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Taking stock of the MiFID and MiFIR review and what still needs to be done

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The European Commission's proposal for a consolidated tape of real time market prices for securities is taking up a lot of energy for data providers and the European Securities and Markets Authority (ESMA). Yet it may not be a game changer on the road towards Capital Markets Union (CMU). It is an ultimatum to trading platforms to cooperate by having a single data feed and, if not, ESMA will become the data host. This will bring more transparency in the pricing of market data, as revenues will need to be shared amongst the data providers. The proposal also addresses other securities trading rules, in the competition between exchanges and investment banks or brokers, to bring more on exchange.

Why MiFID and MiFIR must be amended

When MiFIR, as part of the Markets in Financial Instruments Directive (MiFID II), came into force in 2018 it considerably tightened the conduct of business rules for banks. However, it also saw a multiplication of trading venues including exchanges or regulated markets (RMs), multilateral trading facilities (MTFs), organised trading facilities (OTFs) and systemic internalisers (SIs) in the European Economic Area (EEA), above all in the latter segment.

According to ESMA's data, there were 127 regulated markets in 2020, alongside 142 MTFs, 27 OTFs and 172 SIs, and trading can still take place bilaterally, or over-the-counter (OTC). The enormous fragmentation of venues has led to calls from the regulated markets to bring more trades on exchange, and to have more transparency and better price formation – the context for the current MiFIR amendments.

The proposal for a consolidated tape of real time market prices, an issue that has been raised ever since MiFID I came into force in 2007, is central. Initially, MiFID I did not set rules for data providers, this came into force with MiFID II in the licensing of Approved Publication Arrangements (APAs) and Consolidated Tape Providers (CTPs).

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Since 2022, the largest data providers have been directly supervised by ESMA. However, the licensing did not bring about more integration. The competition between primary financial data providers and financial institutions was heightened with complaints by banks about the pricing of market data, an important source of revenue for exchanges. ESMA then waded into the debate with a call for cost-accounting methodologies of market data.

Different pre- and post-data requirements apply to trading venues. MiFIR requires primary market data providers, mostly exchanges and bond trading platforms, to have data pricing on a 'reasonable commercial' and 'non-discriminatory' basis for data, and to have them free of charge 15 minutes after publication. The question remains as to how to construct a consolidated tape (CT), and what form it will take. Will it be a European Best Bid and Offer (EBBO), and pre-trade single tape, or will it be post trade? If post trade, how rapidly will it be available?

A decision to be made between markets, data providers and users

The MiFIR draft made proposals, but it is now up to the European Parliament (EP) and Council of the EU to decide on this very polarised debate between markets, data providers and users. The French Presidency of the Council has proposed an EBBO, but only available post trade: hence no real-time CT, and only free of charge 15 minutes after publication.

The question remains as to how unique such a CT will be, and how geographical latency will be overcome, which is an issue in a fragmented market like the EU. The pricing and sharing of revenues is another issue. This is a particular concern for smaller markets – of which there are many in the EU – which fear losing out in the revenue-sharing arrangement.

Regulators hope markets will take on the challenge of creating the CT system, which is in their interest. This should contribute to reducing information costs, bringing more competition and transparency about execution quality, and allowing supervisors and users to check best execution. It should thus be an important building block for CMU, provided it is sufficiently unified.

The issue will be to get it right from the start, and not to start with all tasks at once. The market's intention is to start with bonds (where price transparency coverage is limited) in one year, followed by equity, derivatives and exchange-traded funds (ETFs). But there have been several failed attempts in the past, and the success of the project will depend on the scope, design and pricing, issues that can make or break it. And even if ESMA doesn't construct the CT, it will nonetheless have a big role in vetting the system and ensuring it works.

Swinging the pendulum in the right direction

As for the other elements of the review, the fear is that the pendulum is swinging again too much towards the exchanges, in reaction to the proliferation of venues seen over the past few years. Some comments on the draft see it as a renewed concentration rule, the wish to channel as much securities trading as possible to RMs at the expense of other execution venues such as SIs and MTFs. The review of the transparency waiver, the clarification of the share trading obligation (STO) or the limitations on the payments for order flow strengthen the position of the established markets.

The Commission should, however, be aware of the broader competitive landscape of markets, where a lot, or even too much, is legislated in the EU (as we call it in Level 1 and 2). The US empowers its supervisors to act on the interpretation of two basic pieces of existing legislation, which allows for much more flexibility. The UK is also going in the direction of a more flexible regulatory system in its Wholesale Markets Review.

MiFID II, while bringing more competition, also fragmented markets, which has led to more difficulties in the price formation. The MiFIR review is now trying to reverse this. Moving to a CT will be a complex and difficult-to-manage process, and the exact outcome is hard to predict. It should not distract the Commission from more important objectives that results in a more market-driven financial system.

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