relevant equivalence decisions might cause issues for investment firms that wish to undertake trades in non-EEA shares in the primary-listing of such shares." and then explained that the absence of such a determination for a particular jurisdiction could be taken as evidence that the STO was not relevant to that jurisdiction. This was helpful and allowed the market to mitigate the consequences of the very broad scope of the STO.

AFME would support an evidence-based review of the impact of the STO and a consultation on possible amendments to it.

[1] https://www.amf-france.org/en_US/Actualites/Prises-de-paroles/Archives/Annee-2016?docId=workspace%3A%2F%2FSpacesStore%2Fac5c4822-fd35-4764-8e22-2e940d86266d# Speech of Robert Ophèle, AMF chairman, AFME Annual European Compliance and Legal Conference, 01.10.2018.

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Interaction with best execution interests of end investors

A problem that arises with the STO is that even if even a small proportion of liquidity is accessible outside of the EU then the prohibition on accessing that liquidity is a clear disadvantage to investing via EU-based investment managers. Thus, to the extent this is a policy the EU wishes to pursue, the STO should only be applied to stocks where a material majority of the trading occurs in the EU. To do otherwise is simply to introduce incremental frictional costs, both explicit trading costs (fees) and implicit costs (profit attributing to the firms arbitraging the dislocated liquidity pools).

As noted above, AFME has observed that the STO can be at odds with best execution. This may result in less than optimal outcomes for end investors and could position MiFID firms at a disadvantage with respect to non-MiFID firms not subject to the same limitations when executing a trade on behalf of clients who may not themselves subject to the STO.

AFME would welcome clarification that optimal outcomes for end investors as provided for under the best execution requirements should take precedence over those of the STO concentration rules.

Broadening “equivalent trading venues” for the purposes of the STO

The advancement of a level playing field between trading venues and investment firms has been an important policy objective of the MiFID2/R framework and its Level 2 and 3 instruments, which AFME supports. In alignment with this objective, AFME would promote the broadening of “equivalent trading venues” for the purposes of the STO to include systematic internalisers and MTFs[2]. The availability of an equivalence regime for all trading options stipulated for compliance with the STO would put all market participants on an equal footing in the formal legislative framework. For the avoidance of doubt, we refer here to the equivalence of third country venues where EU investment firms can discharge the STO (so Article 23 MiFIR and Article 25 (4) MiFID) and not to equivalence for third country firms wishing to provide services in the Union under Article 46-47 MiFIR.

It should be noted with reference to the comments made in this paper and in this section specifically we are considering only equivalence determinations for the purposes of the STO and not with respect to third country equivalence.

2. DVC (double volume caps)

In the light of the UK’s withdrawal from the EU, equities thresholds for DVC may need to be adjusted. AFME notes the upcoming mandated EC commissioned reports on the effects of MiFID2/R on European market structure (including the double volume caps). AFME supports evidence-based regulation and encourages a robust analysis of the European trading landscape when identifying what the new thresholds might be.

There was no formal impact assessment undertaken when the double volume caps were proposed by the European Council as a method to limit “dark trading.” The implementation and application throughout Europe of the caps have led to inefficient outcomes and sub-par execution quality for end investors, which runs counter to the need to provide best execution. AFME welcomes the opportunity to contribute to the review process and engage in meaningful dialogue on this subject.

3. Tick sizes

Following the political agreement reached on the Investment Firm Review in trilogues, we remain concerned by the new amendments to the MiFIR tick-size regime. While we support the application of the extension of the tick size regime to SIs, we do not agree with the manner in which the amendments have been drafted. Please note the AFME paper on the application of the tick size regime (Annex 1).

[2] While Article 23 MiFIR refers to equivalent trading venues (so includes MTFs) but the equivalence procedure in Article 25 (4) MiFID refers to “third country markets”.

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The application of the tick size regime above LIS (other than trades executed at mid-point) will not contribute to the price discovery process for LIS trades and may actually inhibit appropriate price formation between systematic internalisers and their clients. Furthermore, the ability to execute LIS trades on a sub-tick basis provides meaningful price improvement for clients trading in large sizes which brings benefits to end investors. Moreover, AFME members recognise the mid-point as a globally understood and accepted fair execution price which allows for efficient price formation whilst reducing the bid-ask penalty on investors.

On this basis we believe that tick sizes should not apply to any transactions that are above the Large-in-Scale (LIS) threshold and that for all order sizes, the mid-point should remain a valid execution price permitted to trade at a half tick, both on trading venues and systematic internalisers.

