Minister Bruno Le Maire
President, Economic and Financial Affairs Council
Council of the European Union

Irene Tinagli
Chair of the Committee on Economic and Monetary Affairs
European Parliament

Ref: MiFIR Review Proposal

Dear Mr Le Maire, dear Ms Tinagli,

The European Commission adopted on 25 November 2021 its proposal for a review of MiFIR (Regulation (EU) No 600/2014) on enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.

ESMA is fully supportive of the Commission's efforts to deliver on the implementation of the Capital Markets Union (CMU), including through the MiFIR review proposals.

In light of ESMA's role in providing advice to the Commission and co-legislators and drawing on our extensive experience in implementing MiFID II/MiFIR requirements, I am writing to you today to share ESMA's technical comments on the proposal, notably on the consolidated tape provider (CTP), non-equity transparency, including the trading obligation for derivatives, data reporting and investor protection parts.

<u>Consolidated Tape Providers</u>

ESMA is strongly supportive of the main elements of the MiFIR review proposal on creating the conditions conducive to the emergence of consolidated tape providers (CTP). ESMA recommended in its 2019 review report on the consolidated tape (CT) for equity instruments[1] the establishment of a CTP and many recommendations made in this report are reflected in the Commission's proposal, such as a single real-time post-trade CT per asset class and the mandatory contribution of data by market data providers to the CT. ESMA also shares the objective of the Commission to keep the momentum going on establishing the CTPs by setting an ambitious timeline.

[1] ESMA70-156-1606 mifid_ii_mifir_review_report_no_1_on_prices_for_market_data_and_the_equity_ct.pdf (europa.eu)

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According to the proposal, ESMA will be entrusted with appointing the CTPs and may also be considered as a fall-back solution should no CTP emerge in any of the asset classes. Moreover, ESMA will also be in charge of supervising the CTPs. As this part of the proposal outlines a significant role for ESMA, I would like to highlight a number of challenges that we have identified.

The main challenge relates to the timelines currently envisaged for the selection process (three months after entry into force of the Regulation to organise the selection process and a further three months to decide which entity to select and authorise). The timeline appears unfeasible both for ESMA as well as potential CTP applicants, even more so when considering that four selection procedures, one per each asset class, would have to be run in parallel.

ESMA would hence recommend extending these timelines while maintaining the overall ambition of the proposal. While ESMA will aim at meeting the challenging timeline of launching the selection procedure three months after the entry into force of the legislative framework, more time than the currently proposed three months is needed for applicants to participate in the selection procedure and for ESMA to select the CTP. At a minimum, there should be six months for CTP applicants to participate in the selection procedure and ESMA to select the CTP, i.e. extending the whole timeline for the selection procedure from the current six to nine months. ESMA would like to highlight that in order to start organising the selection procedure, the Level 2 measures specifying the quality and substance of market data to be provided to, and published by, the CTP, have to be in force before the launch of the selection. This will be important since these specifications impact the criteria according to which the CTP should be selected. The timeframes should therefore be aligned to provide that the selection procedure should be launched 3 months after the entry into force of the Level 2 measures.

Moreover, ESMA supports considering a staggered approach for appointing the CTPs, for instance by running no more than two selection procedures in parallel before launching the selection procedure for the remaining two CTPs. This would help to manage the adjustment processes the relevant markets have to go through and to limit the impact on ESMA's resources in running four selection procedures in parallel while not undermining the overall ambitious plan to establish CTPs.

In addition, ESMA believes the proposal would benefit from being less ambiguous on the authorisation of the CTP. While the proposal states that ESMA should select and authorise the CTP, the provisions on the authorisation of CTPs under MiFIR have not been amended by the proposal. This creates legal uncertainty and should be clarified. The selection procedure aims at assessing which entity best meets the selection criteria whereas the authorisation process assesses the compliance of the selected applicant with the MiFIR requirements. Having the selection and authorisation in one step would force CTP applicants to either make investments that will be lost if not selected or might force ESMA to accept a low level of compliance at the start of the CTP operations. ESMA would recommend splitting the selection procedure and the authorisation process for the CTPs.

ESMA is supportive of the high-level criteria included in the proposal for ESMA to consider when selecting a CTP. ESMA intends to further operationalise those criteria for the selection

procedure, taking into account the particularities of the four different asset classes and also reflecting the Level 2 measures on the quality and substance of market data and the quality of the transmission protocol.

