The reference price is in the lit market

Response to the MiFID II consultation by the German MoF

1 Introduction

We are grateful for the opportunity to provide the German Ministry of Finance with our views on the impact that MiFID has had on financial markets in Europe. MiFID II was one of the main pieces of regulation for financial markets in the last decade. It was drafted shortly after the financial crisis and has required major efforts from financial market participants to make the necessary adjustments, from a compliance perspective and on the business side. As with all new major pieces of regulation we support efforts to assess the effects of the new rules in delivering on the intended goals.

As an independent proprietary trading firm we are active on all major European exchanges and MTFs, but we do not provide any services to clients.[1] We will therefore focus our response on the impact MiFID has had on the way financial instruments are traded and the impact of these changes to the end investors.[2]

Below we will first address a few very specific issues where we feel MiFID II may have had some (negative) unintended consequences for the market (micro) structure in Europe. On the next pages we will give a more overall assessment of the impact of MiFID II on the attractiveness and competitiveness of EU financial markets. We will end our response with some suggestions for a way forward.

2 Specific concerns & suggestions

2.1 The share trading obligation

The trading obligation has the potential to lead to suboptimal execution in cases where the main liquidity is on non-EU venues. The equivalence recognition process is inflexible and uncertain given it can be subject to political dynamics (as evidenced recently in the case of Switzerland). We advise that the trading obligation does not apply to shares that have their main listing outside of the EU.

2.2 Frequent Batch auctions

Batch auctions do have a place in modern market microstructure. However, to prevent brokers from effectively outsourcing their internalization, platforms should not be able to allow broker-preferencing of orders in auctions.

[1] We trade on e.g. Xetra, Eurex, LSE, Borsa Italiana, Euronext, CBOE Europe and many other regulated markets and MTFs.

[2] We would furthermore like to stress our support for the arguments made by our industry association FIA EPTA in a separate response to the German Ministry of Finance.

2.3 Systematic Internalisers

The systematic internaliser (SI) regime appears to be mainly benefitting the firms operating them. End-investors might get a marginally better price on an individual level, but at the expense of the overall efficiency and quality of the market. SIs should at least be subject to exactly the same tick-size and transparency requirements as regulated markets and MTFs. But even then SIs might still be able to attract liquidity away from multilateral and transparent markets (and thus hampering optimal price discovery) by for example offering slightly lower transaction fees.

2.4 Transparency waivers and deferrals

Of all the non-equities instruments that are considered to be 'traded on a trading venue' under MiFID II, most are eligible for waivers and deferrals from the transparency requirements. This undermines the objective of increasing transparency. For example, OTC derivatives subject to the EMIR clearing obligation are very liquid and should not be eligible for complete exemptions from pre-trade transparency or four week deferrals from post-trade transparency.

2.5 Interoperability

MiFIR requires the Commission to submit a report to the European Parliament and to the Council by 3 July 2019 on the interoperability provisions in Article 36 of the Regulation. We feel the trading venues should be pushed to allow multiple authorised CCPs to clear transactions on their trading venue. This will promote competition, which will in turn improve efficiency and lower costs to the benefit of all investors.

2.6 Market Data

As the revenues from trading have gone down, the revenues from market data have become more and more important for many exchanges. In 2018 we saw our market data costs increase again with around 15% on average (after similar raises in the years before). We feel regulatory intervention is needed. As part of this, we would support a genuine pan-EU pre- and post-trade consolidated tape to the benefit all investors. Regulators should drive this and not leave it to the market given the inherent conflicting interests in this debate.

3 MiFID II made markets more complex, not more efficient

As market makers, we strongly share the original policy objectives of MiFID 2 -i.e. that ***markets best serve the economy when they are transparent, multi-lateral and centrally cleared***. Furthermore markets should be easily and fairly accessible to all to ensure that a healthy competition, as well as diversity amongst market participants supports efficient price discovery and lowers trading costs for end-investors.

