

Keynote Speech

4th Annual AFME European Compliance and Legal Virtual Conference
9 October 2020

Verena Ross
Executive Director
European Securities and Markets Authority

Good morning Ladies and Gentlemen,

It is a great pleasure for me to be here at the 4th Annual European Compliance and Legal Conference and I would like to thank AFME for inviting me to give this keynote address to such a distinguished group of legal and compliance professionals.

We are experiencing today a very different world than the one we were used to only a year ago. The COVID-19 pandemic has changed the way we work, interact and communicate as shown also in the successful organisation of this virtual conference by AFME.

In light of these circumstances, no speech can omit the pandemic, which has a significant impact on the economy and financial markets, as well as on the working culture of firms and on us, as supervisors. I would like to use this opportunity to briefly look back on what the European Securities and Markets Authority (ESMA) has done in this period, both from a policy and a supervisory perspective.

This conference is also very timely for me to raise two key topics you have discussed or will discuss in other sessions – the review of the MiFID/ MiFIR framework and of the Market Abuse Regulation (MAR).

Since the end of the last year, ESMA has been contributing to the MiFID review through a series of reports. In addition, the European Commission recently published its proposals for short term changes to the market legislation framework ('the quick fix') as well as the action plan on the development of the Capital Markets Union (CMU). All this work links together specific aspects of MiFID with the question of what should be our long-term vision for efficient



financial markets in Europe. Furthermore, having just published the final report on the review of MAR, I thought it to be the right time to walk you through ESMA's findings and recommendations.

Finally, ESMA has just published and submitted to the European institutions its annual work programme for the next year. I will therefore finish my remarks with a short outlook on the key priorities for ESMA in 2021.

Impact of COVID 19

The pandemic and related government measures severely impacted the economy and the financial markets. As the bulk of the work has been done remotely, the COVID-19 outbreak highlighted the role of proper business continuity planning and reliance on the use of digital technology that come with their own risks and challenges.

From the start ESMA took a number of regulatory and supervisory actions in its remit to address the issues arising from this extraordinary situation. ESMA actively coordinated national competent authorities (NCAs) in prioritising and deprioritising their supervisory activities and clarified the application of the regulatory framework in these specific conditions. In addition, we issued a number of statements that provided operational relief to firms. To mention a few examples: ESMA clarified the guidance on call taping and best execution reporting under MIFID II and postponed various reporting deadlines. At the same time, we considered it necessary to remind firms of the conduct obligations in these specific market circumstances. On short selling, ESMA decided to lower the reporting threshold for the net short positions in shares. We also coordinated the action of the NCAs related to the national short selling measures taken in some countries in the acute phase of the crisis. ESMA has also provided to the market more time to react to our regulatory products by prolonging consultations and re-prioritising our work.

Finally on this topic and looking forward, it would be amiss of me not to mention our concerns on the high degree of uncertainty about the medium- and long-term economic consequences of COVID-19. This will lead to a very fragile market environment going forward that could entail further possible market corrections and deterioration in financial market liquidity. In this regard, we underlined in our recent Trends Risks and Vulnerabilities report that financial markets need to prepare for a possible new round of stress and volatility - we continue to live in unpredictable times.

The Review of MiFID II and MiFIR

Turning to more ‘business as usual’ aspects of ESMA’s work, I want to start on the broad topic of MiFID II and MiFIR, which are the cornerstones of EU financial markets regulation. They are the key pieces of post-financial crisis legislative reform, which reinforced the rules applicable to securities markets to increase transparency, foster competition and strengthen the protection of investors. It is now over two and a half years since this legislation came into effect, and it makes sense to look back and analyse what has worked well, and what needs to be improved. While this framework brought about significant advancements to the functioning and transparency of EU financial markets, it is fair to say that, as always, there are areas where a further look is necessary at how the MiFID II framework works in practice and whether the objectives of the co-legislators have been achieved.

By preparing a range of reports on key provisions of MiFID and MiFIR and submitting them to the European Commission that considers our work when proposing legislative changes, ESMA plays a central role in this review. Of course, it should be noted that some more urgent legislative changes are already underway following the Commission’s proposals for a capital market recovery package. In parallel also the latest Action Plan will bring forward significant changes that will foster the building of the Capital Markets Union.

