For a "Consolidated Tape" of Capital Market Trades that brings Value to Individual Investors

BETTER FINANCE
Position Paper

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The European Federation of Investors and Financial Services Users
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SUMMARY POLICY RECOMMENDATIONS

EU action must first address market structure issues before moving to a Consolidated Tape (CT) which would have to "Work for People"

The consolidated tape should aim primarily at ex post check of the best execution of orders (in particular "retail" ones). Individual investors should have easy, intelligible and free access to this ex-post information.

- Ensure that the consolidated tape does not distort competition in favour of opaque, non-transparent venues
- Increase transparent ("lit") trading in the EU
- Reduce market fragmentation
- "Retail" flows should no longer go to internalisers
- Make the consolidated tape freely accessible, in a user-friendly way, to retail investors
- Start with bond markets
- Ensure it's governed by public authorities

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About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

INTRODUCTION

Available data and evidence show significant increases in the trading and investing activity of EU households, sparked by a new wave of young, previously inactive, non-professional investors. Many EU retail investors increased their exposure to listed equities and started to invest via execution-only services (brokerage accounts).

Besides flattening the illiquidity curve during the period of market turmoil of February-March 2020 thanks to their "contrarian" behaviour, retail investors offer a large source of long-term funding for the real economy, which will prove pivotal in the recovery from the COVID-19-induced economic effects. In fact, in jurisdictions such as the Netherlands, the majority of households invest themselves (through execution-only channels), which makes this topic all the more important.

As such, EU capital markets face a significant challenge: to make investing and trading on capital markets fair, simple, transparent, easy, and attractive for the new wave of individual, non-professional investors.

To ensure that investors enjoy optimal outcomes, EU capital markets must foster adequate price discovery and formation mechanisms, which can only happen through "lit" trading of "retail" orders (regulated markets and "lit" multilateral trading facilities). Retail investors must easily access pre- and post-trade data to be able to make informed trading decisions and, also, evaluate best execution on their orders. In practical terms, this translates to a consolidated tape that allows ex post verification of obtained prices and best execution deals by investors. Ex-post is a key element: there are risks to citizens as individual investors of including pre-trade in a real-time consolidated tape. A real-time tape containing pre-trade information would create an ecosystem that is ripe for arbitrage to the detriment of retail investors, like in the US. Such a scenario will make it increasingly difficult to take steps to ensure that retail investors get a good deal from European public capital markets. What matters is that individual investors can ex post easily and freely check their order have been executed in the best of their interests. Therefor all retail orders must be precisely time-stamped, traceable and include information on the precise market venue(s) on which the order was executed.

However, a recent report by BETTER FINANCE on the *Consumer Access to EU Equity Trade Data*[1] revealed that "*EU equity market data have become much less accessible and transparent*" for the average retail investor. Moreover, ESMA's assessment (November 2019) also revealed that many trading facilities did not fully comply with the applicable framework in what concerns delayed data publication.[2]

The pan-European consolidated tape[3] could bring several benefits for retail investors. Unfortunately, theory is far from the reality at the moment. The process should not skip

[1] See BETTER FINANCE's research on *Consumer Access to EU Equity Trade Data: A BETTER FINANCE Research & Policy Paper* (April 2021), BETTER FINANCE, available at: https://betterfinance.eu/publication/capital-markets-union-at-risk-as-european-retail-investors-have-less-and-less-access-to-equity-market-data/.

[2] ESMA Public Consultation Paper on Guidelines on the MiFID II/ MiFIR obligations on market data (6 November 2020) ESMA70-256-2477, available at: https://www.esma.europa.eu/sites/default/files/library/esma70-156-2477_cp_guidelines_on_market_data.pdf

[3] According to the European Commission's report on the consolidated tape, "***Consolidated data** refers to the collection of pre- and post-trade data derived from multiple sources across financial markets that is disseminated through a single, standardised, data feed*" – see Market Structure Partners, *The Study on the Creation of an EU Consolidated Tape: Final Report* (September 2020) European Commission, p. 12, available at: https://op.europa.eu/en/publication-detail/-/publication/82763219-1cbe-11eb-b57e-01aa75ed71a1/language-en; see also European Securities Markets Authority, *MiFID II/MiFIR Review Report No. 1: On The Development in Prices in Pre- and Post-Trade Data and on the Consolidated Tape for Equity Instruments* (5 December 2019) ESMA70-156-1606, available at: https://www.esma.europa.eu/sites/default/files/library/mifid_ii_mifir_review_report_no_1_on_prices_for_market_data_and_the_equity_ct.pdf.

essential steps before advancing towards a consolidated tape, otherwise risking to further damage EU market structures and retail investors.