Transparency and Reporting

4. Traded on a Trading Venue ("TOTV") Criteria

Transaction reporting

AFME supports the use of the current broad scope of the ToTV concept to define the scope of the transaction reporting obligation.

Trade reporting

With respect to trade reporting AFME believes the current broad scope of ToTV to be inappropriate for trade reporting and that therefore the scope should be limited when used for these purposes.

ToTV should be defined differently by asset class to reflect individual asset class characteristics. For example, the application of the ToTV regime to derivatives is not working as the regime was conceived with equities in mind and has not been adapted to the unique characteristics of derivatives.

5. Data Reference Systems

Because ToTV is such a central concept in MiFID2/R, it is important for the industry reliably to identify which instruments are ToTV. As ESMA is responsible for collection and warehousing of reference data within the FIRDS reference database, it is only reasonable that FIRDS should be considered a "golden source" of ToTV securities.

AFME proposes ESMA should be responsible for ensuring delivery of all other reference data sets (ie ToTV instruments, SIs, investment firms and all other common datasets that investment firms are required to reference within MiFID2/R). The concept should be adopted that firms in making reference to all official "golden source" data sets should be safe from any supervisory action resulting from the inaccuracy or paucity of that data.

6. Trade reporting requirements

Trade reporting

Linking a higher position in the trade reporting responsibility waterfall to systematic internaliser status has had unexpected outcomes and does not appear to achieve any obvious policy objectives. Please see the AFME paper *MiFID II / MiFIR post-trade reporting requirements*[3] for an explanation of the current regime. AFME notes that an inability to trade report is a barrier to entry for new entrants and could result in suboptimal outcomes for end investors.

Investment firms' institutional clients (buyside) currently feel compelled to transact with systematic internalisers to ensure their reporting requirements are met (in the case they have not build their own reporting capabilities). This may result in a conflict with buyside firms' best execution requirements.

[3] https://www.afme.eu/globalassets/downloads/publications/afme-mifidii-mifir-post-trade-reporting-requirements.pdf

Furthermore, there are technical difficulties with systematic internaliser to systematic internaliser trading in the absence of a golden source of SI data.

AFME would therefore support the introduction of the concept of optionality in trade reporting to complement the default reporting waterfall. This would mitigate some of the effects described above by allowing counterparties to agree who reports and providing a fallback position in case they do not.

Market Data

7. Market Data Costs

Reasonable commercial basis

The costs of market data (which are a crucial input into the efficiency of a trading ecosystem) continue to be high and complex. MiFID2/R requires trading platforms to make pre- and post-trade market data available on a "reasonable commercial basis". Notwithstanding this requirement, certain features of current market structure have led to significant price increases in some parts of the market (notably the exchanges). AFME asserts that these concerns should be addressed by policymakers.

AFME notes the findings of the paper *Pricing of Market Data: a report commissioned by the Danish and Swedish Security Dealers Associations 28 November 2018*[4] (the "Copenhagen Report"). The Copenhagen Report concludes that the combined effect of trading venues having extensive market power in selling their market data together with MIFID2/R requiring firms to obtain market data has had a detrimental effect on investor outcomes. Market data costs to market participants have increased significantly since the introduction of MIFID2/R.

As an example, Copenhagen Economics notes that it observed a 30-60% increase in fees net of inflation since 2008 using Nasdaq Nordic as a case study. High market data costs have a number of undesirable outcomes. As a practical example of the impact of the high costs of market data, UBS MTF announced that it had decided to stop access to Spanish securities in early 2018 following a significant increase in market data fees (although access was later restored).[5] Costs are ultimately borne by end investors. The cost of market data is a barrier to entry to market participants reducing competition.

There are strong parallels with the concerns in the U.S about the price of equities market data and the level of competition in the market. This was highlighted by the SEC decision on 16 October 2018, where the SEC made a ruling in SIFMA's litigation against NYSE and NASDAQ, determining that the market data fees that they were charging for non-core data (i.e. Level 2 data) were not justified.

Additionally, increasing restrictions around usage rights within license terms unreasonably inhibit and create uncertainty around market participants practical uses of market data. As a result, we believe it is important data providers are held to basic principles on data usage licenses.

Bundling/All you can eat

Another contributing factor to the elevated price level is the ability of venues and data vendors to bundle their services into a single product offering. This means the client is 'forced' to pay for trading, messaging and/or data services in one package. In addition, within the data offering, clients often have no choice but to pay for an 'all-you-can-eat' stream of data, while they would typically use only a comparatively small set.

