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MiFID II Implementation – Achievements and Current Priorities

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Ladies and Gentlemen,

It is a real pleasure to be here in Vienna today at the FESE convention 2018. While discussions so far have covered broader capital market issues, I will focus my contribution on the early days of MiFID II implementation. MiFID II has been in place for nearly six months, and I believe that now is a good time for a preliminary review. I will cover ESMA's assessment of the first months of MiFID II as well as issues identified in the area of secondary markets on which we at ESMA are intending to focus on in the coming months. Finally, I will also briefly touch upon the need for a third country regime for trading venues in MiFID II.

MiFID II is one of the pillars of the EU's regulation of financial markets and aims at establishing a more transparent financial system that works to the benefit of the economy and society as a whole. In particular, MiFID II aims at improving market transparency and price formation, closing loopholes in the market structure framework, and ensuring that more transactions take place on regulated platforms. Of course, a complete assessment on whether MiFID II delivered on these objectives would be premature at this stage. Nevertheless, I believe that at this point we can already identify whether we are on the right track or whether further measures are needed to get it right.

Let me start with the first achievements of MIFID II. Overall, the implementation of MiFID II went quite smoothly. This can probably best be highlighted by some examples:

- While many market participants were concerned that the MiFID II transparency provisions may disrupt financial markets and reduce available liquidity, so far we have not observed any of this. This indicates that we calibrated the transparency regime by-and-large correctly. One might consider that we calibrated it too cautiously since – in particular for non-equity – only very few instruments are currently subject to real time transparency, resulting in various stakeholders complaining about the lack of transparency:

- After a short delay, the double volume cap system has been up-and-running and has resulted – to date – in the suspension of dark trading of more than 900 instruments. The vast majority of suspensions concern shares. As a result, the number and volume of transactions in dark pools has significantly decreased;

- The trading obligation of derivatives started to apply on 3 January resulting in the mandatory trading of certain interest rate swaps and index CDS on regulated platforms, thereby meeting our G20 commitments and ensuring greater transparency;

- MiFID II has begun to deliver on the intended change of market structure. The new category of Organised Trading Facilities (OTFs) is already well accepted. Currently, 72 OTFs are authorised and in the ESMA register. Furthermore, significantly more Systematic Internalisers (SIs) are active under MiFID II, thereby being subject to pre-trade transparency requirements. To date, and this includes only SIs that opted into the regime, we have 109 SIs in our ESMA register compared to 11 SIs under MiFID I. While I am aware of your concerns regarding SIs, the high number of OTFs and SIs nevertheless demonstrates that MiFID II delivers on its ambition to impose a set of transparency and organisational rules on all kinds of trading, be it multilateral or bilateral, thereby contributing to levelling the playing field;

- Also, the new tick size regime appears to deliver on its ambitions. Our colleagues from the AMF carried out a first analysis[1] on the effects of the tick size regime on the liquidity and quality of the market. The study concluded that overall the tick size regime had a positive outcome for market participants since it led to less noise in the order book and increased the number of securities available at the best limit; and

[1] AMF (2018): Mifid Ii: Impact Of The New Tick Size Regime, March 2018, http://www.amf-france.org/en_US/Publications/Lettres-et-cahiers/Risques-et-tendances/Archives?docId=workspace%3A%2F%2FSpacesStore%2F4ee6cbf6-c425-4537-ab74-ef249b9d316d

- Finally, a key requirement for the new data-reporting regimes relates to the LEI, which is essential in supporting regulators' work on transparency and market surveillance. A few weeks ahead of the MiFID II go-live date, we issued a statement allowing a six months period to support the smooth introduction of the LEI requirement. Since then, ESMA and NCAs have been closely monitoring the use of LEIs and have observed a steady and substantial increase in its use: currently 95.5% of the instruments reported in our reference data system have the correct LEI. This positive development led to the confirmation of the end of the six-month period which means that NCAs' activities with respect to the LEI are now shifting from pure monitoring to ongoing supervisory actions. ESMA is working with NCAs to identify the necessary measures to actively supervise the compliance with this important requirement.

