

Keynote Speech

ICI Global Trading and Market Structure Conference – London

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Thank you

Will cover mainly MiFID issues, but also talk briefly about Trade Reporting. On MiFID ...

1. Introduction

- As you will be aware, ESMA has published two papers in May in respect of framing future ESMA technical advice and ESMA technical standards for MiFID II, exceeding 800 pages worth of material in total.
- The consultation period expired on August 1st and within that consultation period, ESMA hosted three public hearings in Paris, covering the whole MiFID II framework. ESMA received more than 700 responses from stakeholders, giving ESMA more than 18,000 pages worth of material to analyse.
- ESMA is on course to approve the final technical advice and a consultation paper covering draft technical standards in the meeting of the ESMA Board on 17 December. Therefore, you will understand that I will not be able to be too specific about the detailed policy proposals contained in those papers here today. However, I can already assure you that these papers will provide you with plenty of reading material over the festive season and beyond.
- I am aware of the challenges for the industry to take all this material in and organise responses but please also appreciate how challenging it is for ESMA to meet the deadlines imposed in Level 1. We are planning to put the consultation paper out for a period of round about two months which is the maximum we can afford if we want to be able to deliver all regulatory technical standards by July 2015.
- Today, I will focus on three key interlinked areas of the MiFID II/MiFIR work – transparency, market data and best execution. I could have chosen other topics out of the large range of areas where the new legislative framework and its implementation will have significant impact, but thought these three were of particular interest to ICI Global and this audience.
- Let me start on maybe one of the most complex areas ...

2. Transparency – Calibration of liquidity thresholds

- Strengthening transparency is one of the main policy objectives of MiFID II, establishing a “positive correlation” between transparency and well-functioning financial markets.
- In order to serve this objective, MiFID II imposes new pre- and post-trade transparency obligations for previously opaque parts of the financial markets and extends the scope of the transparency obligations dramatically – while MiFID applies to shares only, MiFID II takes in ETFs, depositary receipts, certificates, bonds, structured finance products, emission allowances and all classes of derivatives. For all market participants, including, of course, the buy-side, this will without doubt mean a massive change in how these markets work going forward.
- However, MiFID II also acknowledges that sufficient transparency does not necessarily mean full transparency. In this respect, MiFID II/MiFIR has provisions in place in order to calibrate the new transparency rules through appropriate thresholds. So far so good - the principle is ‘simple’ the implementation is more challenging.

It is the role of ESMA to implement the level 1 text and to adequately define the various liquidity parameters and thresholds. ESMA is well aware of the challenges that the extension of transparency requirements represent for market participants. ESMA policy decisions will be based on as much analysis of concrete data as possible and by holding extensive consultations with all stakeholders.

(1) Assessing liquidity and calibrating the thresholds:

- For instance, for bonds’ liquidity only, ESMA presented a preliminary analysis of the bond market based on a sample of more than 73,000 instruments. In light of the feedback received, ESMA has performed a second data exercise which will tackle both the analysis of market liquidity and the determination of LIS (large in scale) and SSTI (size specific to the instrument) thresholds – two acronyms you will get familiar with when dealing with the rather complex MiFIR text. Furthermore, this analysis will encompass this time most types of non-equity instruments.
- In this analysis ESMA has taken into consideration, in addition to the parameters provided by level 1 text, other intrinsic characteristics of the different asset classes and individual instruments. The liquidity of an instrument might indeed be driven by many other different factors, such as issuance size, currency, maturity, credit quality, seasonality, the presence of market makers etc which ESMA tried to take into account.
- The correct calibration of liquidity thresholds is critical in order to provide investors with the right balance between transparency and protection. Indeed, real time transparency obligations will apply for those instruments that are considered liquid, whereas illiquid ones – generally speaking – can be exempted from pre-trade transparency obligations and can benefit from post-trade deferred publication. The correct calibration of the thresholds is fundamental because these thresholds apply

to both liquid and illiquid instruments. In particular, they provide protection to investors from adverse market impact in the context of pre-trade transparency and encourage the provision of liquidity by allowing for deferred publication in the context of post-trade transparency.