The proposal provides that such Level 2 measures should be further specified by the European Commission via a Delegated Act. ESMA considers that the core market data to be published by the CTP has to be aligned with the data to be published by trading venues and APAs in the context of their transparency obligations, which are set out in RTS 1 and RTS 2, and with the respective data elements, standards and formats defined in RTS 23 on instrument reference data, RTS 22 on transaction reporting and RTS 25 on clock synchronisation. This alignment is important to ensure consistency in the data published by trading venues, APAs and CTPs and to reduce compliance costs for these entities. To ensure such consistency, ESMA encourages co-legislators to consider entrusting ESMA with the mandate to specify the quality and substance of the market data and the quality of the transmission protocol, via an ESMA RTS. This approach would ensure consistency with data already reported/published and harmonisation across various reporting regimes, in line with ESMA's and the Commission's data strategies[2]. It would also ensure an efficient use of resources given the expertise within ESMA of establishing reporting data standards. Moreover, such an empowerment for RTS would allow all stakeholders to provide feedback due to ESMA's obligation to consult on RTS, while maintaining co-legislators' important scrutiny rights.

The Commission proposal includes a "fall-back clause" under which, if one year after entry into force of the Regulation no CT has emerged for any asset class, the Commission should review the framework and may set out whether ESMA should operate the CT. While ESMA shares the overall ambition of a rapid establishment of a CT, ESMA considers that reviewing the framework only one year after the entry into force of the amended Regulation would be premature given that by that time it is unlikely that the process for selecting and authorising all CTPs would be concluded. Moreover, the CTPs might not be fully operational right from the start. Hence, as a minimum, the timeline for triggering the fall-back clause should be extended to three years, starting from ESMA launching the selection procedure, to allow for a realistic chance for establishing the CTPs. Should co-legislators be supportive of the staggered appointment of the CTPs, this should also be reflected in the fall-back clause.

Moreover, ESMA encourages co-legislators to further reflect on the proposed "fall-back clause" and the practical challenges for ESMA operating a CT. For instance, due consideration should be given as to whether ESMA would in reality be better placed than a private entity for operating a CT in case there is no interest from the private sector. Certainly, should co-legislators consider that the "fall-back clause" should be maintained, it is important to ensure that ESMA is provided with the necessary resources and funding to establish a CTP as well as ensuring its ongoing operation.

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[2] Strategy on supervisory data in EU financial services, COM (2021) 798 final. In particular, section 4.1 of the EC communication outlines that "*the MiFIR review also advances the creation of a consolidated tape for equities and bonds. The aim is to ensure consistency with data already reported and to develop the transparency standards for the tape as a subset of the reporting requirements. This will improve data quality and avoid unnecessary additional costs for the industry*".

Lastly, ESMA would like to make co-legislators aware of an inconsistency in the Commission's proposal between the scope of the derivatives CTP and the scope of the transparency requirements, which is likely to raise significant practical implementation issues. The transparency requirements are based on the traded on a trading venue (ToTV) concept, which is an unclear concept for derivatives and which ESMA therefore recommended to remove in its MiFIR review report[3] (as highlighted in the reporting section of this letter). The Commission proposal maintains that the scope of the transparency requirements is based on the ToTV scope, whereas the CTP would need to consolidate and publish core market data on OTC derivatives subject to the EMIR clearing obligation, regardless of their ToTV status. This approach would make the consolidation of data by the CTP challenging and error prone since CTP contributors would have to make two separate and complex assessments on the scope of information subject to post-trade transparency and on the scope of information to be provided to the CTP. In line with the objectives outlined in the Commission's data strategy, the ToTV concept should be removed, and the scope of CTP publications should be consistent with the revised transparency scope. This will improve data quality, avoid unnecessary additional costs for the CTP and its contributors and will ultimately ensure the successful implementation of the CT for derivatives.

Equity and non-equity transparency

The Commission's proposal also includes changes to the equity and non-equity transparency regime. Overall, ESMA is supportive of the proposals on equity transparency and the general push to streamline the transparency regime for non-equity instruments. ESMA is supportive of the proposal to remove the size specific to the instrument (SSTI)-waiver and deferral to remove the competitive advantage currently granted to request for quote and voice trading systems compared to other trading systems. This is also in line with the overall objective to have a less complex transparency regime. ESMA understands that the removal of the SSTI should be counterbalanced by lower large in scale (LIS) thresholds to be specified in Level 2 to protect orders and transactions from negative market impact. ESMA stands ready to recalibrate the LIS thresholds in this respect once co-legislators finalise the negotiations on the file.

