

INCEPTION IMPACT ASSESSMENT

This Inception Impact Assessment aims to inform citizens and stakeholders about the Commission's work in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are, in particular, invited to provide views on the Commission's understanding of the current situation, problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Review of the MiFID II/MiFIR framework
LEAD DG – RESPONSIBLE UNIT – AP NUMBER	FISMA (C3)
LIKELY TYPE OF INITIATIVE	<i>legislative, directive and regulation</i>
INDICATIVE PLANNING	Q3 2020
ADDITIONAL INFORMATION	-

This Inception Impact Assessment is provided for information purposes only. It does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by this document, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

MiFID II¹ and MiFIR² started to apply in January 2018, bringing significant improvements to the functioning and transparency of EU financial markets. While the preparation to the new framework has proven challenging for market operators and investment firms, 2 years down the road, the industry seems to have well-adjusted to the new regulatory environment. To assess the overall functioning of the regime, MiFID II/MiFIR require that the Commission presents Parliament and Council with a report on the operation of the new framework, together with a legislative proposal for reform, if deemed necessary.

Under the existing legal text, the Commission will review the overall experience with the implementation of the MiFID II/MiFIR framework, in particular the investor protection rules, the position limit framework and pre-trade transparency for commodity markets and the double volume cap. The review shall also cover information asymmetries between market participants and whether a consolidated trading tape would help in remedying such a phenomenon. In addition to the topics listed previously, there are other less urgent topics on which we also seek stakeholders' feedback.

The MiFID II/MiFIR review is related to the ongoing Capital Markets Union (CMU) initiative and will take into account the relevant actions set out in the forthcoming CMU Action Plan which will build on the recommendations from the CMU High Level Forum (foreseen for publication in May 2020)³. The initiative intends to take into account the conclusions from the fitness check of EU Supervisory Reporting Requirements⁴; the Fintech Action plan⁵ and the various Communications around the International Role of the Euro⁶ and the recent review of the ESA Regulations.

The review period will cover the implementation of MiFID II/MiFIR (from 3 January 2018 until 31 December 2019). All Member States will be covered.

Problem the initiative aims to tackle

¹ Markets in financial instruments directive II (MiFID II) - Directive 2014/65/EU

² Markets in Financial Instruments (MiFIR) - Regulation (EU) No 600/2014

³ https://ec.europa.eu/info/publications/cmu-high-level-forum_en

⁴ https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/191107-fitness-check-supervisory-reporting-executive-summary_en.pdf

⁵ https://ec.europa.eu/info/publications/180308-action-plan-fintech_en

⁶ https://ec.europa.eu/info/business-economy-euro/euro-area/international-role-euro_en

The current MiFID II/MiFIR framework aims at increasing transparency in the trading of financial instruments, fostering competition in executing trades in financial instruments and ensuring high standards of investor protection. However, there is some evidence suggesting that the framework does not always strike the appropriate balance between offering meaningful and targeted information to investors and ensuring a competitive EU trading environment. Subject to further analysis, two main problems have been identified:

1. Inadequate information available to investors and intermediaries

A fundamental principle of MiFID II/MiFIR is to ensure that investment firms always act in the **best interest** of their clients. However, stakeholders and Member States have raised the issue that **investor protection** often takes the form of a series of pre-contractual disclosures and suitability and appropriateness tests that are contained in standardised documents. Filling in these documents proves costly and brings little added value for investors who need primarily more targeted advice on how to make the best investment decisions. In parallel, there should be a careful appraisal of what type of easily accessible and understandable information helps investors make their investment decisions, both at the start and during the investment period.

Another problem is the difficulty in **obtaining reliable and affordable information** about the prices, volumes and main pools of liquidity of financial instruments, especially those traded on several trading venues or systematic internalisers across the Union. This problem affects investors, but also intermediaries who are subject to the best execution obligations. Ultimately, given that access to market data is fundamental for financial market participants, insufficient availability of reliable and affordable data negatively affects the competitiveness and functioning of financial markets in the Union.

As opposed to the United States, Europe does not have a **consolidated tape** as a single source that provides transparency by disseminating prices and trading volumes in a given financial instrument (e.g. shares or bonds) across all execution platforms where this instrument is traded. A consolidated tape, in addition to providing a consolidated view of the trading in the Union, could also help provide legal clarity on the exact scope of financial instruments within an asset class that are under the transparency and trading obligations (STO).

2. Risks to competitiveness and optimal functioning of EU financial markets

Stakeholders and Member States have observed that, subsequent to the introduction of the prohibitions of inducements in relation to research (also referred to as **research unbundling** rules), there has been a decline in investment research expenditures. While the avoidance of duplicative research and a more targeted research spending have been a positive consequence of the “unbundling” rule, the overall decline in expenditure dedicated to investment research might also have had a negative effect on research covering SMEs or companies that are planning an initial public offering (IPO). It has been observed that the first victims of an overall reduction of investment research budgets are SMEs and small cap companies. Stakeholders have noted that the “unbundling” rule might have reinforced an overall trend of reducing research expenditure which might have primarily impacted coverage of the smallest companies in the equities universe. Some have also noted a decline in the quality of SME research reports. Less **coverage of SMEs** may lead to less investments in SMEs, less IPOs and less (digital) innovation in EU markets.