- With respect to classes of derivatives, a valuable source of information for the analysis of the liquidity of OTC traded derivatives was Trade Repositories data. Let me have a small interlude here on a non-MiFID topic and give you an update on the implementation of the reporting regime for derivatives under EMIR.

3. The Trade Repositories Regime

- The reporting of derivatives started on 12 February 2014. This was an important milestone for the EU, since it was the date on which the EU rules implementing the G20 commitments for greater transparency of the derivatives markets went live.
- Although the start of the EMIR reporting was generally described as successful, the tight timelines between the registration of trade repositories and the actual reporting start date introduced certain difficulties for the on-boarding of participants.
- This on-boarding problem was particularly acute in the asset management industry. In some cases because of late enrolling with the TRs (few days prior to the reporting start date), but in many cases because of the peculiarities of the industry (reporting for different counterparties, issuance of LEIs for single funds/sub-funds, confidentiality issues, etc.). The on-boarding queues remained until May. As of today, however, ESMA is not aware of any particular issue in this respect.
- Now, several months after the reporting start date, we can say that the reporting regime in the EU is broadly functioning. After the start of the collateral and valuation reporting – which started in August - there are around 300 million trade reports which are submitted on a weekly basis by the counterparties subject to the reporting obligation. In total since February 2014, there are more than 8 billion reports that have been received and processed by the EU TRs. The number of entities which have direct reporting agreements with TRs is nearly 5,000.
- Although this is a good starting point and the data has already been used for important supervisory or regulatory decisions, ESMA's internal analysis and the feedback by National Competent Authorities shows that there is a need to improve the quality of TR data.
- It is important to emphasise that each of the parties in the reporting regime plays a specific role and there is a need for all parties to fully comply with EMIR. On the one hand, the reporting entities (counterparties and third parties) should report their transactions in accordance with the rules, and on the other hand, the TRs should ensure the accuracy of the submitted information and its timely availability to regulators.
- In order to improve the data quality from different perspectives, ESMA in cooperation with the NCAs has put in place a plan which includes 1) measures to be implemented by the reporting entities and 2) measures to be implemented by the TRs.

- It is worth reminding ourselves that, although under EMIR reporting can be delegated, the reporting obligation stays with the counterparty to the trade. This means that the counterparties, when reporting directly or when delegating, have to ensure that they fulfil certain obligations, such as:
 - (i) use systematically the LEI codes,
 - (ii) agree the trade ID, as clarified in ESMA's Q&A,
 - (iii) agree the details of the trade before submitting it to a TR and
 - (iv) strive at reducing the rates of rejected and unpaired trades.
- As part of the data quality action plan, the TRs have to put in place the following measures:
 - (i) implement harmonised data validations,
 - (ii) improve the functioning of the inter-TR reconciliation process and
 - (iii) implement harmonised publication of data.
- The data validation is a two-stage process comprising format and content validations. The first stage started on 1 December 2014 and from that date on the TRs have started to reject all the trades that are non-compliant. It is worth mentioning that the validations that have now been put in place have been perceived very positively by international OTC derivatives regulators and they will be used as a benchmark worldwide.
- Furthermore, in light of the low reconciliation rates, the TRs were requested by ESMA to streamline the inter-TR reconciliation process and to comply with the specifications agreed among them.
- In addition, by the end of this year the TRs are expected to present to the public data in a more harmonised and easily accessible format. We at ESMA are keen to ensure that the valuable data – while primarily aimed at public authorities – is also made available where possible to the wider public.
- Finally, taking into account experience since the reporting start date, ESMA, together with the NCAs, is currently proposing a slight amendment to the formats and data included in the current reporting framework. This proposal is out for public consultation until mid-February and will create some more clarity on and consistency in the information reported by counterparties.

4. Transparency - Double volume cap mechanism

- With that, back to the MiFID II dossier and a further aspect of the push for greater transparency: Another new obligation that will have an impact on how buy-side firms do business is the implementation of a double volume cap mechanism which limits the use of reference price waivers and negotiated price waivers to a 4% per venue cap and a 8% overall cap measured against all on-venue trading in the European

market on a per-stock basis. This was introduced by the legislators to ensure that waivers (that by their nature reduce transparency) are not too excessively used.

