Article James McKeone, Eurofi February 2022, Paris

A tape is no silver bullet for EU markets – it could do more harm than good

The EU is once again updating its financial markets regulatory framework, known as MiFID/MiFIR. This is an important endeavor that will have long-term effects on the functionality and competitiveness of European financial markets. One of the triggers for this revision is that despite the clear political will for increased market transparency, since the last reform, EU markets have in fact become darker.

Transparent markets are crucial in bringing end-investors and companies together, and in providing companies with access to capital. They also protect investors. By allowing all investors to trade listed financial instruments and ensuring a quality price formation process, exchanges and other transparent markets ensure a fair and verifiable outcome. This is key to well-functioning capital markets and justifies the need to promote and preserve an adequate price formation process.

The proportion of dark trading in the European market is disputed. This is primarily due to the lack of undisputable information about transactions that have happened on various venues active throughout the continent. By comparison, details about the price and execution of transactions happening on transparent markets are easily accessible. This is indeed not the case for trades executed by banks in their internal systems and OTC. A consolidated tape aimed at creating an overall picture of trading happening throughout the European continent would be an important step forward and would allow investors small and large to verify execution quality and to consistently identify venues where the best price can be found.

However, this is not what the European Commission is proposing.

In addition to advocating one post-trade consolidated tape per asset class (shares, ETFs, bonds & derivatives) able to give a full coverage of trading (this is good!), the European Commission proposes to establish a real-time post-trade tape of core market data for shares, leaving the door open to a pretrade consolidated tape in the medium term. This constitutes a significant threat to European transparent markets and the financing of the economy.

What would make more sense is an EU consolidated tape that creates a consolidated view of all transactions that have happened on the various venues and markets across the EU - a post-trade tape. Moreover, this tape should be delayed to allow for a proper sequencing of transaction data. Given the scattered geography of Europe and the multitude of execution mechanisms that will publish transaction data with a different time span, a real time post-trade tape would not show transactions in sequence and the publication of time stamps would not help in this respect, unless the tape is delayed.

What would be equally inappropriate is an EU tape that would want to show quoted prices in the markets i.e., a pre-trade tape. Because these prices would not be accessible to all viewers at the same time, the tape would become misleading. Some market participants will have faster access to prices and in reality, the liquidity shown on the tape will no longer be available – this is a problem that the U.S. tape is facing and that regulators there are currently looking to address.

A badly calibrated EU tape can seriously hurt transparent markets in favor of dark trading. Contrary to the US model, the revenue model proposed by the Commission is unlikely to adequately remunerate transparent markets for the data that they contribute. The model envisaged requires transparent marketplace operators to provide real-time data for the EU tape, free of charge, while the industry has no obligation to consume the same data. Consequently, it is likely that the revenues of the EU tape would only cover its functioning, leaving transparent markets with revenue losses and investment challenges – and all to support a tape with very little added value to the wider financial eco-system and that does nothing to improve the functioning or transparency of financial markets. The EU tape needs to strike the right balance between being useful & valuable to market participants, whilst not undermining transparent markets. An End of Day tape, or a 15 minute delayed tape, can achieve such a balance. The voices arguing that anything but a real-time tape would not deliver an improvement to transparent markets need to consider that a real-time tape will never be truly real time. Market players that have the technical capabilities to overcome latency issues will benefit- to the cost of small firms that do not. The use cases that have been highlighted favor a delayed post trade tape if we are to deliver a tape that is truly useful to all market participants.

The consolidated tape is no silver bullet to promoting transparency in EU financial markets. What is needed is an appropriate reform of the EU market structure and we trust the legislative process will refocus the text and create a market structure that allows European capital markets to thrive and support economic growth and job creation.