FESE response to ESMA consultation on the transparency regime for Equity instruments – Part 1 (Pre-trade transparency)

Introduction

The Federation of European Securities Exchanges (FESE) very much welcomes that ESMA consults on the functioning of the transparency regime for equities. This consultation is very timely and should help to inform the debate of the MiFID II/MiFIR Review launched by the European Commission.

The objective of MiFID II/MiFIR was to significantly improve transparency for equity instruments by bringing more trading to lit multilateral trading venues, i.e. Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs) to improve price formation and investor protection. However, more than two years after the implementation of MiFID II/MiFIR, the situation is at odds with the spirit of the legislation.

The equity market share of continuous lit order books is decreasing, while the combined share of OTC and SI trading keeps growing. The aggregated levels of OTC and SI trading in terms of turnover represent 22% and 18% respectively for 2019 based on STOXX 600 data from Big xyt. This has led to increased complexity and opacity of equity markets with further fragmentation of liquidity, which is damaging the price formation process.

In light of this, FESE wishes to underline that an adequate equity market structure is a prerequisite for a successful CMU, because a well-functioning market structure supports a robust, fair and transparent price formation process in order to deliver efficient and liquid markets (which benefits investors) and lowers the costs of capital for businesses.

Against this background, **FESE proposes a simplified market structure concept designed to strengthen lit markets by**:

- building market models that buttress price formation rather than fragment it,
- making markets more inclusive, especially for local intermediaries in smaller markets, and
- offering investors (big or small) better ways of interacting with multilateral markets.

In order to achieve this, **FESE proposes to use the large in scale (LIS) threshold as the main tool to delineate lit and dark trading**. Above LIS trading constitutes a legitimate dark space in which trades are not subject to pre-trade transparency and benefit from delayed post-trade transparency. This applies to both multilateral trading venues (RMs and MTFs) and bilateral execution venues (SI). Our proposal aims to simplify the fragmented execution landscape, as below LIS, trades should contribute to price formation since those trades have at most only limited market impact. This type of execution should operate in a trading venue, under non-discretionary and non-discriminatory rules, and comply with the tick size and transparency regimes. OTC would be restricted to trades not subject to the share trading obligation (STO).

There would therefore **no longer be a need for a double volume cap (DVC) mechanism** in such a scenario, **since pre-trade transparency waivers would be limited to the LIS waiver** which protects from market impact **and the order management facility (OMF) waiver** as

orders in an OMF facility ultimately become pre-trade transparent and therefore contribute to the price formation process.

Last, in an attempt to **improve data reporting standards and facilitate the 'consolidatability' of data**, FESE suggests applying the **industry-led initiative Market Model Typology (MMT) to all trading venues, execution venues as well as to OTC transactions**. Moreover, MMT should be brought under the governance of ESMA. Investors should be able to analyse executions in a consistent manner with adequate flagging of executed trades using MMT, as already offered by Regulated Markets and MTFs.

FESE would also like to underline that concerns remain regarding reporting of reference data such as consistency of CFI codes. There have also been concerns regarding exchange of information, specifically in outreach to competent authorities regarding clarifications of requirements.

FESE's proposal would greatly contribute to a simplification of rules in line with the EU's better regulation principles as well as provide better opportunities for the MiFID II framework to deliver on its intentions since such simplifications would also make the framework more straightforward for NCAs to enforce.

Q1: What is your view on only allowing orders that are large in scale and orders in an order management facility to be waived from pre-trade transparency while removing the reference price and negotiated trade waivers? Instead of removing the reference price and negotiated trade waivers, would you prefer to set a minimum threshold above which transactions under the reference price and negotiated trade waivers would be allowed? If so, what should be the value of such a threshold? What alternatives do you propose to simplify the MiFIR waivers regime while improving transparency available to market participants? Please explain.

FESE supports ESMA's proposal to limit the available waivers under the transparency regime to the large in scale (LIS) and order management facility (OMF) waivers, removing the reference price (RP) and negotiated trade (NT) waivers in order to increase pre-trade transparency. In such a scenario, the double volume cap (DVC) mechanism would be rendered obsolete. Instead, FESE believes that the LIS threshold should be used as the main tool to delineate dark trading. The main purpose of the waiver regime is to protect market participants from adverse market movements following the execution of large orders and there seems to be little justification for trading small orders via the RP or NT waivers. Using the LIS threshold to delineate dark trading would be an efficient way to incentivise lit trading and address concerns about the impact of dark trading on financial markets and the price formation process all the while contributing to a much-needed simplification of the current framework. In addition, it makes sense to maintain the OMF waiver as an order in an OMF facility ultimately becomes pre-trade transparent and therefore contributes to the price formation process.

However, it would still be important to allow for non-price forming technical trades to be reported off-book on exchange. FESE therefore calls for such a reporting tool to be defined at Level 1.

Overall, quality and consistency of reporting and flagging are necessary in order to improve transparency available to market participants. Against this background, FESE calls for the Market Model Typology (MMT) to be extended and mandated to all execution venues as well as OTC and sees merit in looking at how the technical implementation of MMT could be done under the governance of ESMA.

Q2: Do you agree to increase the pre-trade LIS threshold for ETFs to EUR 5,000,000?