- When those thresholds are reached it triggers the suspension of trading under those waivers for 6 months either at the specific trading venue (if exceeding the 4% threshold) or across the EU (if exceeding the 8% threshold).
- As a result, it is hoped that there will be migration of trading activity to lit order books. But we are conscious there is also the potential risk of a reduction of trading activity, especially for less liquid shares where lit trading might not be feasible. Therefore getting these thresholds right and keeping the data up to date is essential.
- ESMA's role in this area is limited to the setting of technical details and the publication of EU wide data on its website. Providing an efficient, consistent and reliable system in this respect is of utmost importance to ESMA.

5. Market data

- Let me now move on from transparency and talk about another topic of great importance to the buy-side - the area of market data where MiFID II is trying to address some shortcomings. Financial market data plays an important role in the financial system by improving the flow of information for investment decisions and thereby contributing to the price discovery mechanism. Furthermore, market data, in particular post-trade data is important to meet regulatory requirements, in particular the best execution requirement.
- MiFID I revealed three key shortcomings in the area of market data:
 - The high level of prices for market data in the EU, in particular compared to the US;
 - the lack of a consolidated tape providing market participants with a consolidated view of post-trade data;
 - deficiencies in the quality of post-trade data, in particular for OTC-trading, contributing to the difficulty of creating a consolidated tape and reducing the value of the data when competent authorities need it for enforcement purposes.
- MiFID II aims at addressing these shortcomings via the following measures:
 - Requiring data venues to provide market data on a reasonable commercial basis and to offer pre- and post-trade data separately; and
 - establishing a regime for data reporting services providers, including a consolidated tape;
 - more specifically on the consolidated tape – addressing the shortcomings in data quality (e.g. double reporting of trades, lack of harmonisation) to prepare the ground for a commercial solution.
- One particularly sensitive topic in this area is, the provision of market data on a “reasonable commercial basis”.

- MiFID II empowers the Commission to adopt delegated acts clarifying what constitutes a reasonable commercial basis. The Commission has asked ESMA for technical advice and in particular requested to assess various options on how it can be ensured that trading venues provide market data to users on a reasonable commercial basis. ESMA consulted on this issue in early summer and I am sure you have seen the various options presented by ESMA.
- This is a very controversial if not even emotional topic. Data costs are higher in the EU compared to the US. For example, the costs for access per month to aggregated raw market data costs \$74 in the US (about €58) compared to €340-430 in the EU according to a study recently published.
- What is less clear is whether this difference is justified.
- Currently, there is only little transparency on the fees trading venues charge on data, on the content of the data provided as well as on costs of producing and distributing the data and on revenues from market data. More information on these elements clearly would help assessing whether the price level in the EU is justified or not. This is why ESMA expressed a preference in its consultation paper for increasing the amount and quality of information on market data products offered, and enabling users to compare the various products and terms of use available in the market. More transparency might also allow us to get a better grasp on the role of data vendors which are both buyers (data vendors buy raw data from trading venues) and sellers in the market (by distributing raw or processed data to end users).
- In its consultation paper, ESMA also looked at more intrusive measures to bring prices down (revenue cap, LRIC+). We aim to provide more information in our advice to the Commission on the respective pros and cons of these different options.

6. Best execution

- I would like now to address a different area of the MiFID II work. I want to move on to best execution, an area where elements of MiFID market supervision are transformed into issues which are directly relevant for the protection of investors.
- MiFID II has set ESMA two main tasks in respect of best execution and these involve the development of regulatory technical standards.
- Firstly, ESMA must develop standards that specify the content, format and frequency of data relating to the quality of execution that need to be published by execution venues.
- Secondly, ESMA must develop standards that specify the content and format of information to be published by investment firms relating to:
 - the routing of client orders to the top five venues where they executed client orders, and
 - the execution quality achieved for all executed orders.
- To firstly focus on the execution quality data to be published by venues.

