Will the MiFIR review lead to more competitive EU capital markets?

Now that a political agreement has finally been reached on the MiFIR review (with further technical details to be worked out), it is important to look at the expected impact on European capital markets. A key question for us to evaluate the political agreement on the MiFIR review is whether it will benefit the competitiveness of EU capital markets. As Brexit has dealt a severe blow to the aspirations of the EU to become a leading capital market in the world (with London as a major financial center now operating outside the EU), it is even more important that major adjustments to the market structure in the EU are beneficial to the competitiveness of the EU markets. Our assessment is that the MiFIR review is a major step forward, probably even the best feasible advancement in terms of achieving transparent markets but there is some room for further improvement.

As my separate article on the bond CT in this Eurofi magazine argues, we consider the establishment of a CT for bonds an important success: there will be a CT that will add significantly to transparency and execution quality, reducing fragmentation in EU capital markets, increasing visibility, comparability, funding opportunities and improve market resilience. We believe the CT for bonds can play an important role in setting examples for other asset classes.

The CT for equity is next in line. There has been much opposition to the establishment of an equity CT, but the agreement on the MiFIR review endorses the importance of the consolidation of (near to) real-time post-trade transparency for equity. This is by itself already a major achievement and very good news for enhancing transparency in the EU. For the equity CT, we don’t believe it will compete with proprietary market data franchises: this business model for trading venues remains unaffected. In return, better visibility and revenue-sharing models could provide a tangible benefit for smaller and less interconnected venues.

Aside from the CT for bonds and shares, there are other encouraging results of the MiFIR review like the measures to enhance pre- and post-trade transparency (e.g., waiver and deferral requirements, rules on systematic internalizers and amendments to the share and derivative trading obligations). These measures on transparency and market structure are each of them strong contributors to meaningful transparency.

The most important additional result from our perspective is however the ban on Payment for Order Flow (PFOF), including only a very limited time for national discretion to opt out of this regime. The agreement should be seen as a ban to buy off competition in the liquidity provision. Retail orders should be able to flow freely to exchanges with full transparency of costs for investors. Retail orders are the “bread and butter” to the whole of the order and trading chain, and they form an essential basis for price formation in the market. It is encouraging that the EU, like other trading centers around the world, is taking the right turn in this.

Taken all together, the establishment of a CT for bonds and equity, the ban on PFOF and measures to enhance transparency are important steps forward for the MiFID II/MiFIR framework to operate successfully and to improve the competitiveness of EU capital markets.

Let us zoom in a bit more in detail. The establishment of the CT speaks for itself. In simple words its establishment will strongly improve transparency and non-discriminatory access to market information and will thereby contribute to the competitiveness of EU capital markets. We expect that the ban on PFOF and measures to increase transparency will also contribute significantly to the EU capital markets operating in a competitive way.

Does the principal agreement on the MiFIR review leave nothing to wish for? Although we are very positive on the outcome of the negotiations, we think there is still some room for further improvement. The most tangible example of that is the consolidation of pre-trade transparency information for equity. The political agreement allows for the inclusion of only very limited pre-trade information in the equity CT. In our view, investors would be better off with the inclusion of more extended pre-trade information. This would enhance the price formation process and in that way be beneficial to the competitiveness of EU capital markets. We recognize however that this was not feasible, and, in that sense, the current agreement can be considered the best result that could be achieved. The next step is to make it workable and in that respect there is a big role for ESMA in terms of drafting level 2 regulations and the selection and authorization of the CT's for bonds and equity.

Key phrase: *An enhanced operational MiFID/MiFIR framework is key to competitive EU capital markets*

Hanzo van Beusekom - Member of the Executive Board - Dutch Authority for the Financial Markets (AFM)