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FESE agrees to increase the pre-trade LIS threshold for ETFs to EUR 5,000,000. Although this is a step in the right direction, FESE believes that it is important for ESMA to complement this measure with additional ones to further promote transparency for on-venue trading of ETFs (please see FESE's answer to question 6).

Q3: Do you agree with extending the scope of application of the DVC to systems that formalise NT for illiquid instruments?

FESE is in favour of only allowing orders that are LIS and orders in an order management facility to be waived from pre-trade transparency, while removing the reference price and negotiated trade waivers (please see response to question 1). In such a scenario, this question is no longer relevant.

Q4: Would you agree to remove the possibility for trading venues to apply for a combination of waivers? Please justify your answer and provide any other feedback on the waiver regime you might have.

FESE agrees that applying for a combination of different waivers should be avoided, in order to strengthen lit trading through an overall simplification of the market structure for equity instruments. As stated in the response to question 1, FESE calls for an overall simplification of the waiver regime provided for under Article 4 MiFIR. Specifically, FESE believes that the reference price and negotiated trade waivers should be removed. In such a scenario, only orders that are LIS and orders in an order management facility would be eligible to be waived from pre-trade transparency. Hence, this question is no longer relevant.

Q5: Do you agree with the proposal to report the volumes under the different waivers separately to FITRS? Please explain.

FESE agrees with the proposal to report the volumes under the different waivers separately to FITRS. A more granular approach for reporting volumes under the waivers would be more appropriate. It is quite burdensome to report volumes "total excluding waiver a and b". It would be clearer to report separately the total volume as well as the volume under each waiver.

Q6: What would be in your view an alternative way to incentivise lit trading and ensure the quality and robustness of the price determination mechanism for shares and equity-like instruments? Please explain.

This question needs to be placed in a broader context recognising that market structure improvements are a prerequisite for a successful CMU. We believe equity market structure needs to become less complex and build on lessons learned from MiFID II to truly support lit trading. The objective of MiFID II/MiFIR was to bring broker crossing networks (BCNs) to lit multilateral trading venues (i.e. RM and MTFs) in order to increase transparency and improve price formation and investor protection. The current situation is however at odds with the spirit of MiFID II/MiFIR as the market share of continuous lit order books is decreasing while the combined share of OTC and SI trading keeps growing.

The MiFID II review must be placed in the context of industry developments.

First, policymakers should address the concentration of flows via large sell-side banks. Today, over 50% of flows on cash equity come to European Regulated Markets through the smart order routers operated by six non-EU investment banks. This concentration of flow is driven by increased risk taking by the large US banks, i.e. their ability to allocate capital to

run what is, in effect, proprietary risk disguised in central risk books or Systematic Internalisers. Flows from Tier 2 and 3 European regional banks and brokers are channelled through the workflow and smart order routers of the Tier 1 banks and do not hit lit markets, contrary to the objectives of MiFID II. We believe policymakers and regulators should assess this issue as a point of priority as it is critical for the proper functioning of the lit market environment and, crucially, for them to protect the integrity and viability of European regional banks.

Second, the intermediation of orders by the largest investment banks today forms part of a complex workflow. This workflow is designed to maximise the execution of orders away from price-forming, lit markets. Today, large investment banks will seek to match off flows against each other as well as against their own house account under a variety of frameworks (Systematic Internalisation, OTC and proprietary dark MTFs). This means that: (i) public markets only receive residual exhaust flow; and, (ii) investment banks can perpetuate the 'self-fulfilling' claim that public markets are toxic trading environments. This narrative is aggressively sold to asset managers and issuers. Without transparent comparable reporting by SIs best execution claims cannot be verified by investors and regulators.

Any review of MiFID II market structure should address the following:

- The concentration of bargaining power over market structure in the hands of a small number of non-EU investment banks;
- Within the workflow managed by the investment banks, the prioritisation of internal vs public execution. Lit, price-forming markets currently come last in execution policies – they should be the first stop, not the last;
- A simplification of the fragmented execution landscape and a removal of blurred lines (removal of some waivers and removal/limitation of the SI regime). In particular, (i) far tighter regulation of what is an SI vs the central risk book and (ii) what is denoted as "client facilitation" vs prop trading vs market making. These lines are currently blurred at best and being abused at worst.

The overall ambition should be to work on a simplified market structure concept to strengthen lit trading by:

(i) building market models that buttress price formation rather than fragment it,
(ii) making markets more inclusive, especially for local intermediaries in smaller markets, and
(iii) offering investors (big or small) better ways of interacting with multilateral markets.

At this point, the aggregated levels of OTC and SI trading in terms of turnover represent 22% and 18% respectively for 2019 (based on data from Big xyt). This has led to increased complexity of equity markets and further fragmentation of liquidity - in stark contrast with the spirit of the legislation.

While SIs are regulated under MiFID II as execution venues providing bilateral trading, they provide less transparency than on-exchange trading. This can be problematic when the distinction between purely bilateral and hybrid multilateral trading is blurred. In theory, every trade in an SI must take place against the proprietary account of the operator. SIs are prohibited, when dealing on their own account, from entering into matching arrangements with entities outside their group with the objective of carrying out *de facto* riskless back-to-back transactions in financial instruments outside trading venues. However, some investment firms seem to have developed models by which third party trading firms are able to provide liquidity to the customers of SIs.

