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Nordic Securities Association - Position on the ESMA Technical Advice on MiFID II and MiFIR

Summary

The Nordic Securities Association (NSA) welcomes the ESMA's Technical Advice on MiFID II and MiFIR. Appropriately calibrated technical rules will provide a basis for sound development of European capital markets. The most important policy issues for the NSA are:

- **Equity markets transparency –**There is a clear need to create a harmonised EU-level framework for internationally traded shares (blue chip shares) and other similar instruments. On the contrary new rules should not classify shares of small and medium sized companies artificially "liquid" as this would have negative impact on liquidity.
- **Need to dismantle market data monopolies. –** MiFID I has successfully opened EU regulated markets for competition. However, there is pressing need to dismantle prevailing market data monopolies to facilitate a true Single Market for trading.
- **Treatment of financial research.** – The NSA is concerned that ESMA´s approach could have number of unintended consequences on availability of high quality financial research and have negative impact on SME equity and notably bond research.
- **Client assets. –** The EU should have a consistent treatment of safeguarding of client assets. Core rules should be based on Level I text and not on delegated legislation.

Investor Protection

General remarks

The NSA supports creation of harmonised and clear rules on investor protection. The EU Rulebook should provide a consistent and coherent approach regarding financial consumer protection. In this respect the NSA is concerned of the overlapping EU legislation. MiFID II, PRIIPS, UCITS and other dossiers are not adequately coordinated on the level of technical regulation (ie. delegated acts and ESMA´s technical standards). In the end rules on information on costs and financial instruments as well as on product governance might be contradictory or overlapping. An in-depth analysis by the Commission on the subject would be needed.

The Commission should also look into the cumulative effect of different reporting obligations within MiFID II. This could include areas such as suitability reports and minutes on client orders. As stand-alone requirements these would not be an issue to investment firms but the cumulative effect is particularly burdensome to smaller investment firms with less client volumes.

Enhanced quality for the investors via inducements

The NSA welcomes ESMA's approach on the quality enhancement test. It is important that the final rules enable the so-called open architec-

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ture model and providing services and products in more sparsely populated areas than big cities. It needs to be kept in mind that the quality enhancement requirements cannot lead into a de facto obligation to offer independent investment advice. The NSA is also concerned that the text of ESMA´s advice is unclear in this respect.

The treatment of financial research

The NSA is concerned that ESMA's approach could have number of unintended consequences on availability of high quality financial research. There has not been proper and wider policy debate on how new restrictions might effect on research in EU28 countries. Introduction of such a complex regime on Level II is going beyond what was agreed on Level I.

In the context of Capital Markets Union, the Commission should make an in-depth analysis on macroeconomic effects on Small and Mid Cap listed companies. In the end untested rules aiming at investor protection might prove contradictory vis-à-vis EU Growth and Jobs Agenda.

According to the Advice, the NSA feels that research will become a tradable asset which will lead to advice being auctioned off to the highest bidders on the investor-side. This will be a logical commercial consequence of proposals. Leading international investment banks have already started to market their analysis.

The NSA highlights that the Advice does not address the issue when research would be considered as minor non-monetary benefit. Based on ESMA's earlier interpretation the research that would be intended for wider distribution and accessible for large number of persons, would be classified as permissible minor non-monetary benefit. The NSA is of the firm view that this kind of research would not and should not be considered a benefit at all.

It is crucial that any new regime, introduced despite the EU Wide concerns, is workable. For example requirement to seek written agreement from each client will result in a de facto ban to use client resources to purchase research. This will affect the coverage of companies throughout Europe and in particular the SMEs.

The NSA believes that "unbundling" requirement only applies in relation to commission based trading, i.e. only for equities research under the current market structure. This needs to be clarified in the forthcoming delegated act.

Finally the Commission should address complex VAT issues that will derive from the separation of research from dealing commissions. There is a risk that a new regime would create an un-level playing field for discretionary portfolio management if there is not a coordinated approach on interpretation of VAT treatment.

Client information

Professional clients and eligible counterparties

In regards to the scope of the cost disclosure requirements the NSA is disappointed to see that the scope of automatically including professional clients under the same regime has not changed since the consultation that took place in the summer 2014. Seeing that professional clients and eligible counterparties should be considered, already as a starting point, to have sufficient knowledge and expertise to appreciate the risks concerning their investments, it is not unreasonable to state that these clients should be able to agree to a limited application of the

Nordic Securities Association

information disclosure requirements irrespective of the services provided.

