Deutsches Aktieninstitut

MiFID-Review: Better Regulation for efficient Capital Markets

Improve the Framework for a stronger Ecosystem supporting the financing and hedging needs of the Real Economy

Answers to the Questionaire prepared by the European Commission, 18 May 2020

Answers to selected Questions

General questions on the overall functioning of the regulatory framework

Question 1.1 Please explain your answer to question 1 and specify in which areas would you consider the opportunity (or need) for improvements:

From the perspective of non-financial companies using capital markets for financing and hedging purposes we consider the following points as opportunities for improvements:

Regarding derivative markets the ancillary activity exemption could be simplified as especially the market size test is difficult to apply for reasons of lacking data availability. The introduction of a qualitative commodity markets exemption for non-financial companies could provide a simple, efficient and robust longterm solution, and ensure that all non-financial companies active in the commodity markets and commodity asset classes are treated in a similar manner and create a level playing field vis-à-vis third countries. It would also relieve non-financial companies as they are no longer obliged to notify the respective supervisory authority annually as regard the exemption. Furthermore, we think that waivers and exemptions from the transparency requirements especially for derivatives used by non-financial companies for hedging purposes should not be adjusted. In addition, the scope of the position limit regime should be limited and the respective hedging exemption should be extended. Lastly, we do not see any need of supervisory authorities to extend the regulatory scope as regards FX spot transactions.

Related to the equity markets we see the need for improvements in the current investor protection regime. Due to an excessive regulation investment firms more and more refrain from offering shares in their investment advice and reduce their range of other products like corporate bonds, UCIT funds and index ETFs. Due to the documentation processes clients are often annoyed by lengthy investment advices. The introduction of a "semi-professional" client, who is enabled to waive certain or all protection requirements, could solve this problem. Under the PRIIPs regulation the legislator should clarify that all corpoarate bonds are not within the scope. Furthermore, an exemption for SMEs from the research unbundling rules is of utmost importance to restore research coverage for smaller issuers on a "pre-MiFID-level". In addition, MiFID should ensure a transparent and fair pricing process in liquid financial instruments in equity markets, which is a pre-requisite that investors are willing to provide companies capital for investments in growth and employment.

Question 5. Do you believe that MiFID II/MiFIR has levelled the playing field between different categories of execution venues such as, in particular, trading venues and investment firms operating as systematic internalisers?

Our answer refers to the transparency on equity markets exclusively. The listing of shares on a stock exchange is an important source of capital to finance growth and employment for companies. A prerequisite for the willingness of investors to invest in shares and to provide capital for the company is the ability to sell the shares at any time at fair prices in the secondary market. For this purpose, liquidity and integrity on capital markets is of utmost importance to ensure that a fair price discovery process is available.

Besides respective transparency obligations, for example in the context of major share holdings, pre- and post-trade transparency should provide the issuer with the information on where and to what extent the shares were traded. In this regard, we very much appreciate the level of transparency that is in place on trading venues. Futhermore, the transparency regime for Systemic Internaliser should be reviewed in order to improve the efficiency and to ensure a level-playing-field in the overall share trading.

Question 6. Have you identified barriers that would prevent investors from accessing the widest possible range of financial instruments meeting their investment needs?

For corporate bonds the Regulation (EU) No 1286/2014 (Key information documents for packaged retail and insurance-based investment products – PRIIPs) turned out as a barrier for retail investors to meet their investment needs, although these instruments are assets that are held directly by investors and rightfully do not fall in the Key Investor Document (KID) scope under PRIIPs. Nevertheless, according to Börse Stuttgart, a German stock exchange focusing on retail investors, almost 50 per cent of corporate bonds are classified as PRIIPs.

As a result, issuers would have to condense a 100 pages (often more) prospectus into a 3 pager KID that will always be contestable and leaves the issuer with unbearable liability risk. This has already lead corporate issuers to exclude retail investors of those bonds that are likely to be considered a PRIIP, thus avoiding the question whether it is necessary to prepare a KID or not.

This limits not only the opportunities and investment scope of retail investors to invest directly and in a transparent, cost efficient way in investment grade corporate bonds. In addition, this deprives corporate bond issuers of a simple access to an important, diversified investor base for their funding needs that is considered “buy and hold”, i.e. adds to market stability.

To avoid these unintended side effects, we urge the legislator to clarify the scope of the PRIIP in the context of corporate bonds. In particular, the legislator should confirm that certain well-established standard terms and conditions do not turn corporate bonds into PRIIPs. Given that the definition of PRIIPs in Art. 4 relates to investments where the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor, the following features of a corporate bond should be considered for exemption from the PRIIPs-regulation:

- Caps and floors on the interest rate;
- Redemption rights of the issuer (e.g. customarily used “make whole clauses”, “par call clauses 3 months ahead of final maturity”, “clean up calls” or “M&A clauses”);
- Floating rate notes.

