FIX EMEA TRADING CONFERENCE

BY THE INDUSTRY, FOR THE INDUSTRY – NOW A GLOBAL DEBATE!

NOW VIRTUAL!

The FIX Trading Community are pleased to present our special edition newsletter ahead of the first virtual EMEA Trading Conference on Friday 18th September 2020. Inside you will find articles contributed by FIX and our lead sponsors as well as a sponsor directory.

We very much look forward to seeing you online at the virtual event. Don't forget to register!

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NEWSLETTER

WELCOME

WHAT WE AT FIX TRADING COMMUNITY HAVE LEARNT SINCE COVID-19

Rebecca Healey
EMEA Co-Chair
FIX Trading Community

Matthew Coupe
EMEA Co-Chair
FIX Trading Community

Welcome to the special edition newsletter ahead of the first virtual EMEA Trading Conference. While the postponement of the conference from March due to COVID-19 was hugely disappointing, we are very excited by the immersive virtual technology that will help us to deliver one of the strongest and best conferences possible and the ability to reach a truly global audience. Topics to be debated include;

- Recent changes in global market structure – hear from regulators from the UK to Australia;
- Updates on the myriad of recent consultation papers from ESMA and the EU Commission, the likely impact on MiFID of the quick fix proposals and the longer term challenges from Brexit;
- New regulation regarding ESG – now a global debate with conflicting regional approaches highlighting the importance of robust industry standards;
- Changes in liquidity provision as the industry adjusts to the post COVID-19 landscape and the impact on market participants in the ever-evolving search to access liquidity.

Created by the industry for the industry – This non-commercial conference once again has focused on delivering high quality content with subject matter experts fostering industry engagement and togetherness in a collaborative manner for all participants from the Buy Sides, Sell Sides, Venues, Exchanges, Trade Associations, Regulators and Policy Makers across global jurisdictions.

We would like to thank our sponsors and trade association partners once again for continuing to support the new format and we expect it will be a very enjoyable day. Towards the end of this newsletter you will find a directory of these sponsors, most of whom will have virtual booths that you can visit and find out more about their products and services without leaving your desk and we hope that you enjoy reading the articles contributed by our lead sponsors.

We very much look forward to seeing you on Friday 18th September albeit virtually and look forward to continuing the industry debate. If you have questions in regards to the event, please contact events@fixtrading.org. Don't forget to register at www.fixtrading.org/emea2020registration or by clicking the button below.

Rebecca Healey and Matthew Coupe
Co-Chairs EMEA Regional Commitee & EMEA Regulatory Subcommittee

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BUY-SIDE IN CONVERSATION WITH FIX - THE FUTURE OF OUR INDUSTRY POST COVID-19

By Maria Netley
Head of the FIX Trading Community Secretariat for EMEA

As we all come to terms with life post COVID and settling into the routine of working from sitting rooms, bedrooms, and kitchens, one thing is certain that the industry will never be the same again. Just exactly what the longer term changes will be and how these will impact our members is still evolving. What was evident is how quickly and effectively members were able to adjust to working remotely, and, despite the heightened volatility, how well markets and the supporting technology infrastructure functioned under stress. However, longer term challenges are now emerging such as how to manage teams going forward; how members can ensure career development for junior staff; what is needed in terms of technology going forward; and how firms will engage with industry partners in the future.

As some of our member firms start to think about braving the commute back into the office, the FIX Trading Community brought together 3 senior buyside heads to find out a little more about the "new normal" and what it will mean for the industry. Along with our European Co-Chairs Matt Coupe and Rebecca Healey, we took some time to mull over the impact that COVID-19 is having on our working lives across both Fixed Income and Equities and how these issues will form the agenda for the EMEA Trading Conference on September 18th.

One thing that has become obviously apparent is that technology within the investment process is here to stay – evolving individual roles and how market counterparts engage with this new process as well as each other. The new normal may be anything but normal, yet offers huge opportunity for those willing to embrace these changing times.