In addition, more stringent requirements could have an adverse effect on market efficiency by slowing down the trading process. This could make some professional clients avoid doing business in the EU in the future. Also, many investors become professional in order not to receive all the information. We naturally accept the fact that some of the more stringent rules follow directly from Level I (MiFIR Article 30). However, where this is not the case, we see no reason to add more rules for professional clients on Level II. Thus we fully support any proposals by ESMA to take professional clients and eligible counterparties out of scope of the detailed information requirements. Opting out by means of agreements is not a workable solution either, as this would add unnecessary red tape.

Costs and charges

The provisions on costs and charges are extremely detailed and will be very burdensome and costly to implement. It is therefore important to ensure that the requirements can be justified from a cost/benefit perspective and that the rules are clear. Investment firms must be able to use KID and KIID to fulfil their obligations under MiFID II. From a practical perspective, we are also concerned with the requirement to use "reasonable estimates" to determine point of sale costs.

Furthermore and regarding disclosing point of sale costs as a cash amount seems unworkable. Given that at the point of sale only the investment sum, but not the investment outcome at the end of the charging period, can be specified, investors cannot be informed in a reliable manner of the amount of fees and charges that depend on future conditions and actions. It should be clear that disclosing a cash amount in such circumstances provides only a false accuracy that will never produce correct results.

Finally, it is important that the concept of "in good time" is not interpreted in a way by NCAs so as to make certain distribution channels impossible e.g. internet and telephone.

Telephone recording

Clarification is needed as regards to internal calls. A requirement to record internal calls can, in our opinion, only be accepted for internal calls when "trading on own account". It would be far too costly and burdensome to record all internal calls regarding client orders. In order for recording requirements to apply for calls relating to client orders, we believe that the client must be part of the conversation. Otherwise the requirement would create strange circumstances where investment firm staff cannot discuss client orders face to face, but need to resort to phone. Moreover, we are concerned with the provision that clients would be entitled to get a copy of the recordings. As a minimum, the Level II rules should specify that the client must be able to identify which day and time the conversation took place and with whom.

Independent advice cannot have spill-over effects

It is very important to secure that the provisions on independent advice do not have spill-over effects on other investment advice. The investment firms need to have an actual chance to choose whether they are giving advice independently, without accidentally being categorized as independent. Quality enhancement test on allowed inducements cannot lead into de facto obligation to offer independent investment advice.

Product governance rules need to be fit-for-purpose

ESMA has made some amendments to its original proposal on product governance, which the NSA supports. For example, it has been clarified that the "target market" for plain vanilla products (shares and some UCITS) can simply be "retail clients". However, there are still quite a few proposals in the advice regarding product governance which we believe could be difficult to comply with and which will have unintended consequences. One such example is that the distributor should enter into agreements with non-MiFID manufacturers also for secondary market transactions (e.g. state treasuries and listed companies).

Also the requirement to identify "any groups" of investors for whose needs, characteristics and objectives the product is not compatible with is a very strange requirement as this group would typically be all clients not included in the target market (item 10). The NSA proposes that these requirements (in items 9 and 10) are deleted. We are also concerned with requirements on distributors to share sales information with an external manufacturer since this could be very sensitive from a competition perspective. Finally, as mentioned above it is important that the Commission further analyses the interactions between product governance requirements and PRIIPS in order to avoid that that the overlapping and uncertainties cause unnecessary operational risks.

While ESMA acknowledges that the distributor's obligation to report sales to the manufacturer does not mean that every sale is reported, the more generic examples given by ESMA (in paragraph 14 of the Background/Mandate) should be reflected in paragraph 25 of the Technical Advice, which currently states only that "Distributors shall provide the manufacturer with sales information". We are pleased to see that ESMA does not require a distributor to take any pre-determined action when they become aware of an event that could potentially affect the risk of the identified target market, but requires "appropriate action". This is in line with the principle of proportionality.