Disaggregation

Disaggregation of market data could be further facilitated by improvement of standards. As an example, current reporting standards for derivatives (ANNA DSB) make it impossible to tie instrument

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[4] https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/6/466/1543587169/pricing-of-market-data.pdf "PRICING OF MARKET DATA", Copenhagen Economics, 18.11.2018.

[5] http://www.mondovisione.com/media-and-resources/news/ubs-mtf-market-notice-removal-of-spanish-instruments/

identification numbers (ISINs) to derivatives with a common set of characteristics, hindering the formation of time series of data.

Free of charge access to transactions to which investment firms are party

AFME proposes that when an investment firm transacts on a trading venue it should be provided with unfettered free of charge access to transactions to which they are party, where such access would not unfairly advantage them over other clients.

8. Consolidated Tape Providers and market data fragmentation

AFME notes the MiFID2/R regime anticipates the emergence of consolidated data providers which have yet to do so at the time of writing (15.03.19). End-users' ability to access the new market data is significantly impaired by the fragmentation of trading venues and data publishers (APAs). In principle, our members are supportive of a consolidated tape. This would improve actual transparency to market participants and could partially mitigate high market data costs.

AFME looks forward to participating in the September 2019 MiFID Article 90 (2) mandated review on the functioning of the consolidated tape. We note that where the Commission concludes that the consolidated data providers have failed to provide information in a way that meets the criteria set out in the second subparagraph, the Commission shall accompany its report by a request to ESMA to launch a negotiated procedure for the appointment though a public procurement process run by ESMA of a commercial entity operating a consolidated tape.

Investor Protection

9. Costs and charges

AFME supports the transparent communication of cost and charge information to end clients but considers that further thought should be given to the utility and content of the mandatory costs and charges provisions for wholesale clients.

Investment firms' wholesale clients are certainly focused on costs and charges and engage continually on this subject. Investment firms, to that end, produce bespoke and specific information on costs and charges for clients. Therefore, homogenised reporting is redundant for those clients. They often ask to stop receiving that information but at present investment firms cannot acquiesce to those requests and have to continue to produce and provide information that their clients neither use nor want.

For these reasons, AFME would support the introduction of the ability for per se professional clients and eligible counterparties to opt out of receiving the mandatory information on costs and charges.

10. Transparency (waivers and deferrals)

A harmonised regime for waivers and deferrals would be desirable for industry.

Deferral regime

AFME is supportive of market transparency and practicably usable data for market participants where:

a) Products are deemed sufficiently liquid and;
b) where there are appropriate deferrals in place for illiquid products and trades above SSTI (size specific to instrument)/LIS (large in scale).

AFME reiterates the importance of maintaining appropriately calibrated size/product thresholds to ensure real-time risk intermediation for traders is not compromised.

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Non-equity deferral regime

The EU Institutions rightly devised a schematic whereby the publication of certain types of transactions in non-equity instruments may be deferred. This ensures that transactions above SSTI/LIS or in illiquid bonds do not have an adverse impact on the market. Whilst we support the principle of the post-trade transparency deferral regime for non-equity instruments, its implementation has led to a regime that is complicated by a lack of harmonisation and standardisation at the European-level on their use.

Harmonisation of deferral regimes across the EU is essential to prevent regulatory arbitrage and preserve a level playing field across the EU for investment firms and investors who wish to avoid a fragmentation of liquidity.

MiFIR Article 11(3) provides a number of options to national competent authorities (NCA's) in the context of the deferred publication of trades in, among others, bonds and derivatives. It depends on the choice of the national competent authority if, for instance, the volume of large or illiquid trades can be masked for an additional four weeks following the conclusion of the trade.

The extended deferral regime, using the supplementary deferral available for NCA's to use where price is published up to T+2, volume T+4 weeks except sovereign bonds where volume is published in aggregate form at T+4 weeks for all trades larger than SSTI, or in illiquid instruments is key in ensuring that market makers have sufficient time to hedge their positions and protect themselves from the risks they take by providing liquidity to the market.

In many illiquid markets it can take several weeks, possibly months for liquidity providers to hedge/unwind their exposures and in liquid markets large trades are often only proxy-hedged initially, then warehoused by liquidity providers for significant periods of time. The inability to de-risk before the size of a LIS or illiquid trade is made public will act as a significant deterrent to the provision of liquidity.

The full use of the supplementary (4-week volume) deferral as per MiFIR 11(3)(b) and RTS 2 Article 11(1)(b) in conjunction with the initial standard deferral is therefore critical to protect liquidity and allow hedging of risk.

