AUTORITÉ DES MARCHÉS FINANCIERS

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Speech by Robert Ophèle, AMF Chairman - Rosenblatt Securities - 11th Annual European Market Structure Conference - 25 March 2021

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Let me first thank Rosenblatt Securities for giving me the opportunity to discuss some key issues for the European Market Structure.

Today I will mainly focus on two of them: payment for order flow and what I believe is THE missing component for an effective European market structure, namely a Consolidated Tape.

To start, allow me to share some reflections on one of the new and interesting types of phenomena that we have been observing since the pandemic's outbreak: despite (or maybe because) financial markets' stressed conditions, retail investors increased significantly their participation in the financial markets.

Indeed, the pandemic crisis that started over a year ago triggered an uncertainty period that sent the markets down. This has been seen by many individual investors as a unique opportunity to seize. In a very condensed sense, the pandemic increased the attractiveness of financial markets for individual investors.

In France, we observed that during these exceptional circumstances triggering high volatility in equity markets, over 150,000 new investors, 10 to 15 year younger than the average precrisis investor, entered the market within around six weeks from February to March, and started to trade securities from the SBF120 index for the very first time. The AMF recorded around 60 million retail transactions on the stock exchange in 2020, more than twice the turnover seen in previous years (around 25 million transactions). To follow this trend, from now on, the AMF publishes quarterly updates on retail investor activity.

This new appetite of retail investors for stock market investing should be seen as an important and positive trend that has to be strongly supported since they thereby participate, alongside professional investors, in financing the economy and the necessary recovery after the pandemic.

Nonetheless, this trend has to be consolidated. Hence we should do more than encourage and accompany these investors, and especially those who are new to the investment world, as we wish to have them on board for the long term.

For this to happen, and for investors to have a high degree of confidence in financial markets, we must ensure we offer them the proper trading environment.

The development of new offers such as commission-free or zero-fee trading has to be carefully analysed. While there can be no doubt that investors can benefit from lower trading costs, no one should be left believing that access to stock markets is entirely free and that one can get away without incurring any cost whatsoever.

As has been said in many occasions, “if the service comes for free, then YOU are the product”. The absence of an explicit trading fee might mean:

- either that there is a loss leader discount strategy on stock investing just to attract customers into their platform and sell them leveraged products with high markup;
- or that there is an implicit price under the form of a payment for order flow. This, in turn, raises questions on how firms deal with conflict of interests and best execution policies;
- or both.

In terms of conflict of interest, one obvious example could come from the correlation between the risks taken by the investor and the profitability of his or her order flow. The offer of products to investors should be driven by the investor’ interest rather than the hidden margin.

With explicit fees, the investor has all the information he needs to decide if he wants to pay a 10€ commission for a 10.000€ cash trade or for a 1.000€ derivatives trade. With implicit fees as in payment for order flow, that decision is blurred.

In terms of best execution, firms must have robust policies based on transaction cost analysis to ensure they fulfil their obligations.

In Europe, until now, the approach has always been to consider payment for order flow as an inducement. As such, under MiFID2, payment for order flow can only be allowed under three cumulative conditions:

- **First condition:** The investment firm must provide an additional or higher level of service to the relevant client, which must be proportional to the level of the payment for order flow received;
- **Second condition:** This payment should not directly benefit the investment firms without providing tangible benefit to the client as well;
- **Third condition:** As long as payment for order flow is received the client must obtain continuous tangible benefits.

Do we want to leave these three cumulative conditions as the only safeguard against conflicts of interests or poor execution practices?

Actually, enlighten by the experience in the US and in the UK, who are to some extent on both ends of the spectrum, we need to have a closer look to the European practice of payment for order flow and decide if it needs to be reconsidered or even banned outright.

In any case, best execution policies are conditional upon easily accessible and good quality data. It turns out that the consolidated tape is the right answer to deliver both accessibility and data quality.

