CONSOB

COMMISSIONE NAZIONALE PER LE SOCIETÀ E LA BORSA

Market Transparency: The MiFID II/MiFIR Regime

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Outline

1. Sketching out the new trading environment
2. Transparency in non-equity markets: too much of a good thing?
3. MiFIR remedies for non-equity markets
4. Conclusions (food for panelists)

1.

Sketching out the new trading environment

Seeking an integrated market

Competition among trading venues on trading services

- Higher quality of trading services
- Reduced costs

Consolidation of information

- More transparent trading and visible order book
- Broader investor choice

A EU «Transparent Market System»?

Does transparency enhance liquidity?

- In the rule-makers' intention:
  - The visibility of orders ("trading interests") distributed over different venues, and hence
  - The matching of orders
- Increased transparency facilitates the creation of a "virtual" integrated market
- … regardless of the trading platforms where orders are routed

Trading venues and beyond

Regulated market

- Only for market operators (specific authorization required)
- Non-discretionary multilateral matching

MTF

- For market operators and investment firms (qualifies as investment service)
- Non-discretionary multilateral matching

OTF

- For market operators and investment firms (qualifies as investment services)
- Discretional multilateral matching (non-equity and derivatives)
- Proprietary capital and matched principal trading

Systematic internaliser

- For investment firms only (qualifies as investment service)
- Dealing on own account on a frequent and systematic basis outside reg. markets, MTF, and OTF

What will the new markets look like?

MiFID II and MiFIR will intensify two opposite forces:

- **Concentration**: order flows converge; prices originate centrally
  - Obligations to route trading orders to trading venues or SI
  - Data reporting services providers
- **Fragmentation**: pushes order flows away from trading venues
  - Intensified pre-trade transparency for trading venues may incentivize the recourse to OTC

… but an asymmetric regime

- The two forces do not have equal intensity for equity and non-equity

1. Transparency obligations are largely similar for equity and non-equity
2. Trading obligations:
   - Apply to equity (23 MiFIR) and to some derivatives (28 MiFIR)
   - Do not apply to non-equity

- May transparency obligations without trading obligations exacerbate fragmentation of non-equity markets?

2.

Transparency in non-equity markets: too much of a good thing?

Transparency in non-equity markets

- All types of trading venues (and, partially, systematic internalizers): pre- and post-trade transparency
- OTC transactions by investment firms on financial instruments traded on trading venues: post-trade transparency

Twofold objective:

- Not impairing the price-discovery process in respect of particular financial instruments due to the fragmentation of liquidity
- Eliminating room for forum shopping (among trading venues) or reducing it (trading venues v. OTC)

Pre-trade transparency in non-equity markets (trading venues and SI)

Trading venues (RM, MTF, OTF)

- Bid/offer prices and depth of trading interests; includes actionable indications of interest
- Differentiated for: order-book; quote-driven; auction; voice; request for quote

Systematic internalisers (SIs)

- Publication of firm quotes for financial instruments traded on a trading venue for which they are internalisers and for which there is a liquid market, only when:
  - SIs are prompted by a client and
  - SIs agree to provide a quote

An equity-style transparency for non-equity (i)

Quote-driven markets, typical for non-equity, rely on dealers (including market makers)

- Pre-trade transparency creates more market-impact risk
  - As counterparties adjust their orders, marginal benefits for first-movers (already on the market) decrease
  - Hence, pre-trade transparency may dissuade from routing orders to trading venues, so as to keep trading strategies confidential
- OTFs are former OTC world. After MiFID2, OTC area reduced, thus leaving less room for escaping the regulatory burden. What’s next with MiFID3?

An equity-style transparency for non-equity (ii)

For non-equity markets

- Stricter regulation (than today): pre-trade transparency
- Lighter regulation (than equity): no trading obligation

- Is it better some shades of Grey?
- Or Black (no transparency and no trading obligation)?
- Or White (full transparency and trading obligation)?

Level 1 review (2020?) as a last resort opportunity if the overarching approach proves fatally flawed

Not one size but fit for all?

Not only a differentiation in MiFIR between equity and non-equity, but also

MiFIR remedies:

- Corporate v. sovereign bonds
- Class of bonds v. class of bonds
- Within the same class liquid vs non-liquid (e.g. at the issuance and at maturity)

3.

MiFIR remedies for non-equity markets

Key remedy: darkness

Safeguards

Full transparency suffers exceptions:

- **Waivers**: from pre-trade transparency for certain order types and for illiquid instruments
- **Deferrals**: for post-trade transparency for certain transactions and for illiquid instruments
- **Suspensions**: from pre- and post-trade for temporary lack of liquidity

- Other exceptions (e.g. for hedging/packages, collateral, …)

Safeguards at Level 1 (i)

Waivers from the **pre-trade** transparency may be granted:

- for orders that are **large in scale** compared with normal market size (as for equity)
- for actionable indications of interest in **request-for-quote** (**RFQ**) and voice trading systems that are **above a size** specific to the financial instrument, which would expose liquidity providers to undue risk
- for financial instruments for which there is not a **liquid market**

Safeguards at Level 1 (ii)

The disclosure of **post-trade** transparency information may be **deferred** for transactions which:

- are **large in scale** compared with the normal market size; or
- are related to financial instrument for which there is **not a liquid market** (for **non-equity** only); or
- are **above a size** specific to the **non-equity** financial instrument, which would **expose liquidity providers** to **undue risk**

Safeguards at Level 1 (iii)

Competent authorities may suspend **pre- and post-trade** transparency obligations for a class of **non-equity** financial instruments, where the **liquidity** falls below a specified threshold