The ESMA reports contributing to the MIFID Review are wide ranging and have been and will continue to be delivered to the Commission throughout 2020 and 2021. Without getting too much into detail, I want to highlight four areas which ESMA considers important and I believe are of interest to you in the context of the overall review.

- 1) Improving the cost of market data

In our first report in December 2019, we assessed the development of prices for market data since the inception of MiFID II. Our conclusion was clear – MiFID II has not delivered on its objective to reduce the cost of market data charged by trading venues and Approved Publication Arrangements (APAs).

MiFID II requires venues and data providers to publish market data on a reasonable commercial basis, to provide market data in a disaggregated format, and to make market data available free of charge 15 minutes after publication - aiming at lowering the cost for market data. While many trading venues stressed that data prices have been overall stable, data users and vendors complained about complex market data policies and overall higher costs for

market data. For example, based on a model presenting the development in market data prices across the period 2016 to 2019 for a hypothetical firm, the yearly expenditure on market data rose by approximately 27% during that period, on the basis of aggregate costs. Due to the mixed achievements of the market data provisions, it appears premature to conclude that the current approach has failed and should be replaced by an alternative approach, such as price regulation. Consequently, we proposed a mix of legislative changes and supervisory guidance to improve transparency and to ensure that market data is provided on a reasonable commercial basis. In an environment driven by technological development, the demand for market data and its value is increasing, and it is vital that data users know what they are paying for.

In 2021, ESMA intends to deliver guidelines clarifying its supervisory expectations on how the obligation to provide market data on a reasonable commercial basis should be applied. In addition to working on this supervisory guidance, we proposed a number of targeted changes to either the Level 1 or Level 2 texts to strengthen the overall concept, that market data should be charged based on the costs of producing and disseminating the information.

- 2) Creating an EU consolidated tape

The fact that the cost of data has not improved was also compounded by the fact that no consolidated tape has emerged, which would provide live information on the price and size of equity trades. While MiFID II designed the requirements that would be applicable for consolidated tape providers, it did not mandate the establishment of an EU consolidated tape. Instead, it left the creation of one open to a voluntary market-led initiative – which ultimately did not materialise. For ESMA, the main reasons why this did not happen are the limited incentives and commercial rewards to potential providers within the current regulatory framework, as well as possible competition by non-regulated entities such as data vendors.

Nonetheless, we strongly believe that the creation of a real-time consolidated tape for equities would counter concerns about fragmented access to market data.

In recommending the creation of a consolidated tape, we consider a few key factors that would be indispensable to its successful establishment. These include the mandatory contribution of high-quality data by trading venues and APAs; the sharing of revenues with contributing entities; and a strong governance framework. Ultimately, this is a task which will require a substantial investment of both time and resources by all parties involved, but one which will

benefit both brokers and investors greatly by providing a single source for price comparison. We therefore welcome the intention of the Commission to propose the creation of a comprehensive post-trade consolidated tape for equity and equity like instruments as part of the CMU Action Plan.

- 3) Improving transparency while reducing complexity

Let me move on to another important part of MiFID and MiFIR, which is the transparency regime, ESMA has put forward several recommendations with the aim to simplify the current complex regime while trying to improve the overall transparency for both equities and non-equities.

For equity instruments, amongst our numerous recommendations, there is a focus on making targeted amendments regarding the transparency obligations for trading venues and specifically the double volume cap mechanism (DVC). The purpose of the DVC is to limit dark trading by ensuring that the use of certain waivers does not unduly harm price formation. In particular, it sets out threshold limits for trading under those waivers. However, the process is too complex. Therefore, we are proposing to simplify the regime and transform the mechanism into a single volume cap. Additionally, in relation to equities, we have recommended a clarification to the scope of the share trading obligation for third-country shares to address potential challenges linked to access to liquidity pools.

On the non-equity side, the percentage of bonds subject to real-time transparency is insignificant. This means that the introduction of transparency to EU bonds markets has not really worked in practice as hoped. To improve this, ESMA has put forward some options to address these shortcomings, in particular regarding the liquidity determination for bonds.

