MiFID Refit – Euronext Positions on Equities Market Structure

June 2020

MiFID II Objectives

MiFID II's primary objective, in terms of equities market structure, was to shift dark trading to transparent multilateral trading venues in order to **increase transparency, improve price formation** and **strengthen investor protection**. The legislation set out to achieve this by banning Broker Crossing Networks (via the share trading obligation or **STO**) and restricting activity on dark pools (via the double volume cap or **DVC**).

Market Practice Post-Implementation

It is important not to frame this debate as 'exchanges' versus 'investment firms': this debate is about:

(I) **Delivering on end investor needs** – **markets are becoming very complex** for them to navigate – it is time to go back to a simpler vision of market structure; and,

(II) The overall public interest of **ensuring effective price discovery in Europe**.

Large investment firms play a central and unique role: the large sell side firms provide **economies of scale** and **expertise** to their smaller counterparts and to the buy side in **navigating ever more complex and automated markets.** This has naturally created a degree of **concentration of flows** as they intermediate the majority of flows on European blue chips.

However, instead of shifting trading to transparent multilateral trading venues, MiFID II has actually led to a significant **increase in Systematic Internaliser (SI) activity**. The aggregated levels of OTC and SI trading in terms of turnover represented 22% and 18% respectively for 2019 based on STOXX 600 data from Big xyt.

A study published by the AMF in May 2020 revealed that[1]:

- SI volumes represented 15% to 20% of total value traded in French equities in Q1-2020 of which 8%-10% of transactions were considered price-forming.

- Only 22% of value traded on SI were subject to pre-trade transparency, thus, representing only 1.4% of total value traded in French equities in Q1-2020.

- 40% of volumes currently on SIs are traded at a price that will not be possible under the revised tick size regime coming into force shortly, reflecting the fact that this price improvement has not been significant.

In assessing these trends, it is important to distinguish between the two types of Systematic Internaliser that have emerged:

- **Bank-run Systematic Internalisers** account for the significant increase in SI volumes. The wholesale adoption by the large investment banks and transfer of OTC activity to SIs was not anticipated in the drafting process of MiFID II. At the same time, it is unclear to what extent volumes are categorized

[1] May 2020 - https://www.amf-france.org/en/news-publications/news-releases/amf-news-releases/market-share-and-contribution-price-forming-amf-assesses-role-systematic-internalisers-french-market

as price forming and non-price forming, nor the extent to which swap constructions are used to functionally facilitate multilateral trading.

- **Liquidity provider-run Systematic Internalisers** account for around 2-3% of overall equities volumes. They provide semi-lit liquidity (non-binding quotes which are not visible by all market participants) on a bilateral basis alongside MTFs and Regulated Markets.

- OTC volumes have halved as the business has been reflagged by banks as SI.

Dark **MTF trading has continued under the reference price waiver system**, albeit under a system of arbitrary volume caps. However, capped volumes have not transferred to lit venues but rather to 'grey' markets such as periodic auctions. The overall impact is that trading venues and execution mechanisms that *consume* reference prices **account for over half of overall European volumes**[2].

A Vision for European Market Structure - Amendment Recommendations

In our view, EU policymakers and regulators should enable a European equity trading market structure that delivers financing of the real economy through:

(I) A **simplification of market models** that support price formation and the generation of reference prices.

(II) **More inclusive markets**, facilitating and encouraging direct access for pan-European, national and local banks.

(III) **An enhanced offer to investors** (big or small, retail or institutional) of better ways of interacting with transparent markets.

From our perspective, there are **two main strands** to this.

On the one hand, simplification of market models can be achieved by **limiting SI trading in equities to above LIS only** and **removing the Reference Price and Negotiated Trade Waivers.** Price forming, below LIS trading would be confined to Regulated Markets and MTFs exclusively, while the practice of allowing venues to piggyback on price formation enabled by transparent venues would be curtailed. It would also mean that the DVC would no longer be required.

At the same time, we fully recognise that there is a need to address the concerns of **institutional investors in the middle ground** between retail size orders and the large-in-scale market. Alongside ensuring price discovery, the interests of these stakeholders could be served by:

- Consideration of a broader range of market models in this space.
- A lowering of the relevant threshold above which transparency is waived for large transactions.

At Euronext, we are developing a range of commercial initiatives to accompany such a change, facilitating the direct access of both trading members and investors to our markets and we look forward to making a contribution to the ongoing regulatory and policymaking discussion on market structure issues in parallel.

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[2] Data points and references included in our response to the Commission's consultation on the MiFID Refit