In the case of sovereign bonds, aggregation of volume published following the expiry of the 4-week deferral as per RTS2 11(2)(c) is necessary to prevent large, individual sovereign bond transactions becoming public and sensitive inventory information being identified. This is particularly important as this asset class contains a great variety of instruments ranging from very liquid to extremely illiquid.

Such a standardised and harmonised approach would remove the differences across jurisdictions and reduce frictional barriers in the market.

11. Package transactions

The pre- and post-trade transparency regimes, as they apply to packages, have given rise to a complex array of requirements and differing interpretations in the market on their operation. Simplifying the pre- and post-trade transparency assessments in the Level 1 text would lead to a harmonised approach to their implementation and treatment across Europe.

The current approach to package transaction does not work effectively. AFME would appreciate clarification of Level 1 legislation and Level 2 guidance on how to treat packages and would welcome the opportunity to engage on this topic. A determination of non-price forming transactions and packages would reduce complexity in the first instance.

12. Best execution reporting

RTS 27 and RTS 28

Investment firms and their clients continue to be ardent supporters of achieving best execution and transparency. However, the current best execution reporting regime (specifically RTS 27 and 28 reporting requirements) is not functioning optimally for end investors.

End investors do not in the main find the current reports useful due to the overengineered nature of the requirements and the quantity of unhelpful data contained therein. The production of the reports by investment firms is highly costly. Ultimately end investors must bear these increased costs whilst receiving very limited value from them.

We note that investment firms have made significant investments in the required technology and processes required to produce these reports. Therefore, we do not advocate for a hastily formulated wholesale review of the best execution reporting regime. Rather, AFME supports a considered and rigorous consultation process in advance of a review of this regime.

13. Investment research

US research

Prior to the implementation of MiFID2/R in January 2018 industry participants noted that the requirements of Article 24(9) of MiFID for brokers to provide investment research on an unbundled basis creates issues for certain EU investment firms seeking to access research from US broker-dealers. This is because of a conflict with US law under which a broker-dealer receiving cash payments for investment research might be deemed an "investment adviser" and become subject to the Investment Advisers Act of 1940. Many US broker-dealers have raised concerns about the challenges of issuing research out of a registered investment adviser entity, including legal uncertainties and administrative, compliance and operational complexities of subjecting a broker-dealer business to an investment adviser regulatory framework. The US Securities and Exchange Commission (SEC) staff provided temporary "no-action relief" in October 2017, which expires on July 3, 2020, to allow a broker-dealer to receive cash payments for investment research from an investment firm subject to MiFID2/R directly or by contractual obligation without needing to register as an investment adviser.

This limitation has created challenges for global investment firms with operations outside of the EU in that many US broker-dealers are generally reluctant to accept cash payments for investment research from those firms that do not meet the requirements of the "no-action relief." The SEC is considering whether to take additional action, and if so, what action to take. It is possible that the SEC will do nothing and allow the temporary "no-action relief" to lapse. If that were to occur, it is likely to cause significant market disruption as US broker-dealers would need to determine whether to register as investment advisers, or to refuse to provide investment research to EU investment firms seeking to pay cash for that research.

14. PRIIPS and Product Governance

PRIIPs regulation

In relation to the PRIIPs regulation, the uncertainty about its scope and concerns about its requirements have had a serious negative impact on the provision of plain vanilla financial products to retail clients. Our members have also reported that investors do not find the key information document (KID) mandated by the PRIIPs regulation to be useful additional disclosure for such products as the information in a KID relates to structured products. In particular, as noted by other trade associations, there are significant concerns that the methodology for the presentation of performance scenarios produces misleading illustrations for many of the structured products which are in scope. This is due to a reliance on past performance in the methodology set out in the PRIIPs RTS.

One specific consequence of the uncertainty about the scope is that firms have been reluctant to distribute plain vanilla products, such as straight bonds issued by investment grade issuers to retail investors, due to the requirement for a key information document to be published, and then maintained, by the relevant issuer during the life of the instrument. This has particularly affected firms involved in the underwriting and distribution of syndicated transactions. It has led to proposals to distribute to retail investors not being accepted by issuers and international syndicate members since they wish not to incur the additional risks and costs that publishing a key information document entails.