The increase in **electronic trading** along with the industry being more comfortable with trading protocols and automation will lead to better trading oversight, improved risk management and trading efficiency. However, ensuring success will require robust industry wide systems and controls. In times of high volatility, having effective data, facilitates trust in automated systems, allows traders to focus on important trades where value can be added. Improved **systems and controls** around automated trading naturally leads to enhanced compliance oversight, and more efficient risk management, particularly when operating from multiple remote locations – making working from home not only possible, but successful.

In the conversation it became apparent that while equity markets held up well, the cost of trading increased and is likely to remain that way for the foreseeable future. This leads to new questions around accessing liquidity, the impact of timing on trading strategies and whether this will lead to changes in portfolio management, such as a greater propensity to buy and hold. **Enhanced data** is what leads to a better understanding of where liquidity lies and the quality of that liquidity. The industry still suffers from a lack of full transparency. By the industry working together with the regulators to address the issue of a consolidated tape, members will be able to navigate what liquidity is where and the quality of that liquidity with greater accuracy. The exact technical structure of a tape is challenging and will require the industry to work together with regulators to create an accurate data source with industry wide data standards.

While equity markets held up well, the bond markets hit the vicious circle of volatility, widening spreads and balance sheets evaporating, effectively closing fixed income markets at the height of the crisis. This fine balance between protection of bank balance sheets versus the need for greater transparency has to be addressed, to ensure the provision of liquidity is incentivised but not at the cost of post trade transparency. To that end, the conversation demonstrated that buy-side are not only clear of the need for an Equity Consolidated Tape but also Fixed Income. However, harmonisation of deferral regimes and improvement of industry wide data standards in bond markets need to be addressed first to ensure the tape provides value.

Future impact of regulation was also discussed as an area of concern, with rumours circulating around a possible COVID-19 interim regulation making emergency changes to the level one text of MiFID II, with potential changes to RTS 27 and 28 rules, best execution and mid-point matching all on the table as topics to be discussed. The heads of trading agreed that in the main, for equities, regulation to date has largely achieved what was intended with a few minor caveats such as RTS reporting is expensive to operate and currently provides little value. What remains a wider concern is the potential impact of Brexit on the STO; the unknowns such as possible changes to waivers and the SI regime proposed in the recent ESMA papers on the MiFID Review[1]; as well as new proposals relating to AIFMD[2], and proposed changes to bond liquidity[3]. With the European Parliament also looking to address the role of capital markets as an engine for sustainable growth to create a socially fair and climate neutral economy within the new Recovery & Resilience fund[4], it is clear there is still much ahead to debate and assess as we move from how the industry operates today, to how it will operate in the future.

As we approach the EMEA Trading Conference on September 18th, the global heads of trading had four clear areas to put forward for the industry to discuss and debate:

1. Can COVID-19 become the catalyst for change in our industry – to improve diversity; work/life balance; shorter market hours? What can we take as positive changes from the pandemic and what now requires further review?

2. How should market practioners work together going forward? What do the buy-side now require from sell-side partners and vendors? Whilst there was much talk of innovation during this period, much was repurposing existing systems rather than true innovation. Instead staff needed to be more flexible in the role that they were doing on a day to day basis. For the heads of dealing, their role has had to become more adaptable given the new focus on risk management rather than head of dealing. What other roles and services are having to adapt and evolve in response to the pandemic?

Can COVID-19 become the catalyst for change in our industry - to improve diversity; work/life balance; shorter market hours?

3. What will proposed regulatory and political changes in relation to ESG have on the industry? With rising demand for ESG products alongside growing global regulatory concern regarding greenwashing, how will the industry move sustainable investing mainstream? Read more from our co-chair, Rebecca Healey, here[5] on this topic.

4. Electronification of Fixed Income markets requires the FIX Trading Community to take a lead. Discussions regarding the recent market structure failure and current industry inefficiencies have highlighted that improvements will only come with the industry working together on the provision of a consolidated tape. It is time for the gloves to come off and for the industry to start having those hard, but necessary, conversations.

5. More Buyside firms MUST get involved with the FIX Trading Community and help to take the lead on providing leadership and direction as the industry moves through to this new era post COVID-19.