Finally, in the **commodity markets**, the lack of flexibility of the **position limits** regime for commodity hedging contracts might have been a constraint on the emergence euro-denominated commodity derivatives markets that allow hedging the increasing risk resulting from climate change. As position limits are calculated as a percentage of “open interest” on a particular exchange, the limits applicable to smaller exchanges are much lower than those applicable on larger ones. It would therefore appear that position limits that are calculated on the amount of “open interest” (open contracts in the market) might inadvertently give an advantage to the large exchanges, whose position limits are higher than those on smaller exchanges. Stakeholders have also argued that a more finely calibrated system of **pre-trade transparency** applicable to commodity derivatives would lead to a swifter transition of these markets from the currently prevalent over-the-counter trading to electronic platforms.

Basis for EU intervention (legal basis and subsidiarity check)

The legal basis for these EU initiatives are, respectively for MiFIR and MiFID II, Article 114 and Article 53(1) of the Treaty on the Functioning of the European Union (TFEU). The aim of the EU action would be to improve the functioning of the internal market by creating an EU wide price comparison tool and by eliminating unnecessary burdens for both service providers and clients.

Necessity test: the above problems cannot be solved by the Member States acting alone. On the contrary, the lack of a tape consolidating EU wide data for shares and bonds require an EU-wide solution in light of their essentially pan-EU nature. Similarly, low SME research across the EU or rigid position limits on commodity derivative exchanges are detrimental to the wider objectives of creating vibrant capital markets in the EU and deserve a European approach to improve it.

EU added-value test: The current fragmentation of trading data across several EU exchanges or other alternative trading platforms can be solved most efficiently by a single Union trading tape. A single tape consolidating all market data would also seem the most cost efficient manner to , make share and bond trading more accessible to a wider investment community where price and liquidity are optimal. The other areas described are improvements of the existing system in order to increase the added value of information available to all investors in the EU, to heighten the coverage of SME research on a Union wide basis and to increase the trading of euro-denominated commodity derivatives.

B. Objectives and Policy options

In line with the problems identified, there are two main objectives coupled to policy options for a targeted MiFIDII/MiFIR Review.

1. Rationalise information available to investors and intermediaries and make EU financial markets more transparent

One objective would be to ensure that the **client' best interest** is safeguarded at all times throughout the product distribution process. This could potentially require a targeted recalibration of certain information and profiling requirements. One option could be the creation of an opt-out mechanism from some documentation requirements (such as standard information on costs and charges, reports on short-term portfolio volatility) for wholesale clients. Another option could be the introduction of a lighter regime, alleviating the administrative burden at the point of sale for a new client category (**semi-professionals**), comprising experienced retail investors who can prove their eligibility by a rigorous one-off test.

In addition, targeted amendments on the timing of the provision of ex-ante information could make the current regime more adapted to distance communication, hence fostering digitalisation of service.

The objective of increased **market transparency** would be addressed with the introduction of **consolidated tape**. Such a single source of price and volume would be one of the key tools for brokers to demonstrate compliance with the “best execution” obligations. Several options are available to determine which type of consolidated tape could be put in place. For example, should the tape cover equity or also non-equity instruments or should it even comprise certain derivative asset classes? Other options to be explored would be whether the consolidated tape should assemble pre-trade bids and offers or whether it should be confined to consolidating post-trade information on transactions concluded in the marketplace. A further line of options would differentiate whether the tape should be a “tape of record” that is published only at the end of the day or whether the information should be streamed “live” (or as close as technologically possible to real time) throughout the day.

The review will explore several graduations of what a consolidated tape could look like, ranging from a mere end-of-day “tape of record” for equity transactions to a pre- and post-trade live tape consolidating orders and transactions in a broad universe of instruments comprising shares, ETFs, bonds and certain derivatives on a real-time basis. The scope of the consolidated tape would be aligned with the scope of the share trading obligation, thus increasing the **legal certainty for market participants**. For instance, this could entail defining the scope according to an “official list” of all shares that are admitted to any of the Union exchanges and that, in consequence, would also have to be reported to the consolidated tape. A more radical policy

option could be to repeal the share trading obligation but this should be properly assessed.

2. Improve the competitiveness and functioning of EU financial markets

To make sure that the EU financial markets finance the growth of innovative SMEs, the review will explore ways to **increase SME research coverage**. This could be achieved by reviewing the rulebook governing research aspects, such as the above mentioned “research unbundling” rules, the listing practices of stock exchanges, as well as reconsidering the benefits of issuer-sponsored or exchange-sponsored research.