In summary, our members report that one of the key obstacles to the distribution of plain vanilla bonds with investor protective features such as make whole clauses is the apparent inclusion of these products under the PRIIPs regulation, even though they are neither "packaged" or otherwise "complex". This has resulted in the reduction of the distribution pipeline for products suitable for retail investors, which has negatively affected the business of investment institutions in EU countries with a significant retail market, as well as depriving corporate issuers of an important source of capital markets funding. This is contrary to the objectives of the Capital Markets Union and ultimately detrimental to the European economy.

AFME supports the ESA's call in July 2018 for the scope of the PRIIPs regulation to be clarified and also supports the commencement of a review of the regulation as soon as practicable.

Product governance

Separately, in the context of the product governance rules established under MiFID2/R, AFME members consider that the level of detail required with regard to the target market determination appears inappropriate for vanilla bonds and shares. In this context ESMA has used the label "plain" vanilla but has not provided any clarity as to what is proportionate for the purposes of product governance. Regulatory practices appear to be inconsistent across member states and, accordingly, in the case of syndicated offerings of securities, the cooperation of the firms in the syndicate often does not function when the target market is being determined and those firms are based in different member states.

An illustration of this lack of clarity in Germany is that market participants must in effect follow the WM Daten requirements for securities transactions as a result of its link to Clearstream, Frankfurt. These requirements are not consistent with the ESMA Level 3 guidelines leading to further inconsistencies between the approaches of syndicate members. AFME members also consider that the requirement for firms to conduct a regular review of the financial instruments they manufacture with regard to their consistency with the target market as previously determined should be reconsidered. Many products, such as shares or vanilla bonds, are not distributed on a permanent basis. The distribution of these products to investors is usually completed within a relatively short time frame. The mandate given to firms to underwrite and place these products and particularly, the mandate triggering the role as manufacturer (see Recital 15 MiFID Delegated Directive) will terminate at the end of that period. On the other hand, the issuer will be obliged to publish financial reports regularly as required under the Transparency Directive and to make public any inside information directly concerning that issuer according to Article 17 MAR. Hence, there seems to be no reason why a manufacturer should be required to monitor the products it had underwritten or placed in the past after his mandate in this context has ended. Rather, such an obligation appears both unnecessary and disproportionate. This is particularly the case for financial instruments having a term of many years or, by their very nature, even no term at all, as for example shares.

AFME members therefore ask that the review of MiFID2/R should look at the general issues relating to product governance described above.

Other Priorities

15. Open Access to trading and clearing infrastructures

We would encourage policymakers to use the opportunity offered by the July 2020 European Commission review of articles 35 and 36 MIFIR to remove the barriers to 'Open Access' to Europe's trading and clearing infrastructures.

'Open Access' means ensuring non-discriminatory access to trading and clearing infrastructures. Currently, European CCPs are able to offer privileged access to trading venues within their own corporate group. This 'silo' model establishes monopolies, which means the market loses the benefits associated with free competition.

Open access will give market participants enhanced choice in trading and clearing services, thereby avoiding the concentration of risk presented by closed market infrastructures, and leading to lower costs, deep pools of liquidity, improved service levels, greater capital efficiency and innovation.

This view is shared by IOSCO, which identified fair and open access to trading venues and CCPs, based on transparent and objective criteria, as important for ensuring safe, efficient and continuous markets[6].

While article 35-36 MIFIR prescribes non-discriminatory access to CCPs and trading venues, it currently allows competent authorities the possibility to deny such access if it would 'threaten the smooth and orderly functioning of the markets, in particular due to liquidity fragmentation' or if it 'would adversely affect systemic risk'.

Citing these grounds, prior to MIFID2/R go live date, all relevant competent authorities chose to opt their market infrastructures out of the Open Access regime for a period of 30 months (presumably to coincide with the European Commission's review date). This means that the benefits of Open Access have so far been untested.

We would recommend policymakers to review the broad exceptions within the current regime, with an eye on assessing whether the benefits of competition are accurately weighted against the potential for risks.

This could include the introduction of requirements for competent authorities to publish the analysis underlying the invocation of exceptions, increasing the role of ESMA and/or the ECB in the assessment, increasing the burden of proof, narrowing the ground of exceptions or removing the exceptions altogether.

16. Derivatives trading obligation

The derivatives trading obligation (the "DTO") is currently functioning as intended by the policy-makers. The product alignment with equivalent US trading obligations and counterparty alignment with EMIR, has led to the efficient operability of the DTO in both the scope of instruments subject to the obligation and the counterparties to whom they apply.

Similarly, to the Shares Trading Obligation, cross-border application and assessment of equivalence is of critical importance for global OTC derivative markets. Without necessary harmonization liquidity fragmentation due to jurisdictional barriers translating into product silos will occur.