The postponement of the EMEA Trading Conference from March to September brought its own challenges including the necessity to make it virtual, but this in itself has created an even greater opportunity to reach a wider, more global audience and refine the topics to be debated. So join us for the 12th Annual EMEA Trading Conference on September 18th 2020 to participate in this global debate. You can register here.

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1 https://www.esma.europa.eu/sites/default/files/library/esma70-156-2682_mifidii_mifir_report_on_transparency_equity_dvc_tos.pdf
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5 https://www.linkedin.com/feed/update/urn:li:activity:6701817241501011968/

axe trading

A FLEXIBLE FUTURE FOR FIX?

It's widely recognised that FIX has achieved the objective of providing a global standard and normalising machine to machine communication for trading applications. The "syntax" of the FIX protocol is now nearly universally accepted and is well on the way to being the de facto standard that has progressed the industry away from the collection of proprietary APIs that were previously in use. The entire ecosystem of the new trading era has been enabled by FIX.

We have all seen how it adds value and removes layers of complexity whilst enhancing security and stability. It definitely enables FinTech vendors to provide new connectivity, workflows and accommodate new venues far quicker and more efficiently than the myriad landscape of different rules that legacy systems still inhabit. FIX asynchronous messaging delivers convenience, stability and interoperability today but can it do more tomorrow?

The FIX standard is owned, maintained and developed through the collaborative efforts of FIX Trading Community member firms. So far, FIX has proven reassuringly politically and culturally adept at working with every type of regulatory and political governance globally. This is no small achievement as can be seen with the challenges faced by SWIFT and numerous general communications platforms having governments challenge or tamper with them in more or less overt ways.

With over 300 members, the process of getting changes or additions has many pressures and could risk becoming less nimble, understandable considering the number of players combined with the risks and challenges, but it's a situation that may benefit from consideration. The larger meeting and full committees format provides many of the benefits of democracy and openness but may have challenges in providing effective contributions. Whilst the protocol is inherently vendor-neutral, the direction of the FIX project is guided by the needs of the market and this requires careful stewardship. There is a skilful juggling required to balance the needs of the largest players, who have the widest reach, and the possible interests of other smaller market participants. Otherwise there may be a risk that innovation may not be as forthcoming. FIX are working hard to balance these competing needs whilst ensuring progress is maintained.

What is the future for FIX? There is no doubt it is an outstanding contribution to market technology and is growing in strength. FIX is 'quick' and has been able to adapt and be used for very low latency applications, and is showing strength to encompass more exotic use cases. Over the past couple of years consideration has been given to the hot topics of cybersecurity, digital currencies and blockchain in addition to the more mainstream issues of execution transparency and general performance improvements.

FIX are working hard to ensure that it does not become over-engineered and risk being inflexible. There are challenges, in a 'typical' message most of the possible fields are never used but can't be repurposed to deliver what the user may actually need to communicate. Encryption is an important feature of modern fin-tech but is it optimal for this information to be transmitted in the message, when in fact the 'work' is done at each end.

To thrive and grow FIX is looking at many options, possibly embracing more workflows and message types, not just 'out of the box' but to be more easily adapted to custom applications. We would also welcome the FIX Trading Communities drive to further education and publicise to ensure that all users of the protocol are aware of the many tools and techniques available to their users.

As more market data is being consolidated, normalised and shared in the market, FIX is looking at how to be able to adapt to new uses to maintain its now vital market role and remain fast and dynamic.

FIX is 'quick' and has been able to adapt and be used for very low latency applications, and is showing strength to encompass more exotic use cases.

Global Regulation in a Post Covid World

COVID-19 sent shockwaves across financial markets and although capital markets held up, longer term structural changes are now underway. While improving regulatory collaboration to maintain well-functioning capital markets and the protection of end investors is not new, the growing economic implications from worldwide lockdowns are becoming apparent and the need for economies to rapidly adapt is pivoting regulatory oversight in a new direction. From the MiFID II refit post Brexit to the latest virtual roundtable from the SEC on modernising US equity market structure as well as Asian regulators needing to adapt to recent political events, global regulators are rethinking what financial markets should look like, redefining policy for years to come.

