

MiFID 2 review: AMF's proposals for more efficient and competitive European markets

While MiFID 2 has contributed to the reinforcement of the EU single market by strengthening investor protection, enhancing business conduct requirements for investment firms and establishing a comprehensive reporting architecture, it displays a mixed record in terms of transparency of securities markets and channelling of OTC transactions onto trading venues.

In light of its supervisory experience since the implementation of this new legislation in January 2018, the AMF believes that targeted changes to MiFID 2 are needed to fully achieve its original objectives and to contribute to deepening the EU Capital Markets Union.

The AMF proposals are based on five pillars:

(i) provide market participants with a more comprehensive view of financial markets transactions by enhancing transparency requirements on equities, better calibrating and harmonising post-trade transparency requirements for bonds and create a Consolidated Tape to enhance access to post-trade data;

(ii) adjust the scope of the share and derivative trading obligations and adopt a territorial approach in order to ensure competitiveness of European firms;

(iii) promote the development of the commodities derivatives markets in the EU;

(iv) tackle the challenge of supporting financial research by introducing a degree of proportionality to the applicable legal framework clarifying rules relating to issuer-sponsored research, and ensuring a fair pricing of research;

(v) make investor protection rules more relevant and proportionate.

- **Improve the transparency regime by limiting the number of waivers to pre-trade equity transparency and by enhancing pre-trade transparency requirements applying to Systematic Internalisers (SIs)**

The ESMA consultation paper on equity transparency published in February 2020 shows that the percentage of turnover of shares not subject to pre-trade transparency has been around 60% since the entry into application of MiFID 2. This questions the efficiency of the existing pre-trade transparency regime for equities. Indeed, MiFIR allows to waive pre-trade transparency obligations for equity instruments in certain circumstances. Such waivers have been abundantly used by market participants so far, raising concerns on the effectiveness and convergent application of the rules. The need for a waiver such as the large-in-scale waiver is undisputed: it avoids the execution of large trades negatively impacting the market. Yet the case for maintaining other types of waivers is worth revisiting. The AMF is in favour of limiting the types of waivers allowed in MiFIR in order to improve transparency for all market participants. The AMF would also be in favour of enhancing pre-trade transparency requirements applying to SIs by increasing the Standard Market Size (SMS).

- **Streamline the deferral regime for bond post-trade transparency**

The AMF believes that for bonds the focus in MiFIR should be on better calibrating and harmonising post-trade transparency requirements. Hence the deferral regime that allows NCAs a wide range of delays and significant discretion when granting such delays should be subject to a review. The pre-trade transparency requirements should also be analysed carefully taking requirements applicable to third-country venues into consideration.

- **Create of a Consolidated Tape (CT) for post-trade data for EU financial instruments, to enhance access to best execution data and reduce market data fragmentation**

The AMF believes a CT should be a priority for the EU. It should initially cover post-trade information and consolidate data from trading venues and approved publication arrangements (APAs) in order to reach a significant market share in the relevant asset classes. As a first step a CT should cover equity instruments, with a possible extension to bonds at a later stage. Data reported through the CT may be used to adequately document firms' best execution policy but, due to geographical spread and latency considerations, the AMF does not recommend its use as a way to enforce firms' best execution obligations. Similarly, if the CT's scope covers post-trade data it could usefully serve as a source of information for different analyses such as transaction cost analysis, to feed the reporting obligation. The governance framework of the CT should bring together all providers and users of the CT data in order to ensure maximum adherence to the project. It should be sufficiently flexible to allow third-country entities to join the CT should the CT consolidate data on third-country instruments as well. The governance and financing structure of the CT should also take the issue of data quality into account. Any entity reporting poor quality data should be penalised. Accordingly, transactions which do not contribute to price formation, such as transactions benefiting from a pre-trade transparency waiver (e.g. technical trades), should not give right to any remuneration.

- **Limit the scope of the trading obligations, using EU27 currencies as criteria, and solve the existing regulatory unlevel playing field for branches**

The current rules governing the Share Trading Obligation ("STO") and Derivatives Trading Obligation ("DTO") are too complex and need to be clarified and simplified. In addition, conflicting STO and DTO rules between the EU and relevant third countries can create significant challenges for EU firms. These provisions remain a cornerstone of MiFIR and must be preserved. The AMF recommends limiting the scope of the STO to those shares having a European ISIN and denominated in a European currency. Systematic internalisers should continue to be deemed as eligible execution venues for shares subject to the STO, but only for transactions above the LIS threshold.