In addition, it is utterly important and good legislative practice to apply any rule only for those bond issuances after the implementation of such rule. An application of such rule to all bonds irrespective of time of issuance creates significant burdens and risks for all issuers, especially smaller issuers who do not have the ability to update their bond prospectuses issued in the past. It creates also a burden for retail investors, and their ability to trade their bonds issued before the date of the entry into force of the regulation.

I. The establishment of an EU consolidated tape

Question 7. What are in your view the reasons why an EU consolidated tape has not yet emerged?

From the point of view of our members, companies using capital markets for financing and hedging purposes, the reason why a CT has not emerged yet is very easy: There is no need for such a CT. Companies do not see a benefit besides additional cost for the implementation of a CT.

Question 30. Which of the following measures could in your view be appropriate to ensure the availability of data of sufficient value and quality to create a consolidated tape for bonds and derivatives?

Our answer focuses on derivatives used by non-financial companies for hedging purposes. The particularities of these instruments are acknowledged by the exemption of derivative transactions that are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity from the pre-trade transparency requirements according to Art. 8(1) MiFIR. To provide coherence in the legal text this provision should also be inserted in Art. 21 MiFIR regarding the post-trade transparancy for non-equity instruments.

This well-justified exemption acknowledges that OTC derivatives used by non-financial companies for hedging purposes – including contracts executed on MTFs or OTFs – are different from securities and in particular for shares: These are no fully fungible and standardized transactions; they are individually requested by customers when required. Like loan contracts, leasing contracts, saving account contracts etc. these derivative transactions are contracts bilaterally agreed between clients and banks. Trading of these “bespoke” derivatives in question on secondary markets does never take place.

There is also no investor involved who should be protected. On the contrary, especially for larger transactions or transactions referring to an illiquid underlying it is very likely that transparency distorts the price formation process to the detriment of the non-financial company. If an order is split up into smaller buckets (which is a common practice for larger and/or illiquid transactions), orders executed at a later stage will become remarkably more expensive. The reason for this is that it is unlikely that various companies demand an identical transaction at the same time. The supply side can therefore conclude that the split orders can be attributed to the same end-user, and bet against him. As a result, prices will increase which makes risk management more expensive.

In addition, to advocate for retention of the existing exemptions, we suggest harmonizing how NCAs implement the possible waivers. If some of them run stricter national regimes with less waiver applied, this is constructing unlevel playing fields across companies in the EU.

II. Investor protection

Question 31. Please specify to what extent you agree with the statements below regarding the experience with the implementation of the investor protection rules?

Regarding the regulatory burden, the costs for the implementation of the respective MiFID-rules were significant among investment firms. This holds also true for clients, especially corporate clients. After the enter into force of MiFID II our member companies, non-financial companies using the capital markets for financing and hedging reasons, struggled heavily with MiFID-related documentation provided by investment firms. This concerned in particular consent letters and other agreements regarding e.g. taping requirements, transparency, cost information, client categorisation or execution policies. Some investment firms incorporated the newly adopted MiFID requirements in their general business terms comprising up to 80 pages.

As investment firms requested the consent of the client in many cases, corporates had to evaluate carefully the information received. Matters were made worse by the fact that corporate clients were uncertain whether the paper forwarded was for information purposes only or required the consent. Bearing in mind that corporates have business relations to 20 or more investment firms the result was a paper overload of 2,000 pages and more. Furthermore, the distribution channels differed by investment firms, some used an outreach-platform, others e-mail, website or paper.

This client “information” caused a significant additional workload among corporates in terms of time and staff lacking any benefit regarding investor protection.

Question 32. Which MiFID II/MiFIR requirements should be amended in order to ensure that simple investment products are more easily accessible to retail clients?

Besides the above mentioned instruments, we would include stock listed shares in the categoriy simple and transparent products. Shares are easily accessible, traded in a fair and transparent manner on exchanges. Due to a huge bulk of requirements, the issuer is obliged to disclose information about its business model and events affecting the share price. The cost structure is simple and clear, as it merely comprises the bank provision as a fixed amount or a percentage of the market value, the trading costs and the costs for the bank deposit.