Despite regulatory intentions to harmonise policy, buy-side firms are likely to have to stay abreast of regulatory changes in multiple jurisdictions; adjusting to shifting liquidity patterns, and the venues and execution strategies which will benefit from the diverging regulation. It is this switch in focus to greater investor protection where the greatest immediate challenge for asset managers lies. The ability to deliver on best execution and the optimal means to measure performance is set for further scrutiny along with operational resiliency. New industry initiatives on routing transparency are set to intensify as asset managers are put under the spotlight, moving execution away from the sell-side domain to that of the buy-side, leading to greater use of technology, data and analysis as well as outsourcing providers.

Alongside the immediate challenges, more significant longer-term changes to the asset management industry are emerging which will have a profound effect on how the industry operates. The current investment cycle is maturing in a period of radical geopolitical change and consumer demand for greater transparency will make it increasingly difficult for managers to consistently make accurate investment decisions operating under the status quo. The growing accessibility of unstructured datasets and advancements in technology in other industries is leading to new approaches to the digitalisation of the investment process itself, facilitating more bespoke and targeted specialist offerings.

Accuracy of information provided to end investors is now a high regulatory objective. Whether it is in Europe with the forthcoming ESG disclosure regulation beginning March 10th 2021 or the demand in the US for public capital markets to have access to clear, high-quality, timely information regarding the financial and operating status of companies; asset managers will be required to evidence how they incorporate ESG data and sustainability factors in their investment decisions reinforcing the need for improved data standards globally.

The far-reaching industry changes will not only impact the research and investment process but will have significant implications for how investment decisions are made and which data is required to evidence whether correct processes and procedures have been followed. Traditional sell-side research based on annual reports and cash flows will be replaced with alternative datasets covering a vast array of non-financial information.

While asset management firms presently focus on winning mandates, increased regulatory scrutiny will require automating the investment process to enable firms to not only win, but keep mandates by delivering measurable outcomes, all of which will require increased access to data and technology, agility to adapt to the changing regulatory environment in whichever location, and global industry standards to make this feasible.

As firms redefine their investment processes to remain ahead of the curve and evidence the value they deliver to end-investors, those who fail to adapt to this new age of transparency will ultimately be left behind as the industry continues to evolve and the regulatory scrutiny intensifies in a postpandemic world.

Read more on what the crisis means for Global Regulation here

[1] https://data.consilium.europa.eu/doc/document/PE-87-2019-INIT/en/pdf [data.consilium.europa.eu]
[2] https://www.sec.gov/news/speech/clayton-redfearn-modernizing-us-equity-market-structure-2020-06-22#_ftn5

Liquidnet

DELIVERING ALPHA FOR THE LONG TERM

By Dr Robert Barnes
Global Head of Primary Markets and CEO Turquoise, London Stock Exchange Group

Equities have long been the bedrock of retirement savings, but their contribution has gradually magnified. Successive pension reforms mean millions of members of defined contribution schemes all over Europe are counting on equities to fund retirements. Until recently, equities, bonds and cash deposits have shared the weight of expectation. But low interest rates have eroded cash earnings. And while some fixed-income investments have delivered equity-like returns over the past decade, the sovereign bonds that added ballast to many a balanced portfolio are now in negative yield territory.

This widescale dependence on equities is not a new phenomenon. The Lamfalussy report that informed the original Markets in Financial Instruments Directive (MiFID) observed that employees would need to invest 20% of their annual salary to amass a satisfactory pension pot if the real rate of return was just 2%[1]. The recent QE era has not only seen low inflation and negative interest rates, but also difficult conditions in which to make differentiated equity-market returns. With ETFs offering low-cost exposure to blue chips, the challenge for active managers is to identify tomorrow's titans among today's mid- and small-cap stocks, without sacrificing alpha through wide spreads and slippage costs.

Buy-side traders can also contribute to pension pots by choosing the most efficient routes to market. And MiFID II is keeping them honest through best execution requirements that make it easier for investors to compare execution costs and practices. But trading mid- and small-cap stocks on primary exchanges can be an expensive business. With limited liquidity, small-cap spreads can be much wider than for blue chips, with this difference being compounded when markets are volatile. And with average trade sizes on European exchanges at €10,000 and shrinking, natural blocks are few and far between.