ESMA would like to raise some technical concerns on the proposal to amend the non-equity deferral regime. We understand that the proposal has been developed for bonds and not the remaining non-equity asset classes, in particular derivatives. Based on this we have concerns regarding whether the proposal might be appropriate for all non-equity instruments. We are also concerned that the proposal as it currently stands is overly complex and may result in inconsistent calibrations of the pre- and post-trade transparency requirements which would be unfortunate. Therefore, ESMA would recommend a simpler approach as suggested in the ESMA review report on non-equity transparency.[4]

[3] Final Report on MiFIR review report on the obligations to report transactions and reference data, ref. ESMA74-362-1013 (here).
[4] ESMA proposed to (i) require the publication of post-trade information for transactions above the LIS threshold and in illiquid instruments as close to real time as possible with the volume being masked and (ii) publish all the details of the transaction, including the volume, two weeks after the execution of the transaction.

As far as the derivatives trading obligation (DTO) is concerned, the proposal only includes an investment-firm specific suspension. In respect of this suspension, ESMA would recommend for co-legislators to consider in their deliberation the importance of maintaining a level-playing field across the Union, e.g. by clarifying that any suspension of the DTO should not be limited to investment firms from the Member State requesting the suspension but should cover all investment firms in the Union being in the same situation. Furthermore, we recommend that co-legislators reflect on adding a stand-alone suspension option for the DTO, i.e. independent of a suspension of the clearing obligation, in order to have the necessary tool at hand in scenarios where it may be necessary to suspend the DTO but not the clearing obligation.

Reporting

ESMA would like to emphasise the benefits that a broader revision of MiFIR in relation to reporting requirements could bring. Reducing the complexity and scale of reporting while improving data quality can contribute positively to the CMU objectives. In line with the principles outlined in the Commission data strategy[5], ESMA's Final Report on the MiFIR review of the obligations to report transactions and reference data[6] aimed at simplifying and streamlining the current reporting regimes whilst ensuring quality and usability of the reported data, thus reducing compliance costs for reporting entities.

ESMA suggests that co-legislators consider replacing the ToTV concept to avoid gaps in reporting and transparency publications under MiFIR. This concept should be replaced with the Systematic Internaliser (SI) approach as advised in the Final Report, whereby the respective MiFIR obligations would apply to derivatives belonging to the same sub asset class of derivatives for which the investment firms is an SI. Such approach would also facilitate the creation of the derivatives CTP, as described above.

In addition, ESMA would like to highlight that the current MiFIR provisions do not allow for a broad exchange of MiFIR transaction data among NCAs because data can only be exchanged with the competent authority "*of the most relevant market in terms of liquidity*". Such narrow reference does not allow for an exchange that adequately reflect NCAs' evolving supervisory needs to monitor the most recent market developments. In line with the principles outlined in the Commission data strategy to maximise the potential usage of transaction reporting for all suitable purposes and avoid duplication of reporting flows[7]. We would invite the co-legislators to consider permitting NCAs to share transaction reports for wider purposes.

Lastly, ESMA stands ready to contribute to the objectives of the Commission data strategy by regularly reviewing its technical standards to ensure alignment across reporting regimes, provide for reusability of data and thus reduce compliance costs as well as achieving better data quality. For this purpose, it would also be helpful if co-legislators were able to broaden

[5] https://ec.europa.eu/info/publications/191107-fitness-check-supervisory-reporting_en and Strategy on supervisory data in EU financial services, COM(2021) 798 final.

[7] Section 3, point (2) of the European Commission Strategy on supervisory data in EU financial services, COM(2021) 798 final.

the mandates for ESMA to develop technical standards under Articles 26 on transactions reporting and 27 on reference data.

Payment for order flow (PFOF)

ESMA shares the Commission's analysis regarding PFOF and is aware that further studies by NCAs have been published and/or are ongoing. In fact, ESMA's own analysis of earlier last year, as expressed in its public statement of 13 July 2021, provided a warning to firms and investors about the risks arising from PFOF. In this statement, ESMA stressed that the receipt of PFOF by firms from third parties raises significant investor protection concerns. A particular concern is the conflict of interest between the firm and its clients due to the receipt of PFOF, as the firm will be incentivised to choose the execution venue offering the highest payment rather than the venue offering the best possible result for its clients when executing client orders. Indeed, ESMA concluded in its statement, based on the current MiFID II requirements on investor protection, that due to the significant investor protection concerns raised by PFOF, it would in most cases be unlikely that receiving PFOF would be compliant with MiFID II.

Should you or your staff require any further information please do not hesitate to contact me or Fabrizio Planta, Head of the Markets and Data Reporting Department (fabrizio.planta@esma.europa.eu).

Yours sincerely,

Verena Ross

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