

A MIFID review that works for end users of financial markets

Key principles

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Introduction

During these unprecedented times of a pandemic outbreak, European capital markets have continued to intermediate market liquidity and facilitate risk management for corporates and investors.

Open, competitive, and efficient markets continued to prove its resilience and purpose, whilst banks helped corporates raise record level of financing and investors reallocate portfolios and investments at a time of heightened volatility.

This paper aims to set out key principles that should help inform a MIFID review that works for end users of financial markets to ensure markets will continue to play their role in helping economic recovery, on investments and growth.

Key Principles

- A MIFID review ought to be evidence-based to solve the issues requiring an urgent fix. The review should focus on delivering fair, efficient, and liquid markets while also fine-tuning the investor protection regime where experience shows that a more proportionate approach would be beneficial. Ultimately, the review should aim at improving the EU competitiveness and connectivity globally in the near-term by enacting features that allow for enhanced outcomes for end-users, including SMEs and retail investors.
- The various trading modalities all serve different functions and market needs. No trading modality is superior to others. Banks' risk-intermediated trading is not interchangeable and play a critical role for pension and investment funds.
- Direct retail investor participation should be carefully nurtured, whilst indirect participation of pensioners and savers, who entrust their money to asset and portfolio managers should not be less favourably treated. Trading modalities and features that cater for each group's needs should be readily available and treated on an equal, neutral basis.
- Wholesale clients are sophisticated and have negotiating power, therefore we argue they should be treated in a proportionate manner. Standardised information that is not adapted to their needs (i.e. disclosure obligations on costs and charges and other disclosures of a similar nature) should not be required as it creates costs without any appreciable benefit. Proportionality should underpin Europe's financial markets regulatory policy, which, in turn, would increase market participation at all levels with no detriment to investor protection.
- The trading obligation for shares should be revoked, or, failing that, limited to shares admitted to trading in the EU at the request of the issuer. The double volume cap thresholds, if not removed, should see the thresholds made flexible, at the determination of the European Commission. This would limit possible unintended negative impacts to end investors and to the attractiveness of the EU capital markets.
- Pursuing best execution on behalf of end investors is a key investor protection principle that should be protected. Restricting alternative trading modalities reduces the ways market impacts can be managed, which would result in higher implied trading costs (i.e. wider spreads) for end investors, reducing the value of their pensions and savings, higher volatility and, ultimately, reduced liquidity.
- Transparency requirements for fixed income instruments should continue to be calibrated for different types of financial instruments and take into account the interest of issuers and market liquidity. The value of banks' risk-intermediated trading for end investors on the heterogeneous fixed income markets ought to be recognised to avoid negative impacts on liquidity.

- Financial markets regulatory policy should be data-driven and be based on evidence provided by thorough data analysis. New market policies should demonstrate the benefits for end investors, issuers and other participants and be subject to robust impact assessment analysis.
- Capital markets data should be deemed as a public good and should be easily accessible to all investors and participants at a reasonable cost. European supervisory authorities should maintain data systems that can be relied upon as public “golden source” of reference data.
- A truly integrated European capital market requires market infrastructure that is not fragmented along national lines so European corporates, European investors and more generally, the European economy of the future, can thrive in a vibrant capital market. Open access between market infrastructures should continue to be promoted.

Financial markets regulation tailored to end users of capital markets

Financial markets policy is the cornerstone for a vibrant European Capital Market Union. A **targeted, yet ambitious review of MIFID** is therefore necessary to unlock the full potential of European capital markets by increasing investor participation, deepening pools of liquidity, reducing fragmentation and facilitating corporate financing in public markets.

Capital markets regulation should positively contribute to an **optimal allocation of European investors' savings** so that investors obtain good outcomes and corporates and governments in demand of **diversified forms of capital markets funding** can have their financing needs satisfied at competitive prices.

This can only be provided by **open, competitive, and efficient markets**, in an environment where **financial stability is ensured**, and **investors are protected in a proportionate manner, according to their needs**.

These are the key attributes for a European financial markets regulatory framework that works for end users.

An open and competitive marketplace for a more efficient European capital markets

A **MIFID review** ought to be evidence-based to solve the issues requiring an urgent fix. The review should focus on delivering fair, efficient, and liquid markets while also fine-tuning the investor protection regime where experience shows that a more proportionate approach would be beneficial. Ultimately, the review should aim at improving the EU competitiveness and connectivity globally in the near-term by enacting features that allow for enhanced outcomes for end-users, including SMEs and retail investors.

Banks, trading venues and other financial service providers all play a critical role in such an ecosystem. Innovative services and products that help end investors and users achieve better outcomes should be encouraged.