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FESE’s market structure concept proposal

1. Systematic Internaliser Regime

FESE believes that restricting SI trading to above LIS only would be an efficient way to incentivise lit trading, ensure the quality and robustness of the price formation mechanism, in line with the initial objective of MiFID II/MiFIR.

In such a scenario, the LIS threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading should be confined to Regulated Markets and MTFs exclusively. FESE underlines that rules applicable to MTFs should continue to apply, specifically operators of MTFs would still be prohibited from engaging in proprietary trading, running bilateral systems and applying discretionary and discriminatory rules. These trading venues would in principle always be subject to real-time pre- and post- trade transparency requirements thus creating a lit space for trades below LIS. There would no longer be a need for a double volume cap mechanism since pre-trade transparency waivers would be limited to the LIS and OMF.

SIs activity would be restricted to above LIS only. Above LIS trading constitutes a legitimate dark space in which trades are not subject to pre-trade transparency and would benefit from delayed post-trade transparency. This proposal applies to both multilateral trading venues (RMs and MTFs) and bilateral execution venues (SI) and it would result in an appropriate limitation of dark activity and a welcome simplification of the fragmented execution landscape. Above LIS, transactions receive privilege (waivers) to avoid market impact. To take away from the price formation process is only warranted when the potential market impact is sizable.

2. Dark and OTC trading

FESE suggests to limit dark trading by reducing the number of available waivers to mainly LIS - this includes the repeal of the double volume cap mechanism: The main purpose of the waiver regime is to protect market participants from adverse market movements following the execution of large orders.

OTC would be restricted to trades in shares not subject to the STO. FESE would also suggest extending MMT to all execution venues as well as to OTC transactions under ESMA governance.

3. Request for Quote systems

MiFID II introduced increased transparency requirements applicable to ETFs however the fundamental concern is that the majority of trading - approximately 90% - still takes place on alternative trading systems, as opposed to on-exchange lit markets. FESE suggests that ESMA investigates this liquidity shift from lit order book trading to Request for Quote (RFQ) trading and assesses its potential long-term impact on ETF market structure. ESMA should propose mitigating measures if this trend is perceived to be non-compliant with ESMA’s objective to ensure the quality and robustness of the ETF price determination mechanism for all types of investors. FESE suggests that RFQ trading systems should only be made available for ETF transactions above the LIS thresholds (1,000,000 EUR) so that the bulk of trading, i.e. smaller size trades, are executed on transparent trading platforms thereby contributing to the price formation process.

4. STO

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FESE proposes to modify the share trading obligation (STO) regarding its third country dimension, scope, exemptions and application to asset classes:

i) To address the third country impact of the current scope, the STO should apply to those shares with an ISIN starting with a country code corresponding to an EU27 Member State plus those starting with a non-EU country code but where the issuer has its primary (fully-fledged) listing within the EU27;
ii) The STO should not apply to those shares with an ISIN starting with a country code corresponding to an EU27 Member State where the issuer has its exclusive listing in a third country;
iii) In cases where the security is dual-listed on both an EU trading venue and a non-EU trading venue at the specific request of the issuer, we propose that the STO should still apply but that there is an exception in the provision to allow for trading to take place on the non-EU trading venue where the issuer has admitted the security, in addition to the EU venues;
iv) Exemptions should be removed where trades are “non-systematic, ad-hoc, irregular and infrequent”, instead exemptions should only apply for those trades that do not contribute to price formation based on a clear and consistent list of qualifying non-price forming trades; and

The scope of the STO should be extended to ETFs in order to incentivise lit trading and investor protection in this growing asset class. “Listing” in this sense is always made upon the request of the issuer and involves various obligations for initial listing and for maintaining a listing.

5. Midpoint trading

FESE would also take this opportunity to point out that while some would argue that mid-point is a valid execution price since it is predictable and based on tick sizes, any order pegged at midpoint means that some orders are entered in between tick sizes, which was not foreseen by MiFID II/MiFIR for trading venues’ lit order books. It should also be noted that midpoint is a non-displayed order and therefore plays a role in reducing market transparency. Against this background, midpoint orders are executed at the expense of participants willing to set or display a price. Ultimately, the idea that a mid-point price is fairer is flawed, as pegging can in some circumstances act similar to a reference price without being subject to a waiver. Any review of MiFID II/MiFIR should address these concerns and FESE considers that for below LIS orders, midpoint pegging should not be allowed in central limit order books. However, midpoint pegging should be available for orders above LIS.

This market structure proposal would enhance the ability of MIFID II/MiFIR provisions to increase investor protection and further the level playing field amidst concerns about the impact of dark trading on financial markets and the price formation process.

FESE is mindful of the links that exist between the complexity of legislation and the challenges in relation to enforcement and believes that this proposal would greatly contribute to a simplification of rules in line with the EU’s better regulation principles. Better opportunities should be given for the MiFID framework to deliver on its objectives and a simplified framework would be more straightforward to enforce by NCAs.

Q7: Which option do you prefer for the liquidity assessment of shares among Option 1 and 2? Do you have an alternative proposal? Do you think that the frequency of trading should be kept as a criterion to assess liquidity? If so, what is in your view the appropriate thresholds for the percentage of days traded measured as the ratio between number of

days traded and number of days available for trading (e.g. 95%, 90%, 85% etc.)? Please explain.