In our view, there are policy and supervisory actions that need to be taken beforehand in order to address current inefficiencies in the market, most notably re-increasing trade transparency and consolidating the EU market. Moreover, the consolidated tape should not endanger competition in favour of price-taking execution venues in the EU as this would lead to a further deterioration of "lit" trading and, ultimately, harm best execution outcomes for retail investors.

POLICY RECOMMENDATIONS

Ensure that the consolidated tape does not distort competition in favour of opaque, non-transparent internalisers

Price discovery and formation is a mechanism by which issuers (sellers) and investors (buyers) interact and, based on accumulation of information (such as fundamental analysis or market data) adequately evaluate assets and obtain optimal transactions or investment returns. The stronger the price formation mechanism is, the better capital markets function, ultimately benefitting households and the real economy.

In the EU, trade orders (buy/sell) can be executed on two types of venues: *price makers* and *price-takers*. Price-making venues are those where investors publicly interact and directly trade with one another, thus competing for the best prices as trading is governed by fair, orderly, and non-discriminatory rules (Art. 51 MiFID II). Due to **transparency obligations**, these venues set the market price for assets.

Price-takers are investment firms that interpose between investors, acting as a buyer for sellers and then as a seller for buyers. These firms use reference quotes from securities exchanges (such as regulated markets) to execute trade orders for their clients. Nowadays, bilateral trading forms a very large part of all trades (by turnover) in the EU, leaving price-makers to lag behind (see chart in the next section). Given that the quality of post-trade data from bilateral trading venues is of poor quality, aggregating and making publicly available all post-trade data in the EU will favour non-transparent venues, such as systematic internalisers and over-the-counter (OTC) trading. Moreover, the EU market structure ecosystem is composed of many small securities exchanges at national level (such as the Ljubljana, Athens, Sofia stock exchanges) which will be required to open and provide their data in favour of bilateral trading facilities, further improving their dominant position on the market at the expense of a level playing field to be pursued.

The consolidated tape could have many use cases and benefits for retail investors, but not under the current market conditions, especially from a regulatory and supervisory point of view. If these frictions are not addressed before moving to the consolidated tape, the EU risks of distorting competition on securities trading in the EU, which will ultimately harm EU households.

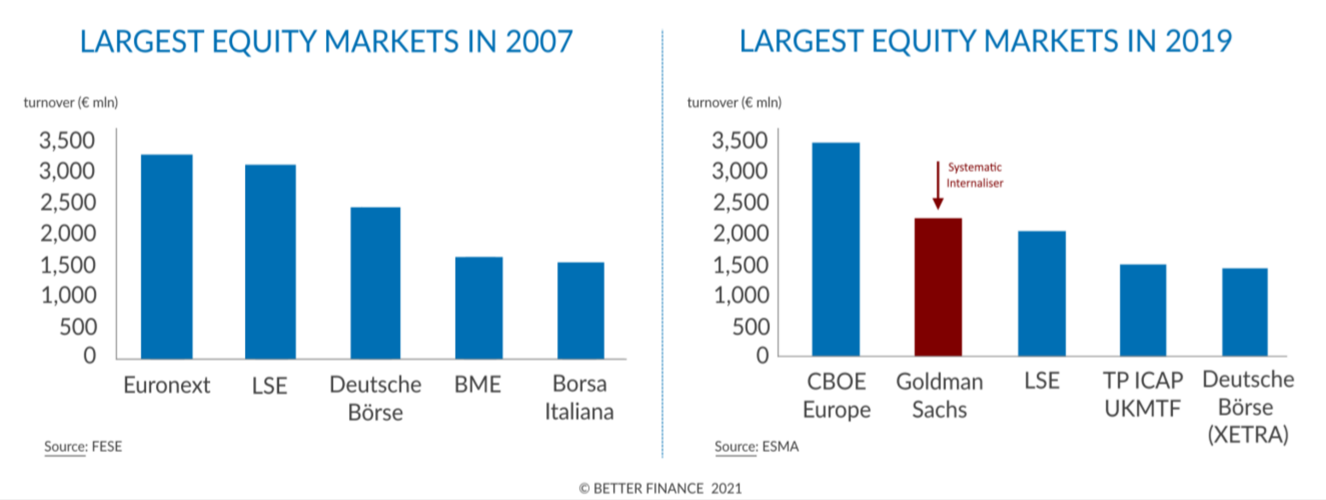
Significantly increase transparent ("lit") trading in the EU