While there are clear positive achievements under MIFID II already, we also have to acknowledge that there are some areas where improvements are needed to ensure its smooth functioning and that it delivers on its objectives. These improvements are high on our agenda for the coming months.

The Double Volume Cap Mechanism (DVCM)

First of all, while the double volume cap is up- and-running now, and we are confident that we identify correctly nearly all instruments that should be subject to the cap, we are still facing some data quality issues and we have spent significant time and effort to address these already. In order for the DVCM to work it is of utmost importance that all trading venues submit complete data to our IT-system in a timely manner, including the resubmission of corrected data. We have seen significant progress in trading venues' submissions over the last months, following intensive work with national competent authorities (NCAs) and trading venues to improve the data quality in the system. However, for a number of trading venues we are still dealing with data quality issues. I therefore urge those of you who have not yet submitted all necessary and correct data, to step up your efforts.

I am also aware that at times some data issues were due to the ESMA IT system. I can reassure you that we are working hard on this to further reduce outages and provide additional guidance on how to submit data.

Let me move away from data quality issues to the first impact of the double volume cap on market structure. From our first observations, it appears that trading flow previously executed under one of the two waivers covered by the double volume cap, is in particular flowing to SIs and periodic auction trading systems. While the share of trading on new periodic auction trading systems is still low, it can be observed that periodic auction trading systems are increasingly attracting trading flow. For instance, since the first suspension of dark trading in March, trading volumes on periodic auction trading systems have tripled.

These developments have caught our attention and has triggered a concern that some periodic auction systems may be designed with the intention to circumvent the double volume cap. Therefore, we are therefore currently carrying out a fact-finding exercise on the different periodic auction trading systems to understand the various features of these systems. This is an exercise that requires an in-depth analysis as no two auction trading systems are the same. If deemed necessary, this may result in further ESMA measures or recommendations.

The Systematic Internaliser (SI) Regime

SIs appear to be the other type of execution venue enjoying a significant increase in market share under MiFID II. It was one of the objectives of MiFID II to strengthen the SI regime and ensure that investment firms dealing with clients in an organised way are subject to minimum transparency and organisational rules bringing them closer to trading venues.

However, I share your concerns about a lack of a level playing field between SIs and trading venues that may result in changes in the market structure away from trading venues to SIs. We therefore proposed an amendment to the ESMA RTS 1 that deals with the transparency provisions for equity instruments to ensure that quotes of SIs meet the tick size requirements. The draft amendment is with the Commission for endorsement.

I am aware that many of you consider that this amendment does not go far enough since it only covers quotes from SIs that are below the standard market size and you may therefore rather support an amendment of the Level 1 text. I certainly have some sympathy for that approach but a change of Level 1 is not for ESMA to decide. We proposed to amend RTS 1 since there we have the right of initiative and we considered it the most pragmatic way to edge closer to a level playing field between trading venues and SIs in the short- to medium-term.

Bond liquidity assessment

On 2 of May we published the results of the first quarterly determination of the liquidity status of bonds. As you know, due to data quality issues we published only the results for a limited number of bonds. We are clearly not satisfied with the results of this first publication, both in terms of data quality and the very low number of liquid bonds. We are working on the data quality issues in close cooperation with NCAs and trading venues to ensure that the August publication covers a significantly larger number of bonds. I want to reiterate my earlier call to those trading venues that have not yet submitted all necessary and correct data to step up the efforts. With broader coverage, I would expect that the August publication will result in a larger number of liquid bonds. However, I should manage expectations, as even when the data issues are addressed, the number of liquid bonds will be modest considering the clear political direction to have a cautious start of the bond transparency regime.

Market Data Issues

Another area we are focussing on and in which we are investing significant resources concerns the MiFID II requirements on the provision of market data. We currently have three open work streams in this area.

First of all, we recently published a Q&A providing further guidance on the concept of making data available free of charge 15 minutes after publication. The Q&A sets out ESMA's expectation on how this requirement should be applied and highlights practices that we consider to be in violation of the law. We will continue to monitor how trading venues and Approved Publication Arrangements (APAs) make data available free of charge and may update the Q&A should we observe further non-compliant practices.