FESE is of the view that using ADNT and ADT as parameters to assess liquidity would be an improvement in comparison to the four conditions currently used. FESE would caution against looking at market capitalisation as a parameter since this would introduce undue complexity. It should also be noted that free float data can in some cases be unreliable.

Q8: Do you agree in changing the approach for ETFs, DRs as proposed by ESMA? Do you have an alternative proposal? Please explain.

FESE agrees with changing the approach for ETFs and DRs as proposed by ESMA.

Q9: Do you agree in removing the category of certificates from the equity-like transparency scope? Please explain.

FESE disagrees with ESMA's proposal to remove certificates from the equity-like transparency scope. The intention of MiFID II was to extend the transparency regime to a wide set of asset classes and this also includes certificates. However, it is important to have a more precise definition and clarification on what falls under the certificates-framework.

Q10: Do you agree in deeming other equity financial instruments to be illiquid by default? Please explain.

Before answering this question, FESE would ask ESMA to first clarify what is meant by "other equity financial instruments".

Q11: Do you agree in separating the definition of conventional periodic auctions and frequent batch auctions? Do you agree with ESMA's proposal to require the disclosure of all orders submitted to FBAs? Please explain.

FESE in principle sees merit in distinguishing between various types of auctions. Trading venues operating auctions is nothing new, on the contrary, auctions are widely used to orderly open and close trading sessions and many venues also organise intra-day auctions. However, the frequent batch auctions (FBAs)- which appeared after the implementation of MiFID II / MiFIR - differ from conventional periodic auctions. One distinction to be made could be whether the auction includes an element of price formation or not, along with other features like the length of the call phase and the level of pre trade transparency.

It should be noted that the various auctions are modelled to serve the market participants' needs for efficient trading within the overall transparent and multilateral environment.

Regarding the information to be made public, *ESMA suggests that all orders (volume and price) submitted to FBAs should be disclosed to meet the MiFIR pre-trade transparency requirements*. FESE would need more information on the exact requirements suggested by ESMA as, at this point, it is unclear whether ESMA intends to align the pre-trade transparency requirements for FBAs with those applying to "continuous auction order book trading system" or define new specific requirements. As such, FESE considers that any consideration of regulatory measures in this area should be based on a thorough analysis of the overall market structure, paying special attention to the price formation provided by auctions.

Q12: Do you agree that all non-price forming systems should operate under a pre-trade transparency waiver? Please explain?

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FESE believes that trading models allowing for non-price forming transactions combined with insufficient levels of pre trade transparency should operate under a pre-trade transparency waiver, provided that this does not prejudice the possibility of reporting non-price forming technical trades as off-book on-exchange. Such a reporting tool should be formulated at Level 1.

Consistent with supporting the repeal of the negotiated trade waiver and the reference price waiver (see our answer to question 1), trading models allowing for non-price forming transactions and insufficient pre-trade transparency would either operate under one of the remaining pre trade transparency waivers under MiFID II, namely LIS and OMF waivers or not be allowed anymore.

In addition, FESE would caution against distinguishing between price-forming and non-price forming *systems*. Rather, and in the interest of consistency and simplicity, FESE supports working off the current Level 2 framework on non-price forming *transactions* (RTS 1 Article 2 and Article 13 provide a list of such transactions). This would prove more effective than a definition of non-price forming/price forming models as it would avoid potential loopholes. We would also suggest extending MMT to all execution venues and OTC under ESMA governance to ensure proper flagging of trades.

FESE response to ESMA consultation on the transparency regime for Equity instruments – Part 2 (The SI Regime)

Q13: What is your view on increasing the minimum quoting size for SIs? Which option do you prefer?

FESE acknowledges that the current minimum quoting size of 10% of the SMS is incredibly low and leads to very limited mandatory pre-trade transparency for SIs as outlined by ESMA in the consultation paper. A minimum quoting size of 100% of the SMS would be more appropriate than what is currently in place.

FESE believes that any review of MiFID II market structure should focus on designing a simplified market structure concept to strengthen lit trading. In order to achieve this, FESE proposes (as outlined in response to question 6) to confine SI activity to above LIS only. In such a scenario, the question of the minimum quoting size for SIs becomes irrelevant. This illustrates, once more, that the use of the LIS-threshold as the main tool to delineate lit and dark trading would greatly contribute to a much-needed simplification of the current framework.

Q14: What is your view on extending the transparency obligations under the SI regime to illiquid instruments?

FESE is of the view that extending the transparency obligations under the SI regime to illiquid instruments would be an improvement compared to what is in place under the current framework.

Although it has not been mentioned in the Consultation Paper, FESE would like to draw ESMA's attention to some additional aspects:

1) **Importance of flagging SI trades at an EU level:** The current flagging is very unclear and inconsistent. A broader implementation of the Market Model Typology (MMT) which currently ensures consistency of exchange data would be a solution. FESE is convinced that the extension of the MMT would enhance data consistency and contribute to the increase of regulatory oversight of SI activity.

2) **Operation of SIs**: ESMA should review how SIs operate by looking more deeply into the transactions they conclude and report. One question is about riskless trading. FESE believes that connectivity hubs that have the potential to link up SIs and counterparties should be monitored to guarantee that they always work on a bilateral basis, and in case they do not, meaning that they operate an internal matching system, they must operate as an MTF. Such activities must be monitored as there is a risk that trading takes place on a multilateral rather than bilateral basis.