Consistent and proportionate rules on safeguarding of client assets

The EU should have a consistent treatment of safeguarding of client assets. Core rules should be based on Level I text and not on delegated legislation. At the moment there are increasing concerns that the EU is applying a silo-based legislative technique based on ESMA's sector specific rules on Level II. As a result, there is a risk that new EU regime complicates the provision of collateral and creates general legal uncertainty. It should be noted that for instance Directive 2002/47/EU on Financial Collateral Arrangements aims to reduce the administrative burden on provision of financial collateral.

The NSA notes that the Commission's request for technical advice seems to be significantly wider than the relevant provisions in article 16(8)-(10) and the empowerment in article 16(12) of MiFID.

The Level I text is clear on that an investment firm shall not conclude title transfer financial collateral arrangements (TTCA) with retail clients. However, proposed rules on TTCAs for non-retail clients and the special rules for Securities Financing Transactions are, in our opinion, unnecessary and will create overlapping and confusing regulation.

Nordic
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Referring to the on-going discussions in EGESC Committee[1], the NSA strongly questions whether Level I mandates ESMA to introduce limits of intra-group deposits of client funds. According to the technical advice, deposits of client funds by an investment firm at a third party within its own group (intra-group deposits) are limited to 20%. Even if this regime is in place in some EU Member States this should not be introduced on MiFID Level II.

We find that the technical advice goes beyond Level I as there is no specific mandate on intra-group deposits, let alone on quantitative limits. It is a general duty of an investment firm to consider diversification of client funds. Therefore the final delegated act should require an investment firm to *consider* diversification in case there are significant client balances and no other relevant safeguards in place. There is a strong case for holding cash with a bank group if it has a better credit rating than other banks and/or there are benefits in terms of coordination, or other efficiencies.

Transparency [2]

Liquid equities should consist of blue chip shares

The concept of "liquid market" is central under MiFID II. The transparency regime is dependent on whether a share or other instrument has a liquid market or not. The NSA agrees that there is a clear need to create a harmonised EU-level framework for internationally traded shares (blue chip shares) and other similar instruments.

On the other hand, MiFID II should capture only instruments that are truly liquid. It should be noted that within EU28 markets majority of instruments listed on a MiFID regulated market are relatively illiquid. Notably this is the case for SME companies. If illiquid instruments are artificially labelled as "liquid" there is a risk that increased and complex transparency requirements (double cap mechanism and other restrictions) paradoxically reduce liquidity even further. As a result the MiFID regime could have adverse impact on SME financing.

Market data

Need to dismantle market data monopolies – Transparency is not adequate – Raw data pricing must be regulated in order to ensure competitive pricing of processed data

MiFID I has successfully fostered competition between EU trading venues. Trading costs have reduced significantly. However, there is still an urgent need to address monopolistic structures in the market for market data

The Commission has stated in their request for advice that market data prices are too high. The NSA agrees. Although transparency requirements are of importance to ensure that venues treat customers equally and fairly and pricing practices become more comparable over the

[1] See. Draft Summary Record of the 9th Meeting of the Expert Group of the European Securities Committee, 13th of January 2015 p. 3.

[2] This Paper Policy paper focuses only on transparency related to equity markets. We have provided a more detailed paper on non-equity transparency.

time, transparency alone **will not** create reasonable pricing since market data products cannot be substituted (market data from venue A cannot be substituted with market data from venue B). Therefore, the Copenhagen Economics suggestion with a cost based price cap on the entire order book and post trade data in raw data format should be imposed (LRIC+).

These measures will imply that **pricing of market data to final consumers will be according to reasonable commercial basis**, as new and existing data vendors (including trading venues) will compete by offering value added data products based on the price regulated raw data from the trading venues. In short, regulating prices on raw data level will **imply competition on processed data level**.

There will of course be some administration and compliance costs with such a model, primarily in the initial process of constructing the LRIC model, but these costs are much less significant than in other regulated industries such as telecommunications and energy distribution where markets and cost structures are much more complex and difficult to disentangle. Even more important, these costs will be lower than the current cost incurred on the market data consumers. Market data consumers are currently spending an enormous amount of resources ensuring that a myriad of complex terms of conditions attached with market data consuming are met.

Microstructural issues

Direct Electronic Access (DEA)

The NSA agrees with ESMA that it is important to clarify what is Direct Electronic Access (DEA) and how it is differentiated from other electronic order transmission systems. The NSA fully supports the interpretation, that common on-line brokerage systems should are not DEA systems in the MiFID II context.