Since Brexit became effective on 1st January, opening a new chapter for the 27 financial markets of the European Union, we have seen a shift of equity trading towards continental Europe, largely as a result of the clarifications brought about by ESMA regarding the STO, based on the criteria of ISIN and currency. However, I think this is not enough for building up robust financial markets in Europe.

As summarised by the European Commission in its February 2020 consultation on the MiFID II review, *“The EU has a competitive trading environment but investors and their* *intermediaries often lack a consolidated view of where financial instruments are traded, how much is traded and at what price"*.

Currently, existing sources of consolidated market data are only affordable to a limited number of sophisticated market participants. I believe that the creation of a comprehensive data tape would help democratise access to market data by all types of participants, be they asset managers, academics or investment firms.

It could in some way contribute to the current debate on the price of market data, by allowing all types of market participants to access a consolidated source of reliable trade information at a reasonable cost.

Therefore, no surprise that the creation of a consolidated tape has become one of the flagship actions of the Commission's new CMU Action Plan. We are particularly pleased to see that the Commission has put this right at the top of its list of priorities.

The ongoing review of the MiFID II framework is expected to provide the necessary impetus to make the consolidated tape become a reality.

In terms of benefits, due to the breadth of geographical locations and latency considerations, we do not recommend the use of the consolidate tape as a way for firms to prove that they have effectively complied with their best execution obligations. However, the overall transparency of where and how trades take place will help market players to determine where liquidity lies. It will provide a useful tool of information for more accurate valuation of certain products and to appropriately monitor trade execution as well as to perform transaction cost analysis.

The consolidated tape will also be instrumental for market participants defining and applying their best execution policy, in particular for those financial instruments that are dealt on multiple execution venues. It will make it possible for firms to determine the execution venue towards which a specific flow should be directed (based on the price and volumes executed).

A real-time post trade tape could be more appropriate to meet these expectations.

One often hears the view that a pre-trade consolidated tape would provide meaningful information on where to route an order in real time and would offer a live European Best Bid and Offer. However, the setting up of a pre-trade consolidated tape would seem to entail several complex technical issues. Its complexity and costs would probably outweigh its benefits. Without denying its advantages, I think such a pre-trade tape is best kept in store for a future stage.

To ensure the creation of an up-and-running consolidated tape from its inception, it could first cover equity instruments, which represent a narrower scope of instruments. Once operational, its scope would be broadened to cover bonds.

A consolidate tape provider can only be successful by setting up an appropriate business model and an appropriate governance model that brings together all providers and users of data and could help ensure market participants' support for the project.

In any case, the tape should operate on the basis of mandatory contributions of data from every venue, above a certain threshold of market share in order to avoid any barrier for new entrants or to increase the marginal cost of data. For venues under that threshold, contribution could still be made on a voluntary basis, as you would expect those venues would wish to participate to the profits redistribution scheme of the consolidated tape.

In such a framework, contributing players could be entitled to a share of the consolidated tape revenue depending on their contribution in terms of data (a kind of redistribution fee). Not only would this help to overcome the issue of operating costs but it would also provide for the necessary skin in the game to make the system viable.

The burden of providing data of sufficient quality is also pointed to as being a deterrent to the CT's emergence. In fact, I believe that setting up a consolidated tape that takes data quality into account from the outset in its fee redistribution scheme will probably lead to data quality improvement. Thus, a reduced redistribution fee for entities reporting poor quality data would provide a useful incentive to improve the quality of reporting. Accordingly, to ensure the consolidated tape provides meaningful information in terms of transparency, it should not be overloaded by data that does not serve market participants. Indeed, transactions that do not contribute to price formation, such as transactions benefiting from a pre-trade transparency waiver (e.g. technical trades), could be exempted.

As you can see, there is quite a lot of work to be done and we are just at the start of the journey. Nevertheless, we need to be ambitious as the tape is key to establish a strong, competitive and robust European single market.

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