3) **Registration process of an SI**: Unlike RMs and MTFs, SIs do not seem to be subject to any specific requirement regarding the operation of the business model. To level the playing field, SIs should also be required to provide a description of the business model and how regulatory compliance is maintained.

FESE reiterates that any review of MiFID II market structure should focus on designing a simplified market structure concept to strengthen lit trading. For this, FESE proposes to restrict SI activity to above LIS only (as outlined in response to question 6). In such a scenario the LIS-threshold would be used as the main tool to delineate lit and dark trading. There seems to be little justification for trading small orders via SIs when these could occur on RMs or MTFs and contribute to increasing transparency in the market. For this reason, below LIS trading should be confined to RMs and MTFs exclusively. These trading venues would in principle always be subject to real-time pre and post trade transparency requirements thus creating a lit space for below LIS. Above LIS trading constitutes a legitimate dark space, such trades would therefore not be subject to pre-trade transparency and benefit from delayed post-trade transparency. Below LIS, trades should contribute to price formation. This type of execution should operate in a trading venue, under non-discretionary and non-discriminatory rules, and comply with the tick size and transparency regimes. In such a scenario, the question of extending the transparency obligation under the SI regime to illiquid instruments is less relevant.

Q15: With regard to the SMS determination which option do you prefer? Would you have a different proposal? Please explain.

FESE supports ESMA's proposal to have different tables for liquid and illiquid instruments for shares, DRs, certificates and other financial instruments in order to have calibrated SMS for different ADT classes for each asset class (option 1). However, for ETFs, FESE prefers table 2 (the SMS for liquid instruments) also for illiquid instruments. The liquidity of an ETF is primarily determined by the liquidity of the underlying market rather than the ADT of an ETF. Correspondingly, ETFs tracking similar underlying markets typically demonstrate similar liquidity profiles in terms of average spreads. Hence, both liquid and illiquid ETFs should be subject to the same SMS. As a result, the table needs to be populated accordingly with appropriate SMS figures for the ADT classes below 500 000 EUR.

Any review of MiFID II market structure should concentrate on putting in place a simplified market structure concept to strengthen lit trading. In order to achieve this, FESE proposes to restrict SI activity to above LIS only (as outlined in our response to question 6). In such a scenario the LIS-threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading should be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre and post trade transparency requirements thus creating a lit space for below LIS. Above LIS trading constitutes a legitimate dark space, such trades would therefore not be subject to pre-trade transparency and benefit from delayed post-trade transparency. In such a scenario, the question of amending the methodology by which SMS is determined is no longer relevant.

Please also see FESE's response to question 6.

FESE response to ESMA consultation on the transparency regime for Equity instruments – Part 3 (Double Volume Cap)

Q16: Which option do you prefer among Options A, B and C? Would you suggest a different alternative? Please explain.

FESE supports ESMA's proposal to limit the available waivers under the transparency regime to the LIS and OMF thus rendering the DVC mechanism obsolete (Section 3.1.2.1 – B. Conclusions and Proposals).

FESE therefore considers that the three options for maintaining or adjusting the current DVC system should be discarded. FESE considers deletion of Article 5 MiFIR to be the best option. Maintaining or increasing the complexity introduced by the DVC is not desirable and goes against effective enforcement of the regulation which would benefit from a simplification of rules.

Q17: Would you envisage a different system than the DVC to limit dark trading? Please explain.

The double volume cap (DVC) has been designed to limit the trading taking place under the RP waiver, provided in Article 4(1)(a) of MiFIR, and the NT waiver for liquid instruments, set out in Article 4(1)(b)(i)) of MiFIR. FESE is calling to limit the available waivers under the transparency regime to the LIS and OMF waivers. In this case, the DVC mechanism would disappear.

FESE does not believe that the RP and NT waivers should remain in place nor that the DVC should be maintained or adjusted. FESE instead suggests a different approach to limit dark trading.

FESE believes that restricting SI trading to above LIS only would be an efficient way to incentivise lit trading and ensure the quality and robustness of the price determination mechanism for shares and equity-like instruments. In such a scenario the LIS-threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading would be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre- and post-trade transparency requirements thus creating a lit space for below LIS. The available waivers under the pre-trade transparency regime (Article 4 MiFIR) would be limited to the LIS and OMF waivers and the DVC mechanism would disappear.

SI activity would be restricted to above LIS only. Above LIS trading would constitute a dark space in which trades would not be subject to pre-trade transparency and would benefit from delayed post-trade transparency. This would result in an appropriate limitation of SI-activity and a welcome simplification of the fragmented execution landscape.

OTC would be reserved to non-price forming trades in such a scenario. In this context, FESE supports working off the current Level 2 framework on non-price forming trades and would suggest extending MMT to all execution venues and OTC under ESMA's governance. Such an approach would enhance the ability of MIFID II/MiFIR provisions to increase investor protection and further the level playing field amidst concerns about the impact of dark trading on financial markets and the price formation process. FESE is also mindful of the links between the complexity of legislation and challenges related to enforcing it. We

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consider that this proposal would greatly contribute to a simplification of rules in line with the EU's better regulation principles.