17. Commodities

Position limits

The position limits regime implemented under Article 57 of MiFID imposes a limit on "the size of a net position which a person can hold at all times in commodity derivatives". GFMA members believe that

[6] See Principle 18, page 101-102, CPSS Principles for Financial Market Infrastructure

any position limits imposed upon EU firms should be appropriately calibrated to ensure that the sensible management of risk is permissible, particularly by commodities producers and traders. Market participants have broadly supported the implementation of the MiFID position limits regime which has been applied in a manner which prevents the development of abusive positions while allowing market participants to utilise commodities markets to manage risk and facilitate client demand. However, GFMA cautions against the application of position limits which are overly restrictive as they risk forcing corporate firms to consider the size and scale of their business due to limitations in their ability to hedge risk. This is particularly the case where there are fewer participants active in a particular contract. In our view, such contracts should be allowed sufficient room to develop and grow instead of facing restrictions to liquidity.

The application of *de minimis* limits for new contracts raises an example where policymakers can bring about change in order to facilitate growth in emerging contracts based in the EU. Under Article 15 of RTS 21, new contracts traded on a trading venue with a total combined open interest in spot and other months not exceeding 10,000 lots over a three-month period shall be set a limit of 2,500 lots. Certain NCAs have interpreted this provision to mean that a limit of 2,500 lots should apply from the first day of trading of a new commodity derivative contract. GFMA members believe that this limit is inappropriately restrictive and represents a barrier to new contracts from developing into deeper pools of liquidity.

A preferable approach would be to allow for a review period during which no position limit is set, therefore allowing the relevant competent authority to monitor the development of the contract and take an evidence-based decision as data pertaining to the relevant contract (e.g. open interest, number of participants or type of underlying commodity), becomes available.

18. Non-equity product calibrators / thresholds

We also note the appropriate calibration of future "liquid" product calibrations and size thresholds for LIS/SSTI is of critical importance moving forward. We would commend ESMA for taking a diligent approach to assessing the product thresholds to date and ensuring excessive transparency does not harm the risk intermediation and transformation process for less liquid products.

19. Instrument classifications

Clear, consistent classification of instruments into CFI (Classification of Financial Instruments) code (and subsequently ISIN), and RTS 2 taxonomy underpin the consistent application of transparency across non-equity products. We are aware of initiatives for the industry to converge on a consistent approach and are supportive of these.

Conclusion

AFME looks forward to engaging with the BMF on specific aspects of the contents of this response and providing further detail in the coming period.

About AFME

AFME advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and

Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.

AFME contacts

Julian Allen-Ellis
Director, MiFID
London Office
39th Floor
25 Canada Square
London, E14 5LQ
United Kingdom
+44 (0)20 3828 2690
Julian.Allen-Ellis@afme.eu

Pedro Pinto
Director, Advocacy
Brussels Office
Rue de la Loi, 82
1040 Brussels
Belgium
+32 (0)2 788 3971
Pedro.Pinto@afme.eu

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Annex 1

AFME on the application of the tick size regime

23 January 2019

Executive Summary

AFME believes that tick sizes have an important role to play in the financial markets. Appropriately calibrated tick sizes must allow for the efficient formation of prices across trading mechanisms offering comparable liquidity whilst seeking to minimise the bid-ask spread. On this basis we believe that changes to the tick size regime must be viewed holistically and so we would like to provide additional feedback on the amendments to the MiFID tick size regime put forward under the Investment Firm Review (IFR). Our view is that:

- trades executed on systematic internalisers (SIs) or trading venues that are above Large in Scale (LIS) or that are non-price forming should not be subject to the tick size regime;
- for all sizes of order, mid-point should remain a valid execution price, permitted to trade at a half tick, both on trading venues and SIs

Purpose of the Tick Size Regime

- The purpose of the tick size regime is to ensure that orderly and transparent trading takes place on trading venues through promoting the effective formation of prices on displayed order books. It also helps to maintain a reasonable depth of liquidity whilst allowing spreads to fluctuate.
- The tick size regime's relevance is principally to order book driven markets which are pre-trade transparent (e.g. on venues that accept orders with a specified limit price), and to alternative trading mechanisms (such as SIs trading below LIS) that are comparable/competitive to order book driven markets (e.g. accessed by market participants alongside (or as an alternative to) pre-trade transparent order books in the course of executing).
- A blanket application of the tick size regime across all venues and trade sizes may increase market risk and penalise investors (which include pension funds) arbitrarily), particularly when trading in larger sizes.