The current regulatory framework (defined by MiFID II and MiFIR) were established with the purpose of creating "*more robust and transparent*" financial markets in the EU.[4] Unfortunately,

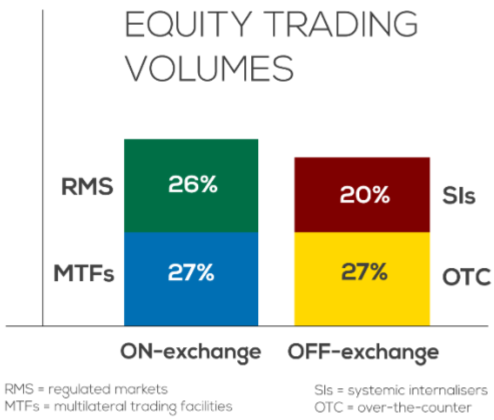
[4] According to the European Commission, 'Summary Legislation: Better Regulated and Transparent Financial Markets' (20 April 2017), accessed 10 November 2021, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:240405_3.

after the entry into force of MiFID II and MiFIR (January 2018) the transparent EU-based regulated markets have seen their share of European equity trading to only about 18% by 2019.[5] The beneficiaries of this trend have been the opaque, less transparent and less retail investor-friendly market venues that are not headquartered in the EU. At the same time, while listings and IPOs have not increased, local securities exchanges did not grow, but instead the already existing markets have become more and more fragmented.

Infographic 3. European Equity Market Leaders (2007-2019)



In very few years, two US-based operators owned by very large US financial institutions have become the top EU equity market operators in lieu of the EU-based "lit" markets. Non-EU-based financial firms have replaced the EU-based "lit" equity markets which are more transparent and friendly to individual investors and SMEs. In terms of the total volume of equity trading in the EU, off-exchange (bilateral trading) takes almost equal to on-exchange ("lit", or multilateral trading) for equity instruments: 47% vs 53%.



Source: BETTER FINANCE composition based on data from the ESMA ASR (2020), p. 10

The upcoming reform must restore the pre-MiFID II state and significantly improve "lit" trading in the EU before moving to a consolidated tape.

[5] The actual figure published by ESMA in its Annual Statistical Report on Securities Markets (November 2020) specifies 26%, but the London Stock Exchange (which was excluded as it is no longer an "EU-based" RM) was worth 7%, thus the figure for "EU-based" lit markets is 18%; see ESMA Annual Statistical Report on EU Securities Markets (18 November 2020), ESMA-50-165-2020, pp. 10 and 51, available at: https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf. However, the data on securities markets available from a public authorities – at the time of writing the report – is the previously quoted report, which seems to include UK volumes and figures as it dates to the end of 2019; BETTER FINANCE relies on publicly available data from public authorities and, as such, there is no updated data series for 2020 and 2021 yet published.

Reduce market fragmentation

Data from ESMA registers at the end of 2019 shows a total of 430 trading venues registered in the EEA: 135 regulated markets, 223 multilateral trading facilities and 72 organised trading facilities,[6] to which we must add the 216 systematic internalisers.[7] This "*high fragmentation*"[8] increases the complexity of the European equity markets and one can question how this could help ensure cost optimisation and improve liquidity. For bonds, ESMA reported 277 trading venues, but the entities with the largest trading activity were systematic internalisers for all types of bonds (sovereign and corporate). [9]