- 4) Enhancing investor protection

ESMA is committed to ensure that investors can make informed decisions in an environment where they know that they are adequately protected. The broad suite of provisions which aim to achieve this are assessed as part of the review. I want to briefly share ESMA's views on two key elements here.

As I mentioned earlier, some proposed changes to MiFID are being accelerated as part of the Commission's proposals for a capital market recovery package in response to the coronavirus pandemic. One of the proposals includes to roll back the "research unbundling" rules and

suggests that permitting the same provider to conduct brokerage and research will foster research coverage, especially for small and midcap companies (SMEs). While we share the concern regarding limited SME research coverage, I should be clear that we have not observed any evidence which indicates that there is a reduction in research coverage due to these rules, nor any sign that they have had any specific detrimental impact on coverage for SMEs. On the contrary, we deem these rules to have had a significant positive impact on the pricing of the execution services and to have addressed a fundamental problem of conflict of interest. So, while we agree that we should work on improving research coverage of SMEs, we do not believe this should be done by effectively making void this important requirement. Moreover, some of the thresholds being considered for when these services can be 'bundled' would basically not just target SMEs but the large majority of listed companies. We hope that these views will be taken into account during the legislative negotiations.

Finally, I want to briefly mention that, as part of our MiFID review report in the investor protection area in April, we recommended that the Commission conduct further analysis on the topic of inducements. We also proposed some changes to the regime, mainly aimed at improving clients' understanding of inducements. While we have not recommended to ban on inducements completely for all retail products, we believe this further analysis should focus on what impact a ban would have on the different distribution models throughout the EU. We stand ready to further work also on this important topic.

The review of the Market Abuse Regulation (MAR)

Let me now focus on the Market Abuse Regulation. I know you had already an in-depth discussion on the topic yesterday, but I thought this would be a good opportunity to highlight some of the aspects from our MAR review report that we have just published. Overall, we concluded that the Regulation works well and is fit for purpose. Consequently, the vast majority of the changes that we proposed to the European Commission represent an evolution, taking into account the experience in its application, rather than a revolution or radical overhaul of the framework. For example, we make proposals in relation to further guidance on inside information, clarifications to the market sounding regime, application of MAR by collective investment undertakings as well as simplification in the area of buybacks and their reporting.

We recommended no amendments to the general definition of inside information. We believe that the current broad definition is effective in preventing market abuse. Changes might lead

to legal uncertainty and thus outweigh the marginal benefits of any potential change. However, we will provide further guidance on the application of the definition as part of our level 3 work, in order to address some apparent difficulties in the practical application.

With regards to the delay of disclosure of inside information, again while we have not proposed any changes to Level 1, we will further clarify the interaction with the prudential requirements. This is the reason why we plan to review the existing Guidelines on delayed disclosure under MAR, to cover explicitly the information conveyed in the Supervisory Review and Evaluation Process (SREP) to issuers that are also credit institutions.

In addition, ESMA proposed changes to the legislation when the requirements of MAR were considered by market participants to be unclear – such as changes to the market soundings regime and application of MAR by investment funds. We have suggested to clarify that the market soundings regime is compulsory and thus if complied with, will protect disclosing market participant from the allegation of having unlawfully disclosed inside information. At the same time, we proposed simplifications to reduce the operational burden of the regime. With regards to the application of MAR by collective investment undertakings, we proposed to clarify the responsibility of management companies in relation to the disclosure of inside information.

Finally, we have decided to propose simplification of several aspects of the MAR regime, such as reporting mechanism of transaction on buyback plans. We propose that issuers report buyback plans only to the NCA of the most relevant market in terms of liquidity and recommended to reduce the amount of information that issuers report to NCAs.

Before passing on to another topic, I would like to highlight another important set of proposals we have made recently that are partially linked to the MAR review. ESMA finalised its inquiry into the Cum/Ex and multiple withholding tax reclaim schemes. Following revelations of alleged large-scale tax fraud schemes, ESMA was tasked to undertake an inquiry on this issue from the perspective of market integrity. While these schemes are primarily a tax related issue and thus regulatory or supervisory responses need to come from tax authorities, we cannot ignore the legitimate expectations of the public with regards to the integrity of financial markets and acknowledge the damage that the use of such abusive schemes can do.