- to be calculated according to a methodology specified by ESMA and on the basis of objective criteria specific to the market for the financial instrument concerned

Safeguards at Level 2 (i)

Flexible (non-static) **approach** to the determination of:

- non-equity financial instruments which do not have a liquid market (and are therefore exempted from transparency) and
- the various thresholds for the purpose of calibrating pre-trade and post-trade transparency obligations

→Possibility to adapt the liquidity status and the thresholds in light of changes in trading patterns on a periodic basis

Safeguards at Level 2 (ii)

Trading venues for **non-equity** financial instruments, operating a **RFQ** system, should make public all submitted quotes - in response to a request for quote - at the same time but not later than when they become executable (Reg. EU 2017/583, Annex 1)

→ This is to ensure that members or participants who are providing their quotes to the requester first (first movers) are not put at a disadvantage (being therefore incentivized to pull out)

4.

Conclusions (food for panelists)

The law of unintended consequences…

Reduced trading activity / larger spreads: Less liquidity?

Or just a matter of perspective?

- Zero option vs concentration of trading information vs concentration of trading?
- Reduced liquidity for single venues (e.g. regulated markets) or for trading venues in general, but increased liquidity on the market as a whole?

What lies ahead? (i)

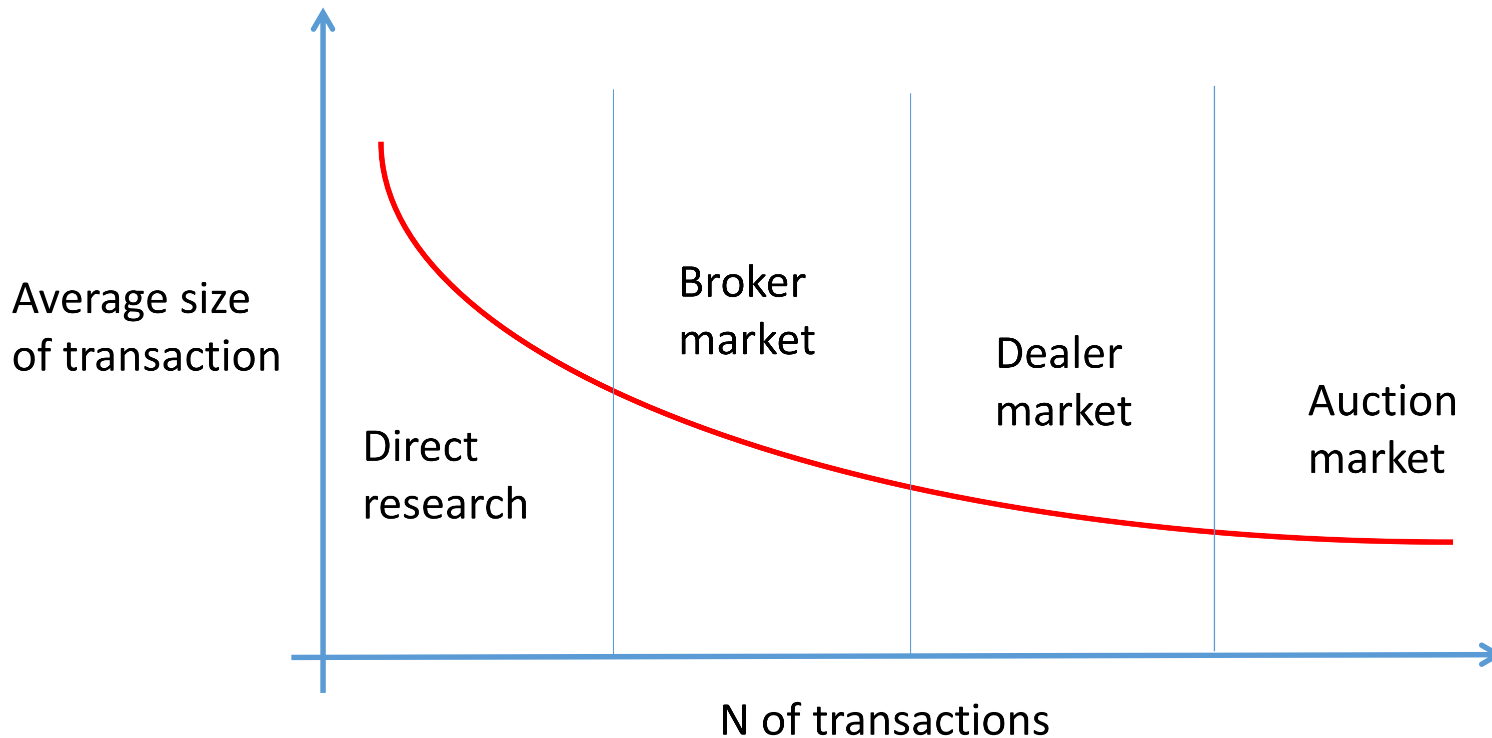
The new trading environment might lie somewhere between (and will most likely combine) two extreme scenarios:

1. Non-equity markets might become more similar to equity markets
   – Are non-equity markets like they are because of the (pre-MiFID II/MiFIR) applicable rules, or were those rules like they were because of inherent market features?

Chicken or Egg?

What lies ahead? (ii)

2. Part of the trading might be squeezed out of trading venues and move to the OTC world
   – Hence, how to identify interested counterparties?



Food for panelist

- MiFID2:
- ***M***ost ***I***ntermediaries ***F***ind ***I***t ***D***ifficult^2?

Or

- MiFIR:
- ***M***ost ***I***ntermediaries ***F***ind ***I***t ***R***easonable?