Retail flows should no longer go to internalisers

Systematic Internalisers (SIs) are a form of non-transparent bilateral trading organised by investment firms (such as investment banks[10]), which have significantly proliferated after the entry into force of MiFID II. From a mere 14 SIs registered in the EU before 2018, in May 2021 there were about 222 registered in the EU. Due to the rise of new brokerage models promoting "*zero commission*" trading – compensated through payment for order flows – large volumes of retail orders are now routed and executed on SIs. As early as 2001, stakeholders highlighted their concerns for "*the capture of retail flows in broker systems and the migration of institutional turnover to crossing networks*".[11]

Of the five largest markets (for equity instruments) in the EEA, ESMA data showed that 29% of equity trades (by volume) took place on SIs, 34% on regulated markets and 37% on multilateral trading facilities.[12] The top four largest SIs in the EEA summed up equity trades up to €3.4 trillion by 2019, which account for 18% of the total equity trading in the EEA and 70% of all SI trading in the EU.[13]

Besides the inherent issue on how internalisers obtain the retail flow,[14] there is also a conceptual problem with retail investors' interests. In short, internalisers thrive from being able to obtain a lower buy price and selling at a higher price, thus increasing the bid/as spread. The problem, conceptually, is that the spread is owned (and benefits only) the internaliser, whereas on multilateral trading the spreads, no matter how high, are mutualised and owned "by the market". As such, investors would benefit directly and indirectly from such spreads. In addition, Internalisers are often the ones paying for retail order flows (PFOF), a practice that is most likely to the detriment of the best execution of such orders.

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[6] ESMA Annual Statistical Report on Securities Markets (November 2020), p. 18, available at: https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf, p. 10.
[7] See the ESMA ASR on Securities Markets (p. 10), available at: https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf.
[8] ESMA Report, p. 18.
[9] ESMA ASR, p. 10.
[10] ESMA remarked that the tendency of SIs to be set-up and operated by large investment banks [AN: non-EU] is confirmed by the top four by volume in 2019: 70% of the value of SI equity trades took place on four venues operated by Goldman Sachs, Barclay's, Morgan Stanley and Credit Suisse – ESMA Report, p. 19.
[11] See European Central Bank, *The Euro Equity Markets* (August 2021), p. 41, available at: https://www.ecb.europa.eu/pub/pdf/other/euroequitymarketen.pdf.
[12] According to ESMA data of the graph ASR-MiFID.S40 from the ESMA ASR on Securities Markets, available at: https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf.
[13] Based on ESMA data from the ESMA ASR (2020).
[14] Discussed more at length in the BETTER FINANCE's *Evidence Paper on Banning Inducements* (November 2021), BETTER FINANCE, available at: https://betterfinance.eu/Inducements-paper-2021.

Make the CT freely accessible, in a user-friendly way, to retail investors

BETTER FINANCE highlighted the difficulties for the average individual, non-professional investor of accessing post-trade market data from the websites of several leading equity trading venues.

Practices meant to circumvent the legal obligations or deter non-professional investors from accessing such data should be sanctioned and ESMA should work to further improve guidelines for operators in terms of accessibility and user-friendliness. As such, the rules on the post-trade data should first be adequately enforced before moving to a consolidated tape which should be governed by the same rules.

In practical terms, a consolidated tape is only of value if it allows ex post verification of obtained prices and best execution deals by investors. In addition, the quality of data (precisely time-stamped trade execution receipts with the possibility to identify all market venues) will also be key for a functioning and efficient consolidated tape.

Start with bond markets

Transparency-, liquidity- and retail access-wise, bond markets are much worse than equity markets. According to ESMA data, only a quarter (24%) of bond trading takes place on "lit" markets (regulated markets, multilateral and organised trading facilities), whereas 26% are executed on systematic internalisers and 50% over-the-counter.[15] EU households' listed bonds assets are down 38% since 2015, the starting year of the CMU initiative. The upcoming MiFID II and MiFIR reform should ensure that transparency and consolidation of trade data starts with bond markets.

Ensure it's governed by public authorities

To "Work for the People", the consolidated tape provider must be a single, public (preferably EU) or publicly supervised (like in the US) authority or independent organisation. A solid governance system must ensure the quality and availability of data at all times. The distribution of revenues from the consolidated tape to market participants should be equitable and free access must be ensured for retail investors.

[15] ESMA ASR, p. 10.

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