Please also see FESE's response to question 6.

Q18: Do you agree in removing the need for NCAs to issue the suspension notice and require trading venues to suspend dark trading, if required, on the basis of ESMA's publication? Please explain.

FESE is calling for a removal of the double volume cap mechanism. In such a scenario, this question is no longer relevant.

Q19: Do you agree in removing the requirements under Article 5(7)(b)? Please explain?

FESE is calling for a removal of the double volume cap mechanism. In such a scenario, this question is no longer relevant.

Q21: Do you agree in applying the DVC also to instruments for which there are not 12 months of available data yet? Please explain

FESE is calling for a removal of the double volume cap mechanism. In such a scenario, this question is no longer relevant.

Q22: Do you foresee any issue if the publication occurs after 7 working days instead of 5? Please explain.

FESE is calling for a removal of the double volume cap mechanism. In such a scenario this question is no longer relevant.

Q23: Do you agree that the mid-month reports should not be published? Please explain.

FESE is calling for a removal of the double volume cap mechanism. In such a scenario this question is no longer relevant.

Q24: Do you agree with ESMA's proposal to include in Article 70 of MiFID II the infringements of the DVC suspensions? Please explain.

FESE is calling for a removal of the double volume cap mechanism. In such a scenario this question is no longer relevant.

FESE response to ESMA consultation on the transparency regime for Equity instruments – Part 4 (Post-trade transparency)

Q25: Do you agree with ESMA's assessment that the conditions for deferred publication for shares and depositary receipts should not be subject to amendments? If not, please explain.

FESE would agree. As only a small portion of large trades benefit from deferred publication it appears that, in general, the MIFIR deferral regime has delivered on its objectives, i.e. to protect large trades while maintaining a high level of real-time transparency.

Q26: Do you agree with ESMA's proposal to increase the applicable threshold for ETFs and request for real-time publication for transactions that are below 20,000,000 EUR? If not, please explain.

FESE agrees with ESMA's proposal to increase the applicable deferred publication threshold for ETFs and request for real-time publication for transactions that are below 20,000,000 EUR.

Q27: Do you agree with ESMA assessment of the level of post trade transparency for OTC transactions?

Yes, FESE agrees with ESMA's assessment of the level of post-trade transparency for OTC transactions and considers that there is no need to apply different thresholds for OTC and on-venue transactions. Rather, FESE thinks that trading OTC does not mean that post-trade transparency shall be minimal. In general, FESE is of the opinion that for OTC transactions of shares, exemptions to the share trading obligation, shall have the same level of quality in post-trade reporting. This is also necessary to monitor the correct application of Article 23 MiFIR and its exemptions.

FESE would also like to take this opportunity to reiterate that the availability, quality and consistency of OTC post-trade data is a major issue. As ESMA underlined in the MiFIR II/MiFIR Review Report No. 1, there are significant shortcomings on data quality in particular for OTC trades and more work needs to be done in this area. Currently, SI and OTC data quality, reliability and consistency is not fit for purpose. Most sources of reliable data, such as exchange data, are consolidated by market data vendors and made available to users. However, there is a lack of non-trading venue quality data. This is because low levels of off-venue post-trade data quality, reliability and consistency of SI and OTC transactions hampers accessibility and readability and consolidation of such data. This concerns both the timeliness and content of the data, as well as inconsistent approaches in respect of flagging trades.

Q28: Do you agree with the proposal to report and flag transactions which are not subject to the share trading obligations but subject to post-trade transparency to FITRS? Please explain.

Yes, FESE agrees and welcomes more transparency in this area. It is important that exemptions to the share trading obligation are clearly identified and flagged. All transactions identified as not contributing to the price formation or being non-price forming should benefit from an individual flag in FITRS. Again, this would ensure proper application of the exemption possibilities to the share trading obligation.

Q29: What is your experience related to the publication of post-trade transparency information within 1 minute from the execution of the transaction? Do you think that the definition of "real-time" as maximum 1 minute from the time of the execution of the transaction is appropriate/too stringent/ too lenient? Please explain.

For electronic order book systems, FESE considers that 1 minute would be too long and that the timeframe could be much shorter. Allowing up to 1 minute to report opens up for potential misuse. FESE would like to stress that exchanges strive to publish the information as fast as possible, based on the type of trade executed and 1 minute is too generous for such systems. We would also like to state that the maximum delay should be equal for all execution venues, including SIs.

When it comes to technical, i.e. non-price forming trades, in general terms we would consider that a 1-minute timeframe is appropriate. However, in some specific cases, the delay could be extended.

Q30: Do you agree with ESMA's approach to third-country trading venues for the purpose of transparency requirements under MiFID II? If no, please explain.

FESE agrees with the approach taken for third-country trading venues regarding transparency requirements, level playing field and ensuring adequate supervision.

FESE response to ESMA consultation on the transparency regime for Equity instruments – Part 5 (Share trading obligation)

Q31: Do you agree that the scope of the share trading obligation in Article 23 of MiFIR should be reduced to exclude third-country shares? If yes, what is the best way to identify such shares, keeping in mind that ESMA does not have data on the relative liquidity of shares in the EU versus in third countries? More generally, would you include any additional criteria to define the scope of the share trading obligation and, if yes, which ones?

FESE agrees with ESMA's proposal to limit the trading obligation to EU shares.