By bringing together the supply and demand on financial instruments, different trading modalities provide for a critical price discovery function that allows liquidity to flourish and different types of investors to fulfil their needs, including those professional investors that execute the mandate on behalf of their savers and pensioners. The most liquid secondary markets benefit from higher asset valuations which, in turn, foster increased issuances in the primary market. To advance these CMU objectives of increased investor participation and capital markets financing, **AFME supports the maintenance and improvement of policies that promote the provision of addressable liquidity, including liquidity provided by banks' risk-intermediated trading capabilities.**

The **various trading modalities all serve different functions and market needs. No trading modality is superior to others.** Trading in less liquid instruments may require specific trading modalities that only banks' risk-intermediated trading capabilities can provide to overcome scarce supply or demand for those securities. This is in the same way as bespoke transactions and trading in different sizes may also warrant features not akin to those provided by central order books to ensure immediacy and minimise market impacts, which otherwise would not be achieved.

Banks' risk-intermediated trading is not interchangeable and play a critical role for pension and investment funds. Banks place their own capital at risk by holding securities in inventory, temporarily absorbing risk that other market participants are unable or unwilling to bear. By doing so, banks ensure that with their risk management expertise, they avoid less favourable prices for clients, inability to trade due to inexistent liquidity or otherwise wider market impacts.

Failing to nurture this **key feature of the liquidity ecosystem** would be a disfavour to investors, who would be unwilling to purchase less liquid securities, or would only buy them at a lower price to compensate for the liquidity risks. This, in turn, would heavily impact corporate issuers of a smaller calibre and the investment environment for the wider economy.

Increased investor participation and protection

The MIFID review should promote **increased participation of all types of investors ranging from retail to professional investors**, creating wider and deeper European pools of liquidity.

Direct **retail investor participation** should be carefully nurtured, whilst indirect participation of pensioners and savers, who entrust their money to **asset and portfolio managers, should not be less favourably treated.** Trading modalities and features that cater for each group's needs should be readily available and treated on an equal, neutral basis.

A more **proportionate treatment of investors** would increase market participation at all levels with no detriment to investor protection. Wholesale clients are sophisticated and have negotiating power so we argue they should be allowed to determine which information they want to receive from their service providers. More standardised information that is not adapted to their needs (i.e. disclosure obligations on costs and charges and other disclosures of a similar nature) should not be required as it creates costs without any appreciable benefit. Misleading or confusing information could hinder the goals of increasing investment.

Proportionality should underpin Europe's financial markets regulatory policy. This should include allowing for *ex-ante* measured assessments on how regulation should take into account, where appropriate, specific differences prevailing in the relevant financial market sector relating to the nature, scale and complexity of risks; business models, practices and investors involved; and the size and type of financial institutions and of markets.

Wider investor participation in a more diverse and liquid marketplace will spur **corporates of all sizes to finance their expansion plans and growth in public markets.** This will allow for a better allocation of investors' savings, enhanced risk sharing and shock absorbing capacity across European capital markets.

Equities market structure that caters for issuers and investors' needs

The **European equities market structure does not compare well with other more global and successful capital markets¹**. This will continue to put European issuers and investors at a disadvantage. To make the European equities market a truly global and effective market where investment choice and accessibility is ensured, certain obligations should be carefully evaluated.

The **existing limitations to open and competitive markets (i.e. the MIFID share trading obligation and the double volume cap), should be revisited** to consider whether they are delivering on their original objectives. It needs to be determined whether the balance of cost and benefit of such limitations is still appropriate in the changed environment in which we find ourselves almost ten years later since the start of the review of MIFID 1.

The **trading obligation for shares should be revoked, or, failing that, limited** to shares admitted to trading in the EU at the request of the issuer. The **double volume cap thresholds**, if not removed, should see the thresholds made flexible, at the determination of the European Commission, to limit possible unintended negative impacts to end investors and to the attractiveness of the EU capital markets. Neither of these policies advance positive outcomes for end-users, but rather increase complexity in market structure.

Maintaining these rules should be subject to there being good evidence that they are beneficial to today's European economy and conducive to the economic future Europe aims to achieve.

Promoting increased lit market trading would not necessarily improve price formation and, conversely, may impact the ability for firms to provide best execution for their underlying clients. Worst outcomes to end users of capital markets, either corporates raising capital or savers and pensioners investing their savings, would over time curtail the European economy and the well-being of its citizens.

The **European decentralised and competitive price formation model is healthy** and does not require remedial attention, particularly in the form of limitations to competition and/or more significant change to Europe's already complex market structure. We believe that this **decentralised model leads to more open, resilient, and deeper capital markets in Europe, promotes innovation and the delivering of best execution to the ultimate investor**.

Decreasing market data costs would strengthen the effectiveness and expand the accessibility of the existing model by eliminating any barriers to entry and reducing the overall costs of trading for end clients.

Pursuing **best execution on behalf of end investors is a key investor protection principle that should be protected**. Curtailing best execution and access to better prices by reducing competition in European equity markets, for example by seeking to reinstate a pre-MIFID I "concentration rule" through a veiled share trading obligation, and by requiring increased trading on lit markets, would significantly limit the ability of investment firms to deliver better outcomes to end investors.

Restricting alternative trading modalities also reduces ways in which market impacts can be managed, which would result in higher implied trading costs (i.e. wider spreads) for end investors, reducing the value of their pensions and savings, higher volatility and, ultimately, reduced liquidity.