The AMF also suggests limiting the DTO to derivatives denominated in a EU27 currency. Additionally MiFIR should endorse a territorial approach for the DTO, ending the existing bias which treats EU branches of third country firms more favourably than EU firms by exempting them from the EU DTO.

- **Adapt the regulatory framework of the European commodity derivatives market**

Shifting commodity derivative contracts into the scope of MiFID 2 position limit and reporting regimes has proved to have a positive impact, as it brings useful transparency to existing contracts. It may however constitute a hurdle for 'nascent' products (new and illiquid) to enter the market. In order to facilitate the creation of innovative products, the AMF is of the view that position limits could be set only for the most significant commodity derivative contracts, based on their liquidity, the number of market participants and the nature of the underlying asset, while other contracts would remain subject to the trading venue's position limits. A limited list could be established by ESMA, in cooperation with NCAs, and reviewed periodically. In any case, all contracts whose underlying can be qualified as "food for human consumption" should remain under the scope of position limits set up by NCAs.

Additionally, the scope of the position limit should be limited to "actual" financial counterparties. Entities from commercial groups, which participate in financial markets to cover hedging needs of other affiliates of the same group should become eligible to the hedging exemption for position limits.

- **Promote investment research by ensuring fair pricing of research, clarifying rules on issuer-sponsored research and introducing proportionality to the inducement rules**

Financial research is one of the pillars on which price formation rests. It plays a significant role in market liquidity, especially in the case of small and mid-capitalisations. In January 2020, the AMF published an action plan in order to promote investment research¹, in which it brings forward a range of measures including:

- (i) clarifying that the price of research should reflect its cost of production, through the application of a '*reasonable commercial basis*' principle or by requiring competition authorities to report alleged cases of dumping practices;
- (ii) ensuring a sound regulatory environment for issuer-sponsored research, establishing the conditions whereby an issuer may pay for financial research directly without such research being deemed a commercial document pursuant to MiFID Delegated Regulation;
- (iii) introducing proportionality by lifting the unbundling rule for research provided in relation to companies with a market capitalisation below €1bn.

- **Make investor protection rules more relevant for investment firms and more protective for investors**

While acknowledging the very positive contribution of MiFID 2 to the objective of investor protection, the AMF supports a number of changes aimed at improving the framework further by making investor protection rules more relevant for investment firms and more protective for investors.

The AMF proposes a number of changes in cases where the/an investment service is provided cross border to enhance the protection of European investors. More specifically, where a firm provides services through a branch to retail customers in a Member State, where it is also authorised to provide the same service under the freedom to provide services, such services to retail customers should be presumed to be provided by the branch. Further, while the AMF welcomes the extension of ESMA's product intervention powers granted by the recently adopted texts in the ESA review, the AMF supports enabling ESMA to adopt product intervention decisions that would be permanent and not time-limited. Lastly, the AMF would not consider it appropriate to implement a general ban on inducements as it could have a detrimental effect on retail investors by depriving them of access to sufficient advice.

On costs and charges disclosure obligations, the AMF supports the possibility for eligible counterparties and professional clients to opt out from receiving *ex ante* and *ex post* information from investment firms provided that the latter previously agrees the format and content of alternative costs disclosures with them.

With regard to product governance requirements, investment firms providing the services of reception/transmission of orders and/or execution of orders on behalf of clients, without active solicitation of potential clients, could only be required to define a distribution strategy rather than defining a full target client base.

The AMF also proposes to adjust the criteria for allowing retail clients to be treated as professional clients on request, in order to improve access to certain financial products, but is not in favour of creating a new category of "sophisticated clients" as it would entail prohibitive compliance costs for firms while necessitating amendments to numerous pieces of EU financial services regulations.

¹ <https://www.amf-france.org/en/news-publications/news-releases/amf-news-releases/amf-adopts-its-action-plan-promote-investment-research>