The share trading obligation (STO) remains necessary and is an important cornerstone of the overall aim of MiFID II/MiFIR to enhance the efficiency, resilience and integrity of financial markets in the EU. For the STO to be fully functional, further work on clearly determining which shares should be considered EU shares is necessary. The approach should avoid undue complexity and be based on predictable and meaningful criteria.

According to the current STO definition, EU investment firms can only undertake trades in shares admitted to trading in the EU on EU trading venues, equivalent third country trading venues and SIs. Ahead of MIFID II/MiFIR application, the STO provision was therefore highlighted by FESE and others to policy makers as one which would likely generate unintended consequences due to its extraterritorial reach. This assessment was made since, if equivalence is not granted, shares traded on third country non-equivalent venues also admitted to trading in the EU would have to be traded in the EU by EU investment firms. These provisions would apply regardless of the liquidity of non-EU shares on EU markets, meaning that shares that are highly liquid on third country venues but for which liquidity on EU markets is low would also have to be traded in the EU.

To date, only a handful equivalence decisions have been adopted, while the Commission and ESMA have de facto limited application of the STO by interpreting the scope in a narrow way. Both the European Commission and ESMA have indicated that equivalence decisions will only be adopted for countries where the EU trading in the shares is of a certain magnitude and that the absence of an equivalence decision therefore does not prevent EU investment firms from trading shares admitted to trading in the EU on non-EU venues.

While the extraterritoriality has been de facto limited this way, the approach does not provide certainty to the industry as the regulation's requirement exempting 'non-systematic, ad hoc, irregular and infrequent' trading has not been clarified in a conclusive way.

In addition, as highlighted by ESMA, there is a further challenge with respect to securities that are dual-listed on an EU and non-EU trading venue as EU brokers may need to access

both pools of liquidity. The STO should not restrict such access to this liquidity as this would harm EU investors and could disincentivise dual-listed issuers to retain their listing in the EU in order to extricate themselves from the STO if their primary liquidity is outside the EU.

Determination of EU shares

Given the various challenges highlighted above in relation to the STO, a careful approach is essential. Therefore, in order to determine which shares should be considered as EU shares, FESE suggests the following approach:

- the STO should apply to those shares with an ISIN starting with a country code corresponding to an EU27 Member State plus those starting with a non-EU country code but where the issuer has its primary listing within the EU27
- the STO should not apply to those shares with an ISIN starting with a country code corresponding to an EU27 Member State where the issuer has its exclusive listing in a third country
- in cases where the security is dual-listed on both an EU trading venue and a non-EU trading venue at the specific request of the issuer, we propose that the STO should also still apply but that there is an exception in the provision (as suggested by ESMA in the consultation – para 278), to allow trading to take place on the non-EU trading venue where the issuer has listed the security, in addition to the EU venues.
- "Listing" in this sense is always made upon request of the issuer and involves various obligations for initial listing and for maintaining a listing.

This approach will ensure that the key objective of the STO can still be achieved i.e. more transparency with OTC trading moving to lit trading, it will also ensure in the case of dual-listed securities, that EU brokers and their investors can still access the main pools of liquidity where the issuer itself has requested its security to be traded and does not in any way disincentivise issuers from listing on EU trading venues.

Furthermore, we would also highlight the following points relevant to the STO:

- For dual-listed securities (where the issuer has chosen to have one of the two listings in the EU), investment firms should have the possibility to trade on either listing venue. To address the consequences of this exemption, reporting arrangements for such dual listed shares ought to be devised to achieve the transparency of these shares in the EU. Exemptions should be removed where trades are "non-systematic, ad-hoc, irregular and infrequent", instead exemptions should only apply for those trades that do not contribute to price formation based on a clear and consistent list of qualifying non-price forming trades – see our response to Q.33 for further detail.
- The scope of the STO should be extended to ETFs in order to incentivise lit trading and investor protection in this growing asset class.

Q32: Would you support removing SIs as eligible execution places for the purposes of the share trading obligation? If yes, do you think SIs should only be removed as eligible execution places with respect to liquid shares? Please provide arguments (including numerical evidence) supporting your views.

FESE considers that SI activity should be limited to trades above LIS. Below LIS, this type of execution venue should operate as a trading venue, under non-discretionary and non-discriminatory rules, and comply with the tick size and transparency regimes. We would recommend retaining SIs as eligible execution places for the purposes of the share trading obligation but limiting the activity to trades above LIS.

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In such a scenario the LIS-threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading would be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre and post trade transparency requirements thus creating a lit space for below LIS. The available waivers under the pre-trade transparency regime (Article 4 MiFIR) would be limited to the LIS and OMF waivers and the double volume cap mechanism would disappear.

SI activity would be restricted to above LIS only. Above LIS trading would constitute a dark space in which trades would not be subject to pre-trade transparency and would benefit from delayed post-trade transparency. This would result in an appropriate limitation of SI activity and a welcome simplification of the fragmented execution landscape. Please also see our response to question 6.

Q33: Would you support deleting the first exemption provided for under Article 23 of MiFID (i.e. for shares that are traded on a "non-systematic, ad-hoc, irregular and infrequent") basis? If not, would you support the introduction in MiFIR of a mandate requiring ESMA to specify the scope of the exemption? Please provide arguments supporting your views.