AFME advocates that maintaining a **variety of execution venues and trading modalities is a prerequisite of an effective Capital Markets Union** and of the attractiveness of Europe's capital markets, not only for European investors and issuers but also vis-à-vis other major international marketplaces.

¹ The Market Finance indicator (which comprises equities and bonds) for European Non-Financial Corporates ("NFCs") is only slightly above 10%, whereas the US NFCs indicator is above 35%. The Market Finance indicator seeks to quantify the proportion of total finance for NFCs, which is provided by capital markets instruments (equity and bonds). The indicator is calculated as annual gross NFC equity and bond issuance as a percentage of the sum of annual gross lending (new loans) to NFCs and equity and bond issuance.

The **provision of liquidity by banks' risk-intermediated trading capabilities is not substitutable by other execution venues or modalities available in the existing market structure**. This risk intermediation is an absolutely essential part of a healthy investment ecosystem as it absorbs price impacts to end-users' investment positions and ensures the best possible execution in all circumstances to the ultimate owners of those investments, European pensioners and savers.

Any **curtailment to this diverse trading ecosystem that is also available on more successful markets should only be based on thorough data analysis and evidence** demonstrating that such curtailments would better serve the needs of issuers and investors. Otherwise, issuers will persist on pursuing their funding and capital raising initiatives (not least their IPOs) outside Europe where global investors find it easier to invest.

The heterogenous nature of fixed income market structure

The nature of capital markets varies depending on asset classes and, within each asset class, on the liquidity of each instrument. The **heterogenous nature of fixed income markets** entails a market structure that is mindful of the interests of a diverse array of corporates and sovereign issuers, the value of risk-intermediated trading and that recognises less liquid fixed income "buy to hold" trading strategies.

Imposing **full and immediate transparency on fixed income markets would fail to recognise the value of such risk-intermediated trading for end investors** and for the wider market, would expose liquidity providers to undue risk, and would therefore negatively impact liquidity.

AFME advocates that the **possibility of deferring the publication of the volumes of transaction by a significant period should not be eliminated or reduced** and, if harmonised across Europe, should provide for the longest deferral period currently available. All existing transparency waivers should also be preserved.

Transparency requirements for fixed income instruments should continue to be calibrated for different types of financial instruments and take into account the interest of issuers and market liquidity.

Calibration should (i) depend on whether the activity takes place on a trading venue or on the risk-intermediated trading facilities of banks and (ii) be based on the type and size of the transactions. The transparency rules should also be differentiated according to the type of trading, including order-book and quote-driven systems, such as request for quote, as well as hybrid and voice broking systems.

Careful calibration of the different transparency obligation and liquidity requirements is an essential part of the existing framework as it **ensures the delicate balance between market transparency and market liquidity**.

Similar to equity markets, the **provision of liquidity by banks' risk-intermediated trading capabilities is not substitutable by other execution venues or modalities available in the existing fixed income market structure**.

Where assessments indicate no detrimental impact to markets, AFME supports a gradual, measured increase of the liquidity requirements and transparency obligations for non-equity markets. **Yet we would advise caution on reviewing those requirements under the current market conditions and based on data that remains inaccurate and incomplete.**

Financial markets policy should be evidence and data-based

Financial markets regulatory policy should be data-driven and based on evidence provided by thorough data analysis. New market policies should demonstrate the benefits for end investors, issuers and other participants and be subject to robust impact assessment analysis.

The MiFID review needs to be based on careful evaluation of evidence as well as on a robust data gathering exercise, which may very well need to go beyond the data currently readily available to industry stakeholders and regulators alike. **We consider that the quality and availability of the existing data remains weak and unreliable.**

Capital markets **data should be deemed as a public good**. Transparency data resulting from actual market transactions and all other regulated data necessary for investors to make informed investment decisions, should be **easily accessible to all investors and participants at a reasonable cost**.

Transparency-related trading **data should be complete and accurate**, and it should be consolidated and easily accessible for the benefit of the end investor. European supervisory authorities should also maintain data systems that can be relied upon as **public “golden source” of reference data**.

In the age of data, European supervisory authorities should ensure that the costs of **market data will not become a new barrier in an increasingly fragmented European capital market**.

Promoting a truly integrated European capital market

A truly integrated European capital market requires market infrastructure that is not fragmented along national lines so that European corporates, European investors and, more generally, the European economy of the future, can thrive in a vibrant capital market.

Policy measures should be enacted to promote more competitive and integrated capital markets in the Europe Union so that European financial services providers and infrastructure can compete on a global scale. **Open access between market infrastructures should continue to be promoted.**

The establishment of a **consolidated tape for trading information in Europe can be the game changer for the promotion of an integrated capital markets in Europe**. Data quality issues and overly expensive existing market data costs ought to be addressed to allow it to be a success.

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About AFME

AFME (Association for Financial Markets in Europe) 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 policymakers 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.

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