We agree with the statement above that simple investment products should be easily accessible for clients. Nevertheless, empirical evidence shows that this holds

not true in practice. Due to excessive regulatory requirements, in particular small and mid-sized investment firms abandoned its investment advice completely, especially in shares, or reduced their investment advice significantly in other instruments like funds. This alarming trend was re-inforced by the introduction of MiFID II causing significant cost-efforts in adopting the additional requirements associated with further legal and compliance risks. In addition, overformalized investor protection processes e.g. regarding the documentation is very time-consuming. Especially those retail clients frequently advised by banks have difficulties to see the benefit of the documentation procedure. They are more and more annoyed and complain about the extra time they have to spend when visiting their bank advisor. Furthermore, due to the regulation they have difficulties to access the products they wish to access.

It is not "one" regulation impeding access to simple products but the whole bunch of regulation. Therefore, we think that all of the requirements mentioned above should be amended. As an option, the "semiprofessional" investor as discussed below in the consultation paper could be allowed to waive one or all of these requirements.

Question 34. Should all clients, namely retail, professional clients per se and on request and ECPs be allowed to opt-out unilaterally from ex-ante cost information obligations, and if so, under which conditions?

As mentioned above (see our answers to Q 31.1 and Q 32.1) coporates spent many ressources handling the MiFID-related documents received by investment firms. As professional clients, they would prefer to opt out from specific requirements, while mainting the possibility to get the information they are benefitting from.

Nevertheless, as the information and documentation "overload" does not solely concern professional clients and ECPs, we welcome an opt out for all client categories. Alternatively, the introduction of the category "semi-professional" client associated with an opt out should also help to strike the right balance between the investor protection and the cost/burden issue.

Question 40. Do you consider that MiFID II/MiFIR can be overly protective for retail clients who have sufficient experience with financial markets and who could find themselves constrained by existing client classification rules?

Characteristics of "retail investors" are too broad to be covered by a one-size-fits-all approach. They differ regarding their knowledge, experience, number of investment advices they already received and therefore, regarding their information needs. This bears the risk that investors do not have access to the full range of

products meeting their needs (see e.g. our answer to Q 6.1). The level of investor protection should better reflect these specifics by introducing a category of "semi-professional" investors.

Question 42. Would you see benefits in the creation of a new category of semi-professionals clients that would be subject to lighter rules?

The benefits of the concept highly depend on its details. In order to facilitate the implementation of the new category among investment firms the definition of "semi-professional" should be as lean as possible. At least, it should be up to the investment firm to offer the category "semi-professional". Investment firms, who are not willing to implement the category, should be allowed to do so.

Furthermore, to be successful and applicable it should be easy to understand for retail investors. A possible way to consider this could be a comprehensive suitability test, which is conducted "one-off". Investment firms should not be obliged to repeat the test or to monitor whether the criteria are still met after the test. After having consented to be categorised as "semi-professional" the client should decide for its own, whether all or certain investor protection rules are applicable. It should be also up to the client to terminate the status "semiprofessional".

Question 43. What investor protection rules should be mitigated or adjusted for semi-professionals clients?

After the "one-off" suitability test and the classification as "semi-professional", it should be the client's choice to opt out from no, from all or from selected MiFID requirements as listed above.

Question 45. What should be the applicable criteria to classify a client as a semi-professional client?

We think that the main criteria defining a "semi-professional" investor should be the knowledge, experience and expertise of the investor. In this respect, the in-depth suitability test proposed above would be the leanest way to define "semi-professional" investors. As "suitability" is already a common MiFID-concept we think that this test should be preferable over the proposed knowledge-test.

Moreover, clients who work in the financial industry and, hence, comply with this requirement for a professional client (without necessarily fulfilling the other criteria) should be categorised as suitable for the "semi-professional" status leaving aside any further test.

As the portfolio value does not allow any conclusion regarding the expertise of the investor, this should not be a criterium. A minimum threshold for the financial assets would unwarrantedly exclude sophisticated, but lower-income investors from the category "semi-professional".

Question 46. Do you consider that the product governance requirements prevent retail clients from accessing products that would in principle be appropriate or suitable for them?

As described above simple products like corporate bonds, stock-listed shares and UCIT funds/index ETFs should be easily accessible for a wide range of investors to foster retail investments and to provide financing for the EU economy. Therefore, simple products should be exempted from the product governance requirements and the "target market" concept.

Question 48. In your view, should an investment firm continue to be allowed to sell a product to a negative target market if the client insists?

We deem the investor as ultimately responsible for his/her decision. If the investor wishes to purchase an investment product also he/she is duly informed that this product does not suit her/his investment needs, she/he should invest in this product without any restrictions. Anything else would be unjustified paternalism.

Question 53. To reduce execution delays, should it be stipulated that in case of distant communication (phone in particular) the cost information can also be provided after the transaction is executed?