- We have set out in the DP our views that this data should include information on price, costs, speed and likelihood of execution. We also proposed that all venues [including SI and market makers] should be included to allow comparison between them.
- To briefly move onto the information to be provided by investment firms. Here we have been tasked with requiring periodic information on the order flow to the top five venues in respect of each class of financial instrument. One of the important aspects here is the definition of a 'class of financial instrument' since it will be significant in determining how detailed the reporting will be for each investment firm. Let me say that we are working hard on this area to ensure that the information to be published is detailed enough to be useful without being too onerous.
- In addition to this, firms must also provide information on the quality of execution that they obtained when executing client orders. So this means that firms will also have to make public details of the execution quality in terms of price, costs, speed and likelihood of execution on an annual basis.
- So what is the objective of all this new information?
- Well, it must be said that until MiFID II comes into effect investment firms and execution venues are not required to publish any information to specifically measure execution quality or order flow. This needed addressing.
- ESMA considers that the data which is to be published by venues will now enable firms to carefully assess where they can get best execution for their clients.
- We also consider that the information to be published by investment firms will not only encourage competition between firms in terms of publishing user friendly data but will help clients to check whether their firm is using the correct venues to execute their orders.
- Before I conclude on best execution let me say that ESMA has, under our supervisory convergence objective, also conducted a peer review on the supervision of the best execution requirements.
- Our findings in this area have yet to be published but without going into any detail let me say that this peer review work has proven very useful in identifying approaches to supervision between different NCAs.
- The main conclusions of the report are that there is room to improve the level of convergence amongst CA's in their supervisory practices and oversight of best execution. A more active monitoring of compliance with best execution through desk-based or onsite inspections seems desirable. While best execution seems to be considered a topic posing less risk in the context of supervision on conduct of business requirements, a more pro-active approach aimed at verifying firms' compliance with best execution requirements on a regular basis and not limited to cases where there is suspicion of irregularities will probably be recommended to enhance the supervisory approach currently taken.

- While this is slightly off topic let me say that while progressing on supervisory convergence is not easy, we consider it to be just as important as our regulatory work and we intend over the next years to step up our activities in this area – and that is not just by conducting additional peer reviews but by using a whole range of convergence tools. We believe that such efforts will lead to more convergent approaches when it comes to implementation, supervision and enforcement by national competent authorities. Particularly looking ahead to the implementation of MiFID II/MiFIR, it will be essential that ESMA provides Guidelines and Q&As for example to help with the huge task of implementation that falls on regulators but also on the market participants.

7. Conclusions

- I hope I was able to give you a flavour of some of the key issues that are currently occupying ESMA in relation to its work on MiFID - on the interlinked issues of transparency, market data and best execution. Maybe I have even wetted your appetite to dip into the consultation paper (and the final advice document) that we will publish.
- Let me conclude by looking ahead beyond the current phase of rule-making. As in the case of EMIR, the work for ESMA related to MiFID II/ MiFIR does not end with the delivery of technical standards and advice for which it has received mandates in the Level 1 legislation.
- The implementation phase of the new regulatory framework will imply for ESMA, besides the issuing of Guidelines and Q&As, also for example the following tasks:
 - the issuance of opinions on pre-trade transparency waivers on a more frequent basis and for a multitude of financial instruments;
 - involvement in decisions around the compatibility of national competent authorities' proposed position limits for commodity derivatives;
 - publishing of up-to date information related to the transparency and micro-structural regimes provided for in Level 2, but also to monitoring their consistent implementation and assessing their effects on EU markets. This latter point will also require some significant IT development, as the information needs to be collected, monitored and published regularly.
- MiFID II/MiFIR technical standards and advice will contribute to the creation of a single rulebook. However, we cannot rest on our laurels after developing a single set of financial regulation across the EU or at international level.
- Regulation needs to be also be applied and supervised consistently within the Single Market. In addition, we will have to continue working with our international counterparts to achieve a consistent implementation of important G20/FSB relevant topics, such as the trading obligation for derivatives.