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EU Regulators Ease Best Execution Reporting Demands in MiFID 2 'Quick Fix' Directive

By Alexander Sedgwick, Global Head of Fixed Income, Abel Noser Solutions

Investment and wealth managers in the European Union have a temporary reprieve from producing some data-heavy best execution reports mandated under the Markets in Financial Information Directive II (MiFID II). In February, the European Commission (EC) published its MiFID II 'Quick Fix' Directive, officially known as DIRECTIVE (EU) 2021/338[1], which acknowledges pandemic disruptions and market concerns in its attempt to streamline certain regulatory requirements.

From a high-level perspective, the changes are focused on reducing the administrative burden on affected firms including exemptions from ex ante cost and charges reporting plus some product governance requirements. Since much has been written in the past few months on the numerous changes in the MiFID II requirements, I will instead focus on updates to best execution reporting requirements and the "rebundling" of research.

Quick Fixes of Note

One notable change in the Quick Fix is a two-year suspension of the requirement for venues to submit quarterly best execution reports (under RTS 27) between February 27, 2021, and February 28, 2023. RTS 27 obligated venues to publish quarterly reports with various execution quality measures so market participants could compare execution quality on different platforms. However, the EC found that many investors did not find them helpful because the measures were aggregated at such a high level that a specific client would be unable to glean much information about their own experience from the data.[2]

The Quick Fix also changes the research requirements that will allow managers to re-bundle costs for research and execution for small and mid-cap issuers where their market capitalization is less than EUR 1 BN. However, managers will be required to inform clients that they have entered into an agreement with the research provider to identify the portion of any payments attributable to research. The EC did not make any changes relating to fixed income research.

The impacts of the MiFID II Quick Fix are likely to be muted. There is little doubt it will provide relief to brokers who will have a reprieve from producing the data heavy RTS 27 reports. These changes do, however, indicate hints about future regulatory changes. The Commission noted it would continue work on a broader MiFID II review focusing on transparency requirements for various types of execution venues, additional investor protection requirements, and the establishment of a consolidated tape.[3]

EU member states will need to transpose the changes into their national frameworks by November 28, 2021, and effective February 28, 2022. The UK implementation date is not yet known.

FCA Wholesale Market Review Consultation

More recently, the Financial Conduct Authority (FCA) published a separate Consultation Paper (CP21/9)[4] which mirrors the EC's proposals while differing from them in some meaningful ways. To start, the FCA

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[1] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32021L0338&qid=1628272309529&from=en

[2] DIRECTIVE (EU) 2021/338

[3] DIRECTIVE (EU) 2021/338

[4] https://www.fca.org.uk/publications/consultation-papers/cp21-9-changes-uk-mifid-conduct-organisational-requirements

recommended suspending not only the publication of the RTS 27 reports but also the RTS 28 reports produced by investment managers. The RTS 28 reports required managers to aggregate large amounts of trading data to outline the top five execution venues used and the execution quality obtained across any of the 22 asset classes the firm traded. Managers are also required to outline the priority of execution factors for each asset class and type of trade. As the EC announcement noted, there is a concern that few investors are reading the RTS 27 reports and the FCA likely shares this concern and expands it to include the RTS 28 reports. Previously, the European Securities and Markets Authority (ESMA) had granted a one-time delay for firms filing the 2019 RTS 28 reports but left the 2020 filing deadline intact. In contrast, the FCA's CP21/9 has called for a suspension on the filing of both RTS 27 and RTS 28 reports.

The FCA also included fixed income and FX research in the exemption from unbundling. This seems to reflect a recognition that research and execution are not linked in fixed income trading in the same way as in the equity markets. As the FCA noted: "If research had been a material part of a broker's costs, we would have expected the inducement rules to have resulted in a narrowing of spreads."[5] More importantly, fixed income dealers earn revenues from the bid-ask spread rather than an agency commission, so the proposed exemption for fixed income research would not create the same opacity risks between transaction fees and research costs as equity research does.

Prepare for updates ahead

In the near term the EC's MiFID II Quick Fix proposals will likely ease the administrative burden created by the existing rules but are unlikely to precipitate any changes in how European markets function. As mentioned, the EC is continuing work on a more holistic review of MiFID II and signaled it will focus on transparency and establishing a consolidated trade tape.

Note: On September 24, 2021, ESMA launched a consultation on proposals for a review of the MiFID II Best Execution reporting regime. More details can be found here: Link

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[5] CP21/9