Phone orders are often placed by investors in order to realise opportunities from a temporary investment window. As the timely provision especially of cost-information is difficult in practice it is often not feasible to place the order in due time. This is not in the interest of the investor. Therefore, it is necessary to allow the provision of cost information after the execution of the transaction. Furthermore, if the legislator adopts the concept described above, the "semi-professional" investor should be able to waive the ex-ante-cost-information at all.

Question 54. Are taping and record-keeping requirements necessary tools to reduce the risk of products mis-selling over the phone?

Taping of telephone conversation often raises privacy concerns among investors. Consequently, they agree with the taping requirement unwillingly or they refrain from phone orders at all. Therefore, the taping requirement should be deleted. At least, retail investors should be able to waive the provision by explicitly expressing their consent.

III. Research unbundling rules and SME research coverage

Question 58. What is your overall assessment of the effect of unbundling on the quantity, quality and pricing of research?

The introduction of the unbundling rules increased the cost pressure among brokers followed by a significant staff reduction. Inevitably, the quantity of research declined. This is especially a problem for SMEs. Today, after the introduction of the unbundling rules, SMEs have much more difficulties to obtain broker-coverage than before. Compared to larger stock-listed companies, where research is provided by brokers and thus largely available, many SMEs have to purchase research, a trend, which is significantly reinforced by the unbundling rules.

Furthermore, we got the impression that due to the cost issue broker replace more and more experienced analysts by analysts having less expertise. As a result, quality of research has declined.

Unfortunately, this trend contradicts the highly welcomed efforts of the European Commission to improve access to capital markets for SMEs and should be remedied as fast as possible.

Question 59. How would you value the proposals listed below in order to increase the production of SME research?

The introduction of an exemption of SMEs from the unbundling requirements should help the respective companies to extend their coverage on a “pre-MiFID-level”. We propose to define a SME (or Small Cap) being a company having a market capitalisation up to 1 bn. Euro. Obviously, these companies are most affected by the unbundling rules.

Furthermore, to facilitate the capital increase by an initial public offering, which will be of utmost importance especially after the Corona-crisis, we propose to exempt

the research unbundling of all companies irrespective of their size for a certain transition period, e.g. ending three years after the IPO. This would leave every company more time to implement an adequate IR strategy in order to reach investors in an efficient way.

As independent research is an important source for analyst coverage especially for SMEs it should be clarified that this kind of research is not in the scope of the unbundling rules. Nevertheless, our member companies did not express any clarification needs so far.

In addition, free trial periods offered by research providers should be out of the scope of the unbundling rules. Free trial periods are cost-efficient instruments to increase the quality of research. Investors can assess the research during a trial period and choose high quality providers leaving aside those with a minor quality without spending money.

Lastly, we do not share the view that prices of research providers are too low. Prices reflect the competition among research providers and low prices are its result. Fixing prices by the regulator bears the risk that research becomes more costly with the result of a decreasing demand, especially for SME research.

Question 60. Do you consider that a program set up by a market operator to finance SME research would improve research coverage?

Some market operators already provide research especially in market segments addressing SMEs. This is one solution among others to increase the coverage of SMEs (see our answers to the other questions). Therefore, we think that the EU-Commission should take market operator financed research into account, but should not neglect alternative solutions especially an exemption from the unbundling rules for SMEs.

Question 61. If SME research were to be subsidised through a partially public funding program, can you please specify which market players (providers, SMEs, etc.) should benefit from such funding, under which form, and which criteria and conditions should apply to this program:

We do not agree that public funding programs should subsidise research. Nevertheless, public money should help to implement a central research database

Question 63. Do you agree that the creation of a public EU-wide SME research database would facilitate access to research material on SMEs?

A central database should help especially SMEs to spread their research among investors. it is important that the database comprises a wide range of research reports. Otherwise, the benefits would be limited.

In this regard we would like to note that the database would only be accessible regarding research sponsored by the issuer. Research provided by brokers is exclusively available for investors, who pay for that service. Investors would not agree with the publishing of the research, otherwise they would not pay for it. Therefore, the coverage of the database is limited as it would only contain issuer-sponsored research.

Question 64. Do you agree that ESMA would be well placed to develop such a database?

ESMA should not run the database. The implementation of the database should be part of a public tendering process, which would ensure a high-level quality standard. This tendering process could be organised by ESMA.

The implementation and ongoing operation of the database should be sponsored by public money. We doubt that neither issuers nor investors nor research providers will be willing to pay for it.

Question 65. In your opinion, does issuer-sponsored research qualify as acceptable minor non-monetary benefit as defined by Article 12 of Delegated Directive (EU) 2017/593?