FESE supports deleting the first exemption under the STO as we consider it has not been clarified in a conclusive manner. The exemption has been subject to discretionary interpretation and therefore not worked in practice.

Q34: Would you support simplifying the second exemption of Article 23 of MiFIR and not limiting it to transactions "carried out between eligible and/or professional counterparties"? Please provide arguments supporting your views.

FESE supports retaining this exemption and strictly limiting its use to transactions not contributing to the price formation process. In practice, this would mean that the OTC space is limited to technical trades. In order to allow for clear and efficient rules, FESE supports reviewing the current Level 2 list of eligible transactions under this exemption and tying its enforcement to an appropriate flagging of trades via MMT under the governance of ESMA.

However, the list should be clear and exhaustive for the STO to be applied in the same way by all market participants. To ensure correct reporting of these trades, FESE suggests extending MMT to all execution venues as well as to OTC transactions.

FESE response to ESMA consultation on the transparency regime for Equity instruments – Part 6 (Closing auctions)

Q35: What is your view on the increase of volumes executed through closing auctions? Do you think ESMA should take actions to influence this market trend and if yes which one?

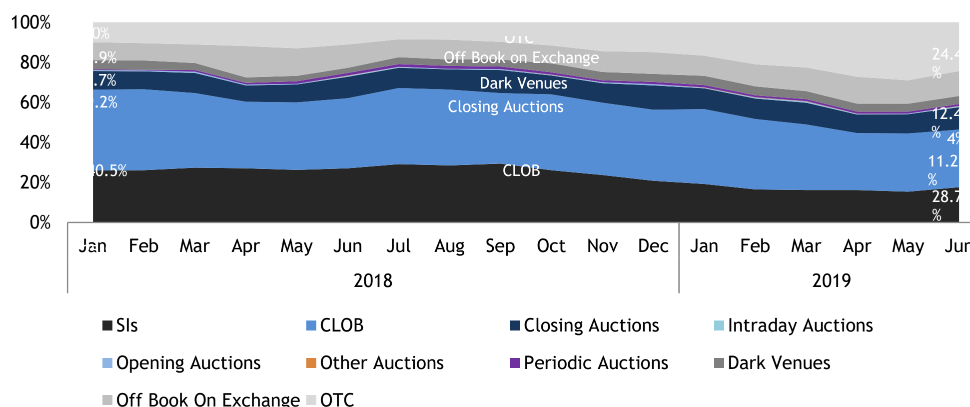
Closing auctions concentrate liquidity over a limited period of time (a few minutes only). The more participants in closing auctions, the higher the liquidity, the more efficient the price and the lower the risk of manipulation.

As their name indicates, closing auctions determine the closing price of a share in the best interest of public companies and investors by pooling all liquidity in the auction. They are relevant to set the reference price for a high number of financial instruments (ETFs, derivatives, traditional funds etc.) and allow market participants to replicate the exact price at which index rebalances are done. In addition, it is the official closing price that is used for calculations for corporate actions and other transactions, and is the generally accepted

reference price for many other purposes, such as tax matters or for the determination of settlement prices by CCPs.

FESE observes that, historically, closing auctions have always concentrated a significant share of the turn-over on trading venues in Europe. But since January 2018, the market share of closing auctions when compared to all other execution venue types grew from 9.7% to 11.7% in June 2019.

Figure 1: Market share per venue type for STOXX 600 instruments on European markets



Source: Big xyt data, FESE calculations

The growing importance of closing auctions can be seen as a result of the increase in SIs and OTC trading which make use of pre-trade transparency waivers. The increase in off-exchange trading has a negative impact on market quality and the price formation process. Hence, in such an environment, investors actively seek out the closing auction which is one of the few times in the day when investors truly receive the benefit of centralised liquidity.

Furthermore, as recently noted by the AMF, the growing importance of this end-of-trading phase can also be explained by the expansion of passive management, whose mechanism for creating and cancelling units usually uses the net asset value at the end of day and which requires trading at the closing price for exact replication (Autorité des Marchés Financiers, Growing importance of the closing auction in share trading volumes, October 2019, Risk & Trend Mapping).

The increased market share of closing auctions has sparked allegations that their centralised nature gives primary exchanges too much power. However, it is important to recall that there are approximately 170 equity execution venues in Europe, which is evidence of a highly competitive market. The popularity of closing auctions shows that there is a significant demand from investors for this highly transparent and non-discriminatory mechanism which is in the best interest of investors, public companies and the market as a whole.

We would like to stress that centralisation in itself does not create uncovered stability risks and, with appropriate safeguards on resilience (e.g. MiFID II Art. 48) in place, primary exchanges have proven their value by maintaining trust in their rules and procedures. The centralisation of liquidity in the closing auctions guarantees that the price formed is dependable since it is protected by the rules established by exchanges. Dispersing trading across a large variety of venues and execution modes will come at the cost of deterioration of price formation. The proliferation of order flow across execution venues raises concerns around liquidity aggregation and the quality, reliability and efficiency of price determination.

In this context, FESE believes it is important that regulators and policymakers consider the range of price formation delivered by trading venues and acknowledge the core value of price formation on exchanges. Hence, FESE believes that ESMA shall not take any action be it by limiting the participation into closing auction or by intervening in the existing competitive landscape.

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