BUSINESSEUROPE

POSITION PAPER

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MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID II) MARKETS IN FINANCIAL INSTRUMENTS REGULATION (MIFIR)

Introduction

BUSINESSEUROPE has long been a supporter of MiFID and its objectives and has previously provided input throughout the development of the new rules, supporting transparency and stability in financial markets and emphasising the importance of ensuring that the rules are supportive of European businesses. BUSINESSEUROPE especially supports MiFID II's provision of a new category of market to provide access to capital for small and medium-sized businesses.

The encouragement of the development of specialist markets that cater for the needs of small and medium-sized issuers is a welcome prospect. BUSINESSEUROPE supports ESMA's principle-based approach to implementing measures that encapsulates a set of principles and regulatory objectives and leaving it to national competent authorities' discretion to determine whether market operators in their jurisdiction offer an appropriate operating model and, consequently, whether particular markets should be registered in the new category of SME-GM.

BUSINESSEUROPE would however like to raise some issues we believe ESMA should consider throughout the Level 2 process and the development of its technical advice:

- Pre- and Post-trade transparency requirements must not undermine the ability for businesses to access the services they need.
- Thresholds for instruments traded on an organised trading facility (OTF) that are able to operate under the SSI waiver need to be applied on an instrument-by-instrument basis.
- Exemptions aimed at non-financial companies (NFC) on "ancillary activities" and "trading for own account" need adjustments to reflect business realities, and certain definitions require clarifications.
- Contracts that do not have the characteristics of financial instruments, such as commodity contracts that are physically delivered or settled, should be exempted.
- The use of bank guarantees by non-financial companies as collateral for central counterparty (CCP) clearing should not be dependent on the guarantees being fully backed with highly liquid assets.
- Position reporting in commodity derivatives should tap existing data in the European Market Infrastructure Regulation (EMIR) trade repositories to avoid costly duplication of reporting infrastructures.

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Pre- and Post-trade transparency requirements must not undermine the ability for businesses to access the services they need.

Transparency, operational efficiency and liquidity are all features of well-functioning financial markets and constitute important pre-requisites for companies seeking to finance their business through capital markets. An inappropriately calibrated transparency regime would result in increased borrowing costs for corporate bond issuers, disincentivising issuance contrary to the objectives of the European Commission. Furthermore, legitimate hedging needs for operative businesses of non-financial companies could be harmed through adverse pricing effects.

These markets should also be able to provide access to products that enhance the stability and efficiency of financial management and help companies to reduce and manage risks associated with their underlying commercial business. MiFID/MiFIR's primary focus on the investment sector should be borne in mind throughout the development of ESMA's technical advice to avoid disproportionate impacts on other sectors.

If not calibrated appropriately, the pre- and post- trade transparency requirements have the potential to significantly depress liquidity and undermine transparency. In illiquid or episodic markets where an instrument trades infrequently, pre-trade transparency would be largely irrelevant and potentially misleading because market and economic conditions could have changed materially since the date of the last transaction. Careful calibration of pre- and post-trade transparency is essential to preserve liquidity, an incorrect balance of what is displayed to the public risks liquidity drying up in certain asset classes because liquidity providers would expose them to undue to risk. In turn, this may mean that end-users may not be able to tailor hedge some of their exposures.

It should be noted that non-equities comprise a diverse range of asset classes that are differentiated in many different ways, including issuance size; maturity; tenor; notional currency; and settlement currency. Ensuring a sufficient granularity in the regulation, at instrument-level for bonds and dynamic calibration (i.e. appropriate for the life cycle of an instrument e.g. monthly calibration), is key in determining whether a certain product qualifies as 'liquid', requiring certain pre-trade disclosures and the level at which to set pre-trade transparency waivers.

In regard to post-trade deferrals, it is important that the volumes of transactions in illiquid instruments and liquid instruments are omitted for a certain period of time. This is consistent with the omission of volumes in the TRACE system in the US. Without this omission, the potential for hedging and issuing costs to increase for businesses is likely as financial institutions will be forced to charge more for their risk management products and as market makers will be discouraged to commit capital. We further believe the proposed waiver time frames are much too short especially for "illiquid" and "large in scale" transactions, which are important to NFC customers.

Thresholds for instruments traded on an OTF that are able to operate under the SSI waiver need to be applied on an instrument-by-instrument basis.

In setting thresholds for instruments traded on an organised trading facility (OTF) that are able to operate under the size specific to the instrument (SSI) waiver, ESMA should consider using a risk-based methodology, which is determined by the risks the waiver is intended to calibrate. BUSINESSEUROPE notes that there should be different thresholds for pre trade and post trade waivers because there are greater risks for pre trade transparency. It would not be appropriate to calibrate such threshold simply as a percentage of the large-in-scale waiver as ESMA proposes in the discussion paper. The SSI waiver by its very nature needs to be applied on an instrument-by-instrument basis. If ESMA does not take this into account, then liquidity providers may pull out of certain asset classes leaving end users either unhedged or facing restrictions in their hedging options.

Further, any requirement for dissemination of pre-trade data beyond the membership (i.e. the 'wider public' as described in the discussion paper), could have adverse effects on competition by encouraging venues to trade illiquid products whilst simply routing to other venues for liquid products whose prices discovery is fully visible to anyone concerned. To incentivise venues to continue trading a variety of products, they should thus be allowed to charge for pre-trade data and make them available to the public only on condition of restrictive onward use.

Exemptions aimed at Non-Financial Companies (NFC) on "ancillary activities" and "trading for own account" (Art. 2(1) MiFID) need adjustments to reflect business realities, and certain definitions require clarifications.

An "ancillary activity" exemption is proposed comparing capital employed for non-hedging activities with other (operative) activities. Capital employed is a concept from the financial world which is not used in the context of industrial companies, which mostly do not allocate or measure capital for treasury activities. For NFCs that are far away from the proposed levels of "trading activities" (<50% of overall activity) there should be an easier way to claim this exemption – irrespective of company size.

Under MiFID I corporate end-users of derivatives benefited from own the account dealing exemption. MiFID II limits this exemption where a person is a "member" of and has "direct electronic access" to a trading venue. As a result, end-users may need to seek authorisation as an investment firm under MiFID II, meet its compliance requirements and also face more stringent obligations under EMIR. They would either need to incur serious costs or limit their use of derivatives for the purposes of hedging. Therefore, BUSINESSEUROPE urges that these definitions should be defined narrowly and clearly to ensure that end-user customers who access platforms, usually electronically, maintain the current exemption.

The use of bank guarantees by non-financial companies as collateral for CCP clearing should not be dependent on the guarantees being fully backed with highly liquid assets.

Currently, non-financial companies may use bank guarantees as collateral for CCP clearing without the guarantees being fully backed. In fact, the platforms consider bank guarantees as flexible collateral which can easily be increased/decreased. This supports the use of transparent trading platforms in markets rather than bilateral non-transparent trading where the use of bank guarantees does not have to be fully backed either. If bank guarantees would have to be fully backed, this would increase the costs of risk hedging adding further costs to end-users. Bank guarantees have limited market risk as issuers are evaluated in terms of credit worthiness and continuously monitored and EMIR already includes detailed requirements regarding the use of bank guarantees.

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