The automation of equity markets has been a bumpy ride for the buy-side. Under MiFID I, low-latency-specific trading strategies were able to front run large orders in the same way that pit traders had done in open outcry. Nevertheless, partnership and innovation in market design is offering opportunities to trade efficiently beyond blue chips. Trading venues like Turquoise have developed market mechanisms that deliver on participant priorities shaped by the needs of end-users. These participants are looking to invest in stocks across the liquidity spectrum, in large size, with minimum slippage costs, and maximum transparency and anonymity.

Turquoise has developed a market structure that reduces costs by minimising slippage and reversing the trend toward lower order sizes by giving buy-side traders the confidence to rest block orders without missing out on liquidity opportunities.

Turquoise Plato offers midpoint matching (relative to the best bid and offer on the primary exchange) not only in continuous trading but also utilising Turquoise Plato Uncross and Turquoise Plato Block Discovery. This means market participants use the same algorithms to combine the benefits of midpoint price improvement with the superior execution quality that derives from Turquoise Plato Uncross's randomised execution functionality (which renders low-latency-specific strategies uneconomic) as well as the ability to interact with large, natural blocks.

The confirmation of 'I would if I could' messages resting in Turquoise Plato Block Discovery is designed to be immediate and automated, permitting only natural blocks to match. Combined with a limit price to protect against price drift, the anonymity and immediacy of the confirmation process gives buy-side traders a high degree of comfort to rest large orders, boosted by the knowledge they can still access liquidity elsewhere on Turquoise's single order book.

It is the combination of these mechanisms, rather than a single silver bullet, which encourages buy-side traders to patiently search for mid- and small-cap liquidity on Turquoise Plato. Rather than crossing the spread in the hope of a quick deal, they see the benefits of waiting for natural liquidity, with lower spread costs, lower price reversion and larger trade size. This also supports future liquidity, as natural blocks can be reported immediately (due to absence of unwinding risk), adding to the price information available to other market participants. Over time, this helps to reduce future bid/offer spreads, especially in those crucial mid- and small-cap stocks.

The proof of the pudding is in the eating. The number of active stock symbols on Turquoise has increased steadily since 2015 within a diverse universe of more than 4,000 securities across 18 markets. Having trended gradually up toward 3,000 active symbols throughout 2019, it is interesting to note that activity continued to rise throughout Q1 2020. Turquoise performed with resilience throughout this period of extreme volatility, providing robust and orderly markets throughout, setting new records in the size and number of blocks traded.

It is our sincere hope that Turquoise can continue to support equities trading in Europe, including investment in the pension income of European investors and the capital raising plans of small- and mid-cap companies, whether listed in London or other markets within our tradeable universe. As international competition for listings intensifies, it is possible secondary market liquidity will become a more significant consideration, with market design and network distribution helping issuers to reach a global investor base.

Turquoise has developed a market structure that reduces costs by minimising slippage, giving buy-side traders confidence to rest block orders.

Ultimately, portfolio managers must go wherever they can – across asset classes and borders – to find and extract alpha, as pressure mounts to deliver the returns demanded by demographic trends. Short-term shocks can assume exaggerated significance, but they can also be catalysts, signalling the future. To attract liquidity consistently, trading venue operators must offer the functionality and framework that helps buy-side traders to capture the maximum benefit of alpha for end-investors, whatever the weather.

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[1] Final Report of The Committee of Wise Men on The Regulation of European Securities Markets (2001), p. 74
https://www.esma.europa.eu/sites/default/files/library/2015/11/lamfalussy_report.pdf

THE SEVENTH WAVE...WHAT NEXT IN ELECTRONIC TRADING INNOVATION?

***By Mike Powell**, CEO, Rapid Addition*

According to surfing folklore, the seventh wave is the largest of the set. This is perhaps a fitting metaphor for what's about to happen in electronic trading. Recapping on the last three decades, we've certainly come a long way, and whether or not you agree with my preceding six waves, they are certainly significant milestones.