IFR Review

AFME is supportive of the intention to ensure that comparable market mechanisms are required to adhere to the same rules. We encourage regulators to consider the differences across the various types of venue in operation today and ensure that application of the regime is calibrated to reflect the nature of the liquidity offered. AFME strongly believes that modifying the tick size regime as proposed by the European Parliament's position of September 2018 amending the IFR proposal (Article 61) would:

- artificially constrain price formation and market transparency
- risk arbitrarily and materially penalising one investor over another where both parties would be satisfied by a mid-point execution
- require some venues to round mid-point orders up or down to the nearest tick to the disadvantage of either the buyer or seller

Given the potential impact on European markets, we remain deeply concerned by the changes proposed by the European Parliament and recommend that these are calibrated to exclude LIS and non-price forming activity from the scope of the tick size regime across all venues (please see Annex 1 for our proposed amendments).

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Level playing field between SIs and trading venues

- AFME supports a level playing field between SIs and trading venues and is of the view that the tick size regime should not be applied to LIS/non-price forming activity on either mechanism.
- It is essential that institutional and retail investors seeking execution of orders can continue to do so at the mid-point of the Bid-Ask spread. The mid-point is understood and accepted globally as a fair execution price, and European markets would be materially harmed (and out of step with global markets) should the ability to execute at the mid-point be constrained. Requiring comparable market mechanisms to ensure appropriate price formation whilst also allowing the conclusion of trades at a non-round tick is beneficial to end investors. It allows for efficient price formation whilst reducing the bid-ask penalty on investors (which is magnified for larger trades).
- We note that the European Parliament proposed amendments on tick sizes within the Investment Firm Review and its related justification does not achieve the stated aim of levelling the playing field between trading venues and SIs. The justification associated with the proposed amendment was that "systematic internalisers should be subject to the tick size regime when **dealing** [*emphasis added*] in all sizes"[1]. Nonetheless, while trading venues must ensure that all orders entered onto their systems comply with the tick size regime, they may still conclude transactions at the midpoint, e.g. for negotiated trades. This not only puts SIs at a disadvantage, but it also deprives investors from access to meaningful and differentiated risk liquidity that may not be available on a trading venue.

Consideration of the relevance of the tick size regime to different transaction types:

1. Point in time execution below Standard Market Size (SMS) and in multiples of SMS but below LIS
   - Provision of liquidity (by banks, and by market making firms) which can be accessed alongside (or as an alternative to) pre-trade transparent order books in the course of executing. This trading activity generally takes place in sizes similar to SMS and above, but only in very rare circumstances in sizes larger than LIS.
   - Multilateral trading venues that bring together buyers and sellers. Where the spread is an odd number of ticks apart, this can result in executions at a mid-point that is on a half tick.

   In respect to these executions, a harmonised tick-size regime, which permits execution at half-tick where it represents the mid-point for both trading venues and SIs, will ensure a level playing field between comparable/competitive market mechanisms while also ensuring that neither buyer nor seller is disadvantaged by forcing venues to clamp mid-point orders to a full tick.

2. Point in time execution above LIS
   - Provision of risk capital to fill large orders where a client seeks immediate execution in a size greater than can be achieved via order books.
   - Large transactions negotiated between investors away from a displayed order book.
   - Equity Capital Markets activity (e.g. placements, Accelerated Bookbuilding) conducted after market hours.

   In respect of these executions the tick regime should not apply, for the following reasons:

   a) Applying the tick size regime to these executions forces disadvantaging investors:
      i. Applying a tick size regime will not contribute to the price discovery process for LIS trades and may actually inhibit appropriate price formation between SIs and clients agreeing trades in large sizes.

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[1] European Parliament Draft Report on the proposal for a regulation of the European Parliament and of the Council on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010 (COM(2017)0790 – C8-0453/2017 – 2017/0359 (COD))

ii. The ability to execute LIS trades on a sub-tick basis provides meaningful price improvement for clients trading in large sizes which brings benefits to end investors. Removing this capacity would amount to the regulation enforcing a bias against end investors (e.g. pensioners' funds) who wish to trade in larger sizes.

