MIFIR REVIEW

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MiFIR Review: three key challenges for the Czech presidency

The coming into force of MiFID II and MiFIR in early 2018 has had a significant impact on the European capital markets. The MiFID/MiFIR framework is the Operating System (OS) for the financial markets. As with any OS, it needs a regular upgrade. So, there is currently the opportunity to further improve this OS by way of the 'MiFIR Review'. The European Commission drafted an ambitious proposal. Negotiations began under the French presidency, with several compromise proposals being discussed. It is now up to the Czech presidency to take up the mantle and finish the good work already done. We would like to summarize what are, in our view, the three key challenges.

The first challenge is Payment for Order Flow, colloquially known as PFOF. It describes the practice where a venue or market maker pays a broker a fee in exchange for the exclusive right to execute the orders of this broker's clients. The AFM believes there is a lack of transparency in the costs to investors and our research shows that PFOF venues underperform in both quoted and executed prices. ESMA has warned about the risks of PFOF as well. A ban on PFOF would appear appropriate, although not all Member States agree. Some are more supportive of these practices and revenue models deployed, for example, by neo-brokers.

We should realize the debate on PFOF is not an EU-only matter, but part of a global policy debate. The UK has a ban on PFOF. Australia has recently installed a ban on PFOF. In the US, in response to the wild-west trading in GameStop, the SEC is moving towards reforming the (PFOF) system substantially, e.g. by creating an order-by-order auction system, but with an outright ban on the table. The negotiations on the MiFIR Review must be seen within this global direction of travel. All major financial markets around the world are banning PFOF due to issues around conflict of interest and best execution. The European Capital Markets Union should not ignore this and take the wrong turn.

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The second challenge is the establishment of consolidated tape provider(s) (CTP) for different asset classes. These consolidated tapes (CT) would add significantly to transparency, resilience, and execution quality. It would reduce fragmentation in the Capital Markets Union, increasing visibility, comparability, funding opportunities and improve market resilience. As with the first challenge, the AFM has been vocal in its support for a CT.

We have been particularly supportive of establishing a real-time post-trade bond CT, facilitating the generation of ideas, business models and proofs of concept by way of our Regulatory Sandbox that includes a group of technology companies and an industry working group consisting of both buy- and sell-side, trading venues and liquidity providers. This allowed for rapid progress to be made and for market based, practical policies to be developed into an agreement on high level technical principles for a corporate bond CTP. The AFM invites the co-legislators to take note of these principles.

An equity CT is perhaps more complicated. The EU market for shares is very fragmented, with a significant amount of local or national exchanges. Whilst a real-time equity CT with limited pre-trade information (on a voluntary basis) is the desired outcome, there is opposition. It should be noted, however, that an equity CT would not compete with proprietary market data franchises: this business model for venues would remain unaffected. In return, better visibility and revenue-sharing models could provide a tangible benefit for smaller and non-interconnected venues in particular.

The third challenge is to enhance 'meaningful transparency'. It suggests transparency should be improved where it makes sense to do so and in a manner that is useful to market participants. An example is the calibration of the deferral regime for bonds. The current regime allows for notable differences between Member States: an EU-wide regime would be a significant improvement in itself, especially if it is both shorter and less complex. Furthermore, the correct calibration of this EU-wide regime is essential for the establishment of a bond CT. A way forward could be to have different categories, with a price being either real-time, 15min. delay or end-of-day, and the corresponding volume at 15min. delay, end-of-day, or two weeks.

Another example of achieving meaningful transparency is the improvement of market data quality and consistency. There are several ways of achieving this. Strengthening ESMA's role in handling and enhancing data quality and reporting consistency is one. Another is to form an industry expert group to advise on some of the key issues in reporting market data, which we strongly support.

In our view these are the three key challenges to overcome in order to have the MIFIR review become successful and providing a useful 'OS' upgrade to the MiFID/MiFIR framework that is a tangible improvement for the financial markets. We wish the Czech presidency the best of luck.