FIX was first formally introduced in 1994 as a means of avoiding transcription errors. This quickly evolved into two-way flow, enabling institutional buy-side to send care orders. The sanctioning of ECNs in 1998 and subsequent US market decimalization in 2001 accelerated the use of algos, with their adoption becoming widespread as liquidity fragmented further following RegNMS and MiFID I. This ignited the latency arms race, spurring the rise of HFT and DMA. Post Global Credit Crisis regulation focused on reducing risk and improving execution quality, leaving brokers to try and differentiate increasingly similar services through the use of Algo Wheels and TCA tools. With MiFID II demanding even broader application of best-ex rules, one could argue that the 6th wave is the increasing electronification across all asset classes.

the seven waves
of Innovation in Electronic Trading

1. 1994 FIX formally launched with v2.7, enabling institutional care orders
2. 1998 sanctioning of ECNs & US 2001 decimalisation grows algo use
3. 2007 RegNMS & MiFID 1 liquidity fragmentation accelerates algo use
4. Latency arms race and rise of HFT, DMA, and sponsored access
5. Post Credit Crisis regulation - prop desk spin-out/rise of hedge funds
6. MiFID II best-ex rules drive electronification across all asset classes
7. Greater end client empowerment in electronic trading?

If every action causes a reaction, then undoubtedly these innovations have had a causal effect on regulation, market structure and the economics of trading. The high costs of participating in increasingly fragmented and regulated markets have combined with real price compression on commissions. Commissions pre-electronification were 20bps and are now less than 1bps in most large liquid stocks. This is compounded by large-scale players leveraging technology to undercut competition to gain share, with the unhealthy consequence being the emergence of powerhouse brokers who dominate many markets. To a certain extent, the availability of improved 'off the shelf' technology and white-label business models for algos and liquidity access has lowered some of the costs of entering and maintaining presence in a given market. While this might help in the short-term, it also means that firms effectively offer very similar services and struggle to differentiate themselves. With price one of the few options left for creating competitive advantage, margins will only suffer further.

The 'differentiation dilemma' is perhaps an opportunity for the 7th wave – a step-change to empower the end client. Despite advances in electronic trading, aspects remain highly inefficient. Client onboarding can take weeks or even months, straining relationships and delaying profitable order flow. Extending trading relationships beyond care orders, adding asset classes, or deploying and tuning algorithms are all time-consuming, resource intensive activities. Co-ordinating relevant staff at counterparties can be painful and further impact time to market. The opportunity to give clients greater self-determination through intelligent tools, allowing them more control of the trading process, can lead to significant efficiency gains. It also meaningfully differentiates firms from their peers. While it might feel counterintuitive for sell-side firms to take a more hands-off approach, many of their clients will find greater control attractive.

Initially, this could take the form of increased transparency, with clients accessing the same level of real-time monitoring as their broker. Self-service tools for risk limit maintenance, updating settlement instructions, and other tasks would all lead to improved efficiency. This can evolve to self-conformance testing, implementing proprietary routing logic, and tuning or switching between algorithms in response to market events. Achieving execution goals effectively becomes a partnership, building stronger relationships as brokers genuinely empower their clients' strategies. Ultimately, high touch intervention becomes exception management as brokers grow increasingly comfortable with ceding tasks to their clients. This in turn drives further cost efficiencies, attracts new flow, and builds customer loyalty.

The irony in all this is that greater levels of self-empowerment create greater client satisfaction and yet, provided the right infrastructure is in place, leads to lower daily operating costs for the sell side.

FIX can be key to this evolution, however, it needs to be much richer in terms of functionality, better facilitating the types of interactive workflow mentioned above. Messages and applications need to be more closely synched than they are today, requiring less customised adaption of FIX, which generates unnecessary overhead. The FIX Trading Community will also need to collaborate more closely in areas such as AML and KYC with other standards bodies like SWIFT, to accelerate greater automation across the trading life cycle.

Whether or not this really is the 7th Wave remains to be seen but reimagining the next level of interaction between sell-side firms and their clients is long overdue. Over recent years our consumer habits have permanently changed, and the current environment is driving change in our working lives too. Firms who embrace this and are at the vanguard of implementing such capabilities have a unique opportunity to position themselves as innovative, customer centric partners in the battle for order flow.