3. Average Price Executions
   - Provision of guaranteed risk-execution at a benchmark price (e.g. VWAP).
   - Institutional investors such as pension funds and savers' fund managers may wish to use a benchmark such as the volume weighted average price (VWAP) to achieve an execution. For example if they are moving into a stock in size (e.g. because it is included in an index that the fund has to track, or they have determined it would offer investors meaningful upside), they will want to ensure that it is bought for their savers at a fair price over the course of a certain period (e.g. a day or two) without their intention to enter into the stock moving the market and penalising those pensioners/savers. In those instances, they will request that their broker enters the market and starts buying up the stock incrementally, tracking available liquidity at the average price of that liquidity at any given point in time. To ensure savers are not penalised they may ask their broker to guarantee that the stock will be executed at the VWAP. This will typically be undertaken by brokers in their capacity as an SI and, because it represents an average price of available liquidity, will in most cases not be at a round tick.

In respect of these executions, the tick regime should not apply, for the following reasons:

a) Guaranteed benchmark executions, and other non-price forming transactions reflecting an average price achieved in the market naturally result in executions that do not conform to a tick table.

b) As for 2 above, a restriction to round ticks on these executions forces favouring of one set of investors and disadvantaging another and imposes on these investors needless cost, while providing no benefit to market transparency (e.g. having to round a guaranteed VWAP execution up or down to the nearest tick).

c) These reports are not price-forming, as they typically duplicate executions or hedging activity already undertaken and subject to the pre- and post-trade transparency regimes.

Application timeline

We are very concerned by the application timeline proposed under Article 63(2a) which appears intended to apply to the European Parliament's proposal (i.e. applying the proposed changes to the tick sizes regime 20 days after publication of the IFR in the Official Journal of the European Union (OJ). Given the lack of legal certainty prior to the publication in the OJ, this represents an insurmountable challenge for AFME members who would need to update procedures, supervision policies, system updates and testing in order to ensure that firms are compliant with their requirements under RTS 6, including measures to ensure that automated controls function correctly. Additionally, firms would need to factor in time to communicate changes to clients given that the European Parliament proposals would represent a fundamental change to how firms should expect to interact with SI liquidity. We therefore respectfully, suggest that the proposed application timeline is extended to 9 months in order to allow sufficient time for any required changes to be made (AFME proposed change to the European Parliament proposed application is included under Article 63 within Annex 1).

Conclusion

- Application of the tick size regime is only relevant to a subset of executions, namely below SMS or in multiples of SMS but below LIS (see 1 above).
- Application of the tick size regime should be understood as permitting execution at half tick, where it represents the mid-point for both trading venues and SIs. This will allow for a level playing field between comparable/competitive market mechanisms while also ensuring that neither buyer nor seller is disadvantaged by forcing venues to clamp mid-point orders to a full tick.

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- Application of the tick size regime to remaining executions types will force the favouring of one set of investors and disadvantaging another, resulting in detrimental execution outcomes for end investors.
- We support a level playing field between SIs and trading venues, recognizing the range of activities SIs perform is not only comparable to lit order books, but also other LIS market models. As such, we are of the view that the tick size regime should not be applied to LIS or non-price forming activity in any context.

ANNEX 1

AFME proposed changes to European Parliament proposed amendment to the IFR text (AFME amendments in red):

DRAFT COMPROMISE K
Article 61 - Changes to MiFIR/ Systematic Internalisers

Bold/***italics*** text represent changes to the Commission proposal.

Article 61 - paragraph 1 - point - 1 (new)

The title of Title III is replaced by the following:

"TRANSPARENCY FOR SYSTEMATIC INTERNALISERS AND INVESTMENT FIRMS TRADING OTC ***AND TICK SIZE REGIME FOR SYSTEMATIC INTERNALISERS"***

Article 61 - paragraph 1 - point - 1a (new)

The following Article 17a is inserted:
Article 17a
Tick sizes
Systematic internalisers' quotes, price improvements ~~on those quotes~~ and execution prices that are, in each case, below large in scale shall comply with tick sizes set in accordance with Article 49 of Directive 2014/65/EU unless the conditions set out in Article 15(3) of Regulation (EU) No 600/2014 apply.

Article 63 - paragraph 2a (new)
Notwithstanding paragraph 2, Article 61(1), point -1 (new) shall apply ~~20 days~~9 months after publication of this Regulation in the Official Journal of the European Union.

Recital 42a (new):
(42a) With the aim of guaranteeing a level playing field and promote the transparency of the European market, Regulation (EU) No 600/2014 should be amended to subject below large in scale systemic internalisers' quotes, price improvements and executions prices to the tick size regime ~~when dealing in all sizes~~.

AFME contacts

April Day, april.day@afme.eu +44 (0)20 3828 2682

afme/
Finance for Europe

Sean Barwick, sean.barwick@afme.eu +44 (0)20 3828 2670