After MiFID I entered into effect in 2007, financial markets in Europe went through a period of significant changes. Exchanges started competing both with each other and with new multilateral trading venues and end-investors saw a reduction in (explicit) trading costs and spreads narrowing.[3] However, abandoning the concentration rule and giving room for other venues to start competing for order flow also led to significant fragmentation of liquidity amongst a range of execution venues, such as regulated markets, multilateral trading facilities, broker crossing

[3] *Understanding the Impact of MiFID,* Report prepared for the City of London, by London Economics, October 2010, p.15.

networks, dark pools and systematic internalisers and pure OTC. This fragmentation made it more difficult for investors seeking to do large trades to source liquidity, reduced the price transparency and increased the cost of market data for investment firms.

MiFID II subsequently strengthened the best-execution requirements, which has probably benefitted end-investors (albeit to a very small, probably unnoticeable extent). For smaller, less sophisticated market participants our experience suggests that execution of trades has improved due to MiFID II and we believe the commissions they pay (at least for options – the market in which we are most active) seem to have gone down. Also more volume is executed on electronic platforms or traded directly against market makers, thus avoiding broker fees. The unbundling rules will also have played a positive role in bringing down costs.

To mitigate some of the negative impacts of the increased fragmentation following MiFID I, the revised version of MIFID furthermore introduced a share trading obligation, banned broker crossing networks (BCNs), limited trading under the dark pool waivers and expanded the pre- and post-trade publication requirements.

Unfortunately, data from ESMA indicates that ***MiFID II (at least for equities) has only marginally succeeded in moving liquidity from less transparent BCNs and OTC to the central limit order books of transparent regulated markets and MTFs***.[4] Instead, since the application of MiFID II, equity volumes previously traded in the dark have mainly shifted to systematic internalisers, block or large in scale venues and to a small extent also to periodic auctions.[5] Whilst for an individual investor and on an individual trade basis these execution models might appear to deliver 'superior' results, from a "public good" perspective, they also lead to a deterioration of the overall market quality. Optiver is concerned about the absence of a meaningful shift of trading volumes towards transparent and centrally cleared trading venues. ***In a properly functioning exchange ecosystem, the reference price is in the lit market.***

4 Suggested way forward

When the European Commission announced its ambitions in terms of the Capital Markets Union, it stated three main objectives: 1) a more diversified financial system complementing bank financing; 2) unlock capital in and around Europe to fund the real economy, giving savers more investment choices and offer business greater choice of funding; and 3) establish a single capital market in the EU allowing investors to invest and business to raise the required funds from a range of diverse sources.[6] Optiver continues to strongly support this ambition. ***Transparent, multilateral and centrally cleared trading markets that can be accessed by all investors are a key success factor to the CMU goals.***

But as explained above, we feel that ***MiFID II has not fully delivered on those CMU objectives and we are concerned as to what this means for the competitiveness of European financial markets***. If we really want to make the EU economy less dependent on (non-EU) bank financing

[4] ESMA Report on Trends, Risks and Vulnerabilities, No.1, 2019

[5] *Block Venue, SIs Big Liquidity Winners as MiFID II Begins Year 2*, Tabb Group, February 26, 2019

[6] https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/what-capital-markets-union_en

and make capital markets better accessible to governments and companies seeking to raise capital, it is essential to evaluate some of the unanticipated effects of MiFID II and determine mitigating actions. The main goal of such efforts should be to shift more liquidity back to transparent, multilateral and centrally cleared trading venues.

Furthermore, any assessment of MiFID II should be made alongside the safeguarding of continued integration with markets in the UK. When more than half of all European trades are executed on London based exchanges, imposing a hard border between EU and UK financial markets would only weaken continental Europe's exchange ecosystem.

About Optiver

Optiver started in 1986 as a single trader on the floor of Amsterdam's European Options Exchange. Today, it is a leading global electronic market maker with over one thousand employees, focused on pricing, execution and risk management. It provides liquidity to financial markets using its own capital, at its own risk, trading a wide range of products: listed derivatives, cash equities, ETFs, bonds and foreign currencies. Its independence allows it to objectively improve the markets and provide efficiencies for end investors by pioneering its own trading strategies and systems using clean code and sophisticated technology.