Reimagining the next level of interaction between sell-side firms and their clients is long overdue. The opportunity to give clients greater self-determination through intelligent tools, allowing them more control of the trading process, can lead to significant efficiency gains, increase customer loyalty, and potentially grow order flow.

MiFID 2.5
BONFIRE OF THE REGULATIONS?

As EU policymakers debate changes to MiFID 2, will we get the Bonfire of the Regulations that European Capital Markets need?

By Rob Boardman
CEO Virtu Execution Services, EMEA

In 1497 the Bonfire of the Vanities was an attempt by the City of Florence to destroy objects considered sinful. Conceived in the aftermath of the 2008 financial crisis, MiFID 2 and MiFIR were attempts by Brussels policymakers to remove the sins of freewheeling markets: conflicts of interest, opaque markets and inadequate investor protection. With 30 months of MiFID 2 experience, many market participants now believe the regulations went too far. Most of the additional reporting yielded no benefit to investors, dark pool caps are arbitrary and chaotic, and overzealous unbundling regulation reduced the competitiveness of European Equity Capital markets. Is it possible to apply what we've learned thus far so as to create meaningful reforms?

Amid the backdrop of the COVID-19 pandemic, policymakers seem willing to reduce some administrative burdens imposed on investment firms. Some "non-essential" reporting requirements defined in the endless regulatory technical standards annexes look set for the chop. So far so good. Greater clarity on the Share-Trading-Obligation is also likely to be welcomed by trading firms. Perhaps even reform of the dark pool caps; if not eliminated entirely, they can be streamlined to avoid frequent changes of scope. All very worthy. But in recent weeks Brussels lobbyists have found policymakers willing to consider a more far-reaching U-turn on a cornerstone of MIFID 2: Research Unbundling.

To understand why, we must look at the new behemoth roaming the EU policy landscape: stimulus to avoid a post-COVID economic depression. For several years the desire to make European Capital Markets service the real economy has united most political forces in Brussels. The Capital Markets Union (CMU) is an EU plan to "unlock funding for Europe's growth", in particular for small to medium sized enterprises (SMEs) that provide the majority of new jobs and wealth creation in our economy. European SMEs have traditionally relied heavily on bank loans to finance growth, whereas start-up firms in the United States seem to enjoy greater access to genuine risk capital. As we look forward to the decade post-COVID, it is essential that the European Union should pull on every policy lever to strengthen the SME sector.

Unfortunately several aspects of MiFID 2 seem at odds with this objective. By restricting the ability of asset managers to purchase equity research through the trading process, surveys have shown that the amount of research produced has fallen dramatically. Small company research has been hit hardest due to its more limited appeal. Other policies in MiFID 2 also stacked the odds against smaller listed companies. For example dark trading, which is an essential tool for trading in less liquid shares, was heavily restricted in MiFID 2. European asset managers could be forgiven for not bothering with small cap equities at all.

Since the drafting of MiFID 2 a lot has changed. For one thing, Brexit has removed the most vocal champion of hard-unbundling (the UK FCA) from the policy debate. Now dovish regulators and policymakers have found common cause with lobbyists from the asset management industry who have campaigned to soften the rules around payments for research. The French AMF has been notable in its advocacy of soft bundling through Commission Sharing Agreements (CSAs). This common-sense mechanism allows asset managers to pay for research through the trading process, yet still have the freedom to select execution broker and trading strategy, irrespective of their research provider.

In the coming months a MiFID 2.5 will emerge. Policymakers have the opportunity to address some of the futile restrictions that have made European Equity Capital markets less effective and competitive than their global counterparts. We can yet hope that policymakers will engage in a Bonfire of the Regulations.

With 30 months of MiFID 2 experience, many market participants now believe it went a bit too far…. but can we apply what we've learned thus far to create meaningful reform?

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Rapid Addition
Rapid Addition was an early pioneer in the development of electronic messaging technology and is now recognised as a market leader in FIX/FAST protocol and FPGA hardware acceleration. The RA platform is a foundational technology that enables financial organisations to succeed in today's increasingly competitive world of electronic trading with a breakthrough combination of performance, configurability and control.
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