As a result of the inquiry, as part of MAR review, we have suggested legislative changes that could facilitate the work of financial supervisors in helping to identify and pursue such schemes. We have therefore proposed to the European Commission to remove the legal limitations for

the national competent authorities to exchange with tax authorities the information obtained through cooperation and information exchange mechanisms from other NCAs. In my view, it is very important to develop a common approach and provide legal certainty for the NCAs to be able to share relevant information with tax authorities on a timely basis. Together with other recent measures in the area of money laundering, I believe our findings highlight again the need for firms to have efficient control systems in place, in order to prevent and report possible illegal behaviour.

Outlook for 2021

Before concluding, let me briefly look a bit further ahead and highlight some key ESMA priorities for next year, which we have just published our 2021 work programme. The current uncertainty about the development of the pandemic and its impact on the economy and financial markets, makes such planning inherently difficult, and the priorities might need to evolve. Our focus for 2021 will be on actions addressing the current situation and supporting recovery, as well as progressing on our regular regulatory and supervisory activities in order to contribution to the medium- and long-term objectives of the EU.

For 2021, we set out our planned activities to respond to the key challenges faced by the EU capital markets. This includes, besides helping to support the recovery, 1) support of the green transformation through promoting sustainable finance and long-term oriented financing, 2) contributing to the development of a large retail investor base to support an efficient Capital Markets Union and 3) addressing the risks and opportunities posed by digitalisation. The pandemic has increased significantly the focus on the use of technology in the financial markets and the security of the data.

In 2021, we will continue our focus on ensuring effective supervisory convergence and give high attention to investor protection issues. Furthermore, our focus will be on execution of the new powers and responsibilities that ESMA has recently been given, including direct supervision of certain systemically relevant third country CCPs. We will also need to prepare the new direct supervision mandates of certain benchmarks and Data Service Providers that will begin in 2022.

As already discussed, in the area of MIFID and MIFIR, we will continue working on supervisory guidance with regards to the cost of data. We will be also monitoring the implementation of the tick size regime and position limits set. Moreover, we will continue our preparatory work

towards the potential establishment of a consolidated tape, with a focus on improving the quality of OTC-data. We will also continue providing advice to the Commission covering key provisions of MiFID II/MiFIR, for example, in provisions relating to algorithmic trading or the functioning of organised trading facilities (OTFs), which we just published for consultation.

Finally, with so much happening regarding new or changing legislative frameworks, and with the EU still in crisis recovery mode, one would be forgiven for forgetting that the story of Brexit continues and will reach a critical point at the end of the year. While the outcome of the ongoing trade deal negotiation remains uncertain, either way, that will not change the fact that from 1 January 2021 UK firms will no longer have unfettered access to the single market. We have spent much time over recent years preparing for many different Brexit scenarios, but it remains important that all market participants finalise their preparations for this change and manage any possible disruptions effectively, in particular by keeping customers informed of any impact. We are confident that any potential financial stability risks have been mitigated, in particular through the recent equivalence decision which permits continued access for EU clearing members to UK CCPs. However, despite all these preparations, certain disruptions at the end of the year will be inevitable, but manageable, if market participants are comprehensively prepared. In 2021, we will continue to work with other EU bodies on the future relationship with the UK regarding financial services.

Conclusion

Ladies and Gentlemen let me conclude. Despite the large number of challenges stemming from the pandemic and Brexit, the financial system has recently shown a good level of robustness to withstand shocks. While in the short term we might need to prepare for possible further market volatility and disruptions, our focus in the longer term should be on the main objective of building an efficient CMU that works for the European economy, supports the recovery, green transition and digital transformation, supports competitiveness but at the same time provides adequate protection to investors. For me, effective regulation and supervision of the financial markets, amongst others through further development of MiFID and MAR frameworks and their efficient and consistent implementation, is one of the ingredients of making the CMU project a success.

Thank you very much for your attention!