Secondly, following the application of MiFID II, we were made aware of substantial increases in the costs of market data, reaching at times up to 400% compared to prices charged prior to 3 January 2018. In addition, we received complaints from stakeholders that not all trading venues and APAs publish the required information in accordance with the reasonable commercial basis principles in MiFID II. As many of you will be aware we are currently gathering further information on this issue. We will assess the feedback over the summer, and in particular test the level of compliance with the rules in place. Should it be necessary, we may provide later this year further guidance on how those rules should be applied.

The third issue concerns the lack of a consolidated tape. MiFID II introduced the concept of a consolidated tape operated by commercial entities to provide for consolidated information on post-trade data covering all transactions concluded on trading venues as well as OTC. We all know that to date no commercial tape has emerged. MiFID II provides for a dedicated review clause, including the possibility that a single consolidated tape may be appointed by ESMA. So you can expect to hear more from us on this issue in the not too distant future.

Tick Size Regime and Third Country Issues

On the first days of trading under MiFID II and the new mandatory tick size regime, it became evident that the tick size regime, based on liquidity in the EU, does not work properly when applied to shares that have their main pool of liquidity outside of the EU. Because the tick size is based on EU liquidity only, the methodology can result in EU trading venues having to implement larger price increments than non-EU venues trading the same instrument, and thereby face a drop in market share to the benefit of their non-EU counterparts.

Based on the evidence reported, and beyond the most urgent remedial actions taken by certain trading venues in coordination with their NCAs, ESMA is considering to propose an amendment to the tick size methodology with a twofold aim: addressing the level playing field issue when the most liquid market is outside the EU and ensuring that a harmonised tick size continues to apply across all EU trading venues for any given instrument. To that end, we intend to issue a consultation paper around mid-July. The consultation paper is likely to suggest different options for setting an appropriate tick size for instruments with their most liquid market outside the EU. I am counting on your participation in this consultation to help us finalise the amendment to the relevant RTS this autumn. This leads me to a broader issue that, in our view, would require further attention in particular in the context of Brexit: the need for a comprehensive regime for third country trading venues. This would certainly make sense where, for instance, based on our own rough estimates, about 40% of trading in shares issued in the EU 27 currently takes place on UK trading venues.

Third Countries and Trading Venues: the Need for a Comprehensive Regime

MiFID II creates specific equivalence regimes for third country venues only for the purposes of the trading obligations for shares and derivatives. It does address remote access to regulated markets situated within the EU by EU firms. However, the conditions under which third-country venues may access EU liquidity through the placing of trading screens in the EU are not harmonised. In other words they are left to national discretion. When preparing the ESMA Brexit Opinion on Secondary Markets, we did some research and noted how diverse and more or less detailed national rules in place are.

To ensure a consistent approach, and that risks for the EU related to third country venues are addressed, it is essential to introduce a harmonised EU regulatory and supervisory framework governing third-country venues. The Commission has been proposing to amend the MiFIR equivalence conditions for third country investment firms ahead of Brexit and we would welcome an initiative by the Commission with respect to third country trading venues.

A harmonised third country regime would have the benefit of ensuring a level playing field between EU and non-EU trading venues and mitigate potential risks related to orderly markets, investor protection and ultimately stability. Where a third country venue provides direct access to EU remote members, this facilitates access by EU investors to the instruments traded on that venue and there should be sufficient confidence that EU investors can safely do so. This approach would be similar to the one already in place in some third countries, including for example the US-CFTC regime in respect of third-country venues.

From my perspective, a third country regime for trading venues would cover both regulated markets and trading venues operated by investment firms or their equivalent, as there seems to be little justification to treat them differently. Any regime should ensure that a trading venue in the third country complies with requirements which are equivalent to those for EU trading venues, and that the EU has the supervisory tools to address risks relevant to the EU. There also needs to be adequate information exchange. Those are some preliminary thoughts and we would be ready to provide further technical advice to the EU institutions on this issue, if required.

Many thanks for your attention and I am looking forward to participating in a lively panel discussion.