Research sponsored by the issuer has evolved as an important source for SME research. We fully agree that issuer sponsored research should be defined as minor non-monetary benefit without any restrictions.

We deem this as justified as this kind of research is no non-monetary benefit as it is paid by the issuer and not the broker. Furthermore, issuer-sponsored research focuses on the relation between the issuer and the research provider. Therefore, it does not bear a conflict of interest between the research provider and the investment firm the legislator aims to address by the unbundling rules.

Question 66. In your opinion, does issuer-sponsored research qualify as investment research as defined in Article 36 of Delegated Regulation (EU) 2017/565?

As far as we are aware issuer-sponsored research used by our member companies qualifies as research as defined in Article 36 of Delegated Regulation (EU) 2017/565. Nevertheless, for cases of doubt the legislator should clarify that issuer-sponsored research fulfils the requirements of the respective Article.

In addition, Article 37 of Delegated Regulation (EU) 2017/565 provides rules on conflict of interests for investment research and marketing communication. Investment research is defined in Article 36 of delegated regulation 2017/565. However, issuers and providers of investment research consider that the definition of Article 36 would in most cases not apply to issuer-sponsored research which as a result, would not qualify as investment research. As a consequence, the rules on conflict of interests applicable to marketing documentation would apply to issuer-sponsored research.

Question 68. Considering the various policy options tested in questions 59 to 67, which would be most effective and have most impact to foster SME research?

As mentioned in our answer above we think that an exemption for companies with a market capitalisation up to 1 bn. Euro would be the most effective way to increase research coverage of SMEs.

IV. Commodity markets

Question 71. Please indicate the scope you consider most appropriate for the position limit regime:

In order to avoid unnecessary beaurocratic burdens the application of the position limit regime should be more focused, which would also better reflect a level-playing field with the US competitors. Position limits should be limited on a set of important “critical” or “benchmark” contracts and would, more importantly, not preventing the development of new and illiquid products. The other (non-critical) contracts would remain subject to the current position management of exchanges and, therefore, remain subject to appropriate position monitoring and management measures by exchanges.

Question 73. Do you agree that there is a need to foster convergence in how position management controls are implemented?

We do not see any shortfalls regarding the existing position management control and therefore do not deem any further requirements to be necessary.

Question 74. For which contracts would you consider a position limit exemption for a financial counterparty under mandatory liquidity provision obligations?

We agree with the arguments brought forward above that the proposal would bring the position limit regime and the ancillary activity exemption in line.

In order to increase liquidity and availability of commodity contracts for non-financial end users, nascent and illiquid contracts should be exempted from the position limit regime given that these instruments are provided under a mandatory liquidity provision obligation. We also welcome the proposal of ESMA to offer an interim-solution until the legislator has adopted a new rule by exempting illiquid products from the position limit regime.

Question 75. For which counterparty do you consider a hedging exemption appropriate in relation to positions which are objectively measurable as reducing risks?

In general, we notice a decrease of the number of suppliers in the commodity derivatives market. Consequently, prices are increasing and the variety of different derivative types is shrinking. That tendency is triggered by the whole set of financial market regulation, of which positon limits are part of. Therefore, rules should be adjusted in order to prevent a withdrawal of further market participants from the market.

V. Derivatives Trading Obligation

Question 79. Do you agree that the current scope of the DTO is appropriate?

As our member companies are not above the clearing thresholds under EMIR they are also not in the focus of the DTO. Therefore, we are not able to provide feedback regarding the questions above. Nevertheless, we want to underline that the exemption for non-financial companies not crossing the clearing thresholds under the DTO regime is justified, well adjusted and should not be changed under the current review.

X. Foreign exchange (FX)

Question 93. Which supervisory powers do you think national competent authorities should be granted in the area of spot FX trading to address improper business and trading conduct on that market?

Improper business and trading conduct in spot FX markets is already addressed by the Global FX Code introduced and developed by the Global Foreign Exchange Committee.

Furthermore, we do not deem FX spot contracts as financial instrument, neither a security nor a derivative, but a standard operative payment instrument. Thererfore, a definition as financial instrument under MiFID would be misleading. We also refer to the possibility to declare even certain FX Swaps as payment instruments, instead of derivatives, which follows the same logic.

In general, the inclusion of physical products into financial regulation has also the risk of duplicative regulatory obligations and/or restrictions (e.g. overlap between MAR and BMR, or MAR and REMIT), market infrastructure and dynamics may differ significantly and therefore any inclusion of physical products into the scope of MiFID should be considered very carefully.

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