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Beyond PFOF: how technological changes and new business models can create challenges and opportunities for EU capital markets

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Thank you for this opportunity to share with you some of my thoughts about the topics your panels will discuss.

It is impossible to talk about financial services without thinking on how technology has transformed and continues to transform our markets.

This has led to some good things.

Retail investors have greater access to markets than any time in the past.

During the pandemic we have seen that an ever greater number of individuals have entered the market.

Some were looking for creating a savings account, some were aiming to spend time ‘discovering’ trading, and others were looking for profitable opportunities.

It is clear that on the one hand this was made possible by the technological transformation, with many people being able to trade through an application on their smartphone.

But technology is not just about granting greater access to the markets, it is also about creating new and useful products.

A clear example of this could be the Consolidated Tape that we are currently discussing as part of the MiFIR review.

This is a tool that if well implemented will offer a single view of the prices and liquidity available in EU capital markets which is lacking today.

This consolidated view should benefit all market participants.

It could also reduce the overall costs of trading, in particular the costs of market data, and create a pan-European database for trading.

Your panels will discuss communication in the markets.

Today, in addition to the form of communication of traditional financial intermediaries, we see social media and new forms of communication and marketing becoming more pervasive and central for the way people make financial decisions.

These channels facilitate the communication between those wanting to trade - with many looking at social media or the internet to find advice and suggestions on how to trade and how to spot the best opportunities.

Changes in technology and communication have led to a greater participation in the capital markets by retail consumers, a welcome development in line with the goals of the Capital Market Union.

But they have also led to challenges.

It is increasingly difficult to effectively protect retail investors, who get trading advice through many different and at times unsupervised or unregulated channels.

Fresh in our memory is of course the Game Stop event, when a large number of retail investors talked to each other via Reddit and then entered the markets, with the results that we all remember very well.

The Game Stop episode also brought to the centre of the discussion another phenomenon that is going to be central to today's discussions: payment for order flow.

As you all know, the Commission has decided to propose banning the controversial practice of brokers receiving payments for forwarding their investors order for execution.

Currently, that proposal is under discussion in both the Parliament and the Council, where there are diverging views between policymakers and legislators.

Indeed, payment for order flow can raise conflicts of interest issues.

ESMA and other supervisors described how payment for order flow could distort routing decisions, as there is a trade-off between payment for order flow and price improvement for customers.

There are, as we all know, regulators in the world that either have banned the practice or are considering it.

What makes the PFOF “zero-commission” brokerage environment different from other brokers, is that investors do not see the costs, so they may perceive trading as cost-free.

But there is the risk that the costs that are not paid in the form of explicit fees when using a PFOF broker, are paid in the form of worse execution prices compared to a non-PFOF broker.

On the other hand, PFOFs have also allowed the emergence of new business models that have been able to offer access to trading to higher numbers of retail investors, particularly young ones.

By facilitating access to the markets, they also offered a way for individuals to allocate their capital more efficiently, especially in the low-interest rates environment.

It is clear that we need to assess the risks - as well as the benefits - of the PFOF model, to understand whether a ban is warranted or whether the option of a compromise should be explored.

But any compromise solution must provide sufficient safeguards to prevent conflict of interest and ensure best execution.

For example, brokers could be allowed to receive PFOF only if they meet a number of conditions, such as the requirement to provide price improvement compared to the best price available on European multilateral venues, the requirement to open up the execution of their order flow to competition, and the establishment of more stringent control and disclosure procedures.

In the Parliament, we have just started dealing with the issue, and all options are on the table for the moment.

We will need to give a hard look at whether PFOF brokers have inherent conflicts of interest, and whether customers are getting best execution or not.

And we need to consider whether it is fair that PFOFs are allowed in a very limited number of countries and they are banned or de facto not present in many other countries.

With increasing digitalization in finance and a growing share of retail cross- border participation, the unlevel playing field for brokers in different member states may create competitive advantages and disadvantages, contrary to the spirt of the Capital Market Union.

I understand that you will discuss the issue of PFOF in the context of supervision of financial markets and new business models.

And let me say that there are clear challenges related to supervision.

The PFOF case - but this also applies to other emerging business models - is an example of how different supervisory interpretations can have distorting effects on the markets.

The fact that EU is not a unified jurisdiction has historically led to a prescriptive approach to rules making.

In the European capital markets supervisory action has to be framed within the remit of either ESMA or NCAs or both.

By definition this prescriptive way of regulating creates rigidity and often hinders the agility and the extent of supervisors' activities.

The fragmentation of supervision also has other, more hidden costs.

It gives way to regulatory competition, reduces investor protection and increases the cost of capital.

Ultimately it can reduce EU competitiveness, especially as we see other jurisdictions having much more agile regimes.

The question is how far the legislators could move toward more principle based regulation, creating a more agile and flexible system fit for changing markets.

It would be interesting to hear how do you see this challenge.

How can we ensure that the supervisory system that we have put in place is better prepared to deal with the future changes brought about by digitalisation models.

How can the legislation that is often designed for already-existing business models be made fit for emerging new models.

The discussions around crypto assets highlighted these difficulties.

Digitalization of many practices is creating many ‘grey’ areas, and the role of social media and communication channels is raising the question on how to regulate and improve financial information sharing.

In such an environment, it seems legitimate to look for rules that are flexible enough, yet provide the certainty and protection that investors need.

Let me conclude by saying that in this environment Europe needs to deliver effective, understandable and future proof changes to the regulatory framework of European capital markets.

There are still important discussions and legislative changes to undertake in the current legislative term.

I think of MiFIR, EMIR, the Distance marketing of consumer financial services, the Listing Act, the Retail Investment Strategy or the Open Finance proposal.

We need to reflect on better use of the flexibility in the legislative system in a way that reduces the red tape for market participants and let them innovate.

We also need to find ways to improve the supervisory system - empowering ESMA for its duties as EU supervisor and reducing the divergence in supervisory interpretation where possible.

And, last but not least, we need to further invest in achieving consumers’ trust in financial products.

With this I would like to thank again the AMF for the invite, and I wish you a fantastic discussion.