As part of the effort to foster more **commodity derivatives trading denominated in euros**, rules on pre-trade transparency waivers and on position limits for nascent contracts could be recalibrated. The aim of these adjustments would be to foster more trading of euro-denominated commodity derivatives contracts. For example, MiFID II could contain a specific requirement that a nascent market must benefit from more relaxed (higher) limits before a position has to be closed. Another option would be to allow for trades negotiated OTC to be brought to an electronic exchange for post-trade publication in order to gradually familiarise commodity traders with the beneficial features of trade transparency inherent in electronic trading.

C. Preliminary Assessment of Expected Impacts

Likely economic impacts

Market-based intermediation is key to promoting innovation and productivity, and at financing new sources of growth. Having EU financial markets that are as efficient and attractive as possible is crucial to maintaining investor returns and safeguarding pension incomes that derive from investment in capital markets.

Possible targeted changes to the information and conduct requirements or the possible introduction of a new client category could lower the administrative cost of compliance for investment firms while maintaining the highest standards of investor protection.

The **consolidated tape** of quotes or completed trades aims to provide a single source of **market data**. This would allow EU investors to have a clearer picture of executed trades, pockets of liquidity and, if a pre-trade tape were chosen, information on trading opportunities, in relation to all financial instrument covered by the consolidated tape. The consolidated tape would also foster transparency by rewarding those execution venues that contribute price forming transaction data with a higher compensation per unit reported than for trades executed under transparency waivers. Lastly, it might lower the costs of attaining market data across all trading venues and systematic internalisers. . The current costs are a source of worry among financial market participants.

Nascent “euro” commodity markets would be able to grow as the transparency waivers and position limits that are more generous for smaller markets would allow more EU non-financial companies to hedge more of their business risk in euro denominated markets.

Likely social impacts

Improving the level of information and increasing the effectiveness of the EU financial markets will allow (digital) innovative companies and potentially unlisted firms, including SMEs to seek market financing. As innovative companies contribute considerably to job creation this is expected to have a positive impact on employment.

More appropriate information could lead to investors who engage or intend to engage with equity or bond investors in being better informed about such investments. This in turn could lead to the public being better informed about investing in capital markets in general.

Likely environmental impacts

In order to mobilise the financial resources needed to support the EU sustainable agenda, our EU financial markets need to remain among the best in the world. Ensuring that information is distributed efficiently and making EU financial markets even more attractive would enable not only more investor participation from EU citizens but can attract investments more internationally, contributing indirectly also to wider sustainability objectives.

Likely impacts on fundamental rights
There is no relevant impact on fundamental right from this initiative.
Likely impacts on simplification and/or administrative burden
This initiative aims to make EU financial markets more transparent and more competitive. Depending on the policy option chosen this could reduce the administrative burden for market participants by freeing businesses from the need to connect to multiple market data providers. Ultimately this could facilitate and, where possible, streamline the information flow for more efficient investment decisions.
D. Evidence base, Data collection and Better Regulation Instruments
Impact assessment
An impact assessment is being prepared to support the preparation of this initiative and to inform the Commission's decision.
Evidence base and data collection [max 10 lines]
The Commission has engaged actively with market participants and consumer associations to gather evidences on the potential shortcomings of the existing MiFID II/MiFIR regime since its application on 3 January 2018.
ESMA reports
The European Securities Markets Authority (ESMA) is required to contribute to the Commission's reports on the functioning of MIFID II/MiFIR. ESMA expects to deliver some of its contributions by Q1 2020 ⁷ with technical advice related to the possible changes as presented above, such as investor protection aspects, the consolidated tape and position limits.
Studies
The Commission has undertaken an extensive study on the effects of the unbundling regime on the availability and quality on research reports on SMEs and a study on the digitalisation of the marketing and distance selling of retail financial services. A study has been commissioned to assess the feasibility of the creation of an EU consolidated tape for equity, government bonds and corporate bonds. The results from that study are expected by end Q2 2020 and will feed into the impact assessment.
Workshops
The Commission organised several workshops on various topics of direct relevance for the review of MiFID II/MiFIR and in particular a workshop on the scope and functioning of the consolidated tape (June 2019).
Consultation strategy [max 10 lines]
Preliminary discussions with Member States took place during a meeting of the Expert Group of the European Securities Committee (EGESC) on 29 November 2019. The Commission will also launch an open public consultation in Q1 2020. The consultation will be published on https://ec.europa.eu/info/consultations_en . The public consultation, together with the workshops and studies, will allow the Commission to assess potential changes to MiFID II/MiFIR.
Will an Implementation plan be established? [max 5 lines]
The Commission will establish an implementation plan.

⁷ https://www.esma.europa.eu/sites/default/files/library/esma70-156-907_letter_chair_to_eu_commission_on_the_mifid_review_reports.pdf