FESE Response to the ESMA Consultation Paper on Algorithmic Trading

Brussels, 12th March 2021

Introductory remarks

In principle, FESE is supportive of the MiFID II framework for algorithmic trading and therefore welcomes ESMA's consultation paper. While we generally agree with ESMA's suggestions, we provide some additional recommendations in connection to a number of topics. We believe that the framework has proved its efficiency over the last years and, therefore, any changes should be limited and targeted.

FESE Members play an important role in supporting the stability of the financial system and are taking several measures to build up their resilience to protect their systems. Trading venues systems are reliable, monitored in real-time, dimensioned and scalable to the order flow's needs. We agree, for example, with ESMA's analysis that at the beginning of the COVID-19 crisis trading venues proved to be broadly resilient. Circuit breakers were efficiently used and trading capacity was tested by volumes reaching all-time highs, with few operational issues.

In connection to the above, we welcome ESMA's efforts to ensure a consistent level of protection across trading venues. However, we see many pitfalls in an approach where a one-size-fits-all regime is set for OTR per asset class and therefore we do not agree with ESMA's proposal. We believe that the maximum allowed OTR should be based on an assessment related to trading venue and member's system capacity, latency problems, excessive market data flows etc. to safeguard orderly and sound trading activity. To level the playing field, we believe that the definition of algorithmic trading should apply to SIs and trading venues irrespectively. Given the role that SIs play in today's equity markets, we consider necessary to address the risks attached to OTC algorithmic trading at the SI level, especially from an investor protection point of view. In addition, FESE agrees with ESMA's proposal to remove the obligation for DEA clients that are dealing on own account to be authorised as investment firms because it would ensure equal treatment of EU and non-EU firms.

FESE agrees with ESMA's analysis that the MiFID II/MiFIR market-making regime has contributed to clarity and a more stringent framework. However, we believe that because of adverse selection no incentives will outweigh the risk in stressed markets. Therefore, incentives might have an insignificant impact on market-making behaviour during stressed market conditions. Market conditions rather than incentives drive market-making behaviour.

We also consider that, although speedbumps can work for derivatives and options markets, equity markets have not benefitted in the same way. Nevertheless, FESE does not support the suggestion that such arrangements shall be prohibited for equity markets without evidence of any detrimental effect of speedbumps on European equity markets. The current legal framework ensures a well-calibrated balance between allowing for innovation and the imperatives of market integrity and investor protection.

Regarding the tick size regime, we appreciate that RTS 11 was amended to allow tick size adjustments for non-EU shares. However, we propose an adjustment to make any shares

considered as non-EU eligible for an adjustment of their tick size. FESE Members have also observed that the Level 3 Guidelines in respect to frequent batch auctions, for example, are applied differently across jurisdictions. Furthermore, we would also encourage policymakers to look into how the tick size regime is being applied at the SI level in practice.

Finally, we generally agree with the compliance assessment of fee structures and related disclosures by the trading venues conducted by ESMA and NCAs. As per MiFID II/MiFIR, co-location services and fees are transparent, fair, and non-discriminatory.

FESE looks forward to continuing its cooperation with ESMA on this matter.

Q1: What is your overall assessment of the MiFID II framework for algorithmic trading, HFT and DEA?

FESE generally agrees with the MiFID II framework for algorithmic trading. In general, we are supportive of ESMA's proposals but provide some additional recommendations in our response.

Q2: In your views, are there risks other than the one mentioned in MiFID II or impacts on market structure developments due to market electronification/ algorithmic trading that would deserve further regulatory attention? Please elaborate.

No, FESE believes that MiFID II/MiFIR as well as MAR provide well-functioning and appropriate frameworks to address any risks and we have not identified any new developments in relation to algorithmic trading that would require further action. Trading venues have implemented these frameworks in their rule books to which market participants need to adhere. These are complemented by a comprehensive set of functional and technical mechanisms such as circuit breakers, OTRs, or testing requirements that have proved their efficiency since MiFID II/MiFIR.

Q3: Do you consider that the potential risks attached to algorithmic trading should also be given consideration in other trading areas? Please elaborate.

No, in line with our response to Q2, FESE believes that MiFID II/MiFIR as well as MAR provide well-functioning and appropriate frameworks to address any risks and we have not identified any risks attached to algorithmic trading in other areas.

Q4: Do you agree with this analysis? If not, please explain why.

FESE agrees with ESMA's view that DEA clients should adhere to MiFID II requirements where they apply algorithmic trading technology. According to the current Level 1 and Level 2 requirements, DEA providers have a contractual relationship with DEA users and are responsible for their clients' order flow. FESE, therefore, notes that the DEA provider should also be responsible for clarifying whether their clients apply algorithmic trading techniques and whether they adhere to the respective MiFID II provisions.

Q5: Did you encounter any specific issue with the definition of HFT? Do you consider that the definition should be amended? Do you have any suggestion to replace the high message intraday rates with other criteria or amend the thresholds currently set in Level 2? Please elaborate and provide data supporting your response where available.

FESE has not encountered major issues with the definition of HFT and finds the current methodology generally well-calibrated. The current methodology and criteria have proved

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their efficiency since MiFID II came into effect and ensure a high level of transparency and predictability.

FESE would therefore not recommend any dynamic intraday calculation to be included.

Q6: Based on your experience, is sub-delegation of DMA access a frequent practice? In which circumstances? Which benefits does it provide to the DEA user and to the sub-delegates? Are you aware of sub delegation arrangements in the context of Sponsored access? If so, please elaborate.

According to the Level 1 and Level 2 provisions, DEA providers have a contractual relationship with DEA users and are responsible for their clients' order flow. Therefore, the information on clients and sub-delegation is not available at the trading venue level. FESE Members cannot thus comment if sub-delegation of DEA access is a frequent practice.

Q7: (for DEA Tier 1clients) Do you sub-delegate direct electronic access? If so, are your Tier 2 clients typically regulated entities/investment firms? Are they EU-based or third country based?

N/A

Q8: Do you agree with this analysis? If not, please explain why. Do you consider that further clarification is needed in this area? If so, what would you suggest?

FESE agrees with ESMA's analysis. We do not think that further clarification in relation to online brokerage would be required. MiFID II clearly established a differentiation between DEA, where the person transmitting the order to the trading venue has more control over the order and timing of its submission, and intermediation, where submitters of orders do not have control over the parameters of the arrangement. FESE also concurs with ESMA's view that retail clients are not considered to perform investment activities on a professional basis and should therefore not be required to be authorised as an investment firm. For clients categorised as retail clients under MiFID II, the due diligence procedure shall ensure that statutory investor protection and know-your-client requirements are met, that the service provided is suitable for the client and that the client is reasonably informed of the terms of the services and applicable rules and restrictions.

Q9: Do you agree with ESMA's proposal? If so, do you consider that the requirements considered above relevant? Should there be additional ones? If you disagree with ESMA's proposal, please explain why.

FESE believes that the definition of algorithmic trading should apply to SIs and trading venues irrespectively. We believe that the application of RTS 6 requirements to investment firms engaged in algorithmic trading in trading venues should be extended to all investment firms with algorithmic OTC trading to ensure a level playing field. These requirements include (i) general organisational requirements (including procedures for the development, deployment and subsequent updates of trading algorithms, solving of problems identified when monitoring algorithms, separation of tasks and responsibilities of trading desks from risk control and compliance), (ii) staff with sufficient knowledge of algorithmic trading and strategies, (iii) responsibility when outsourcing IT and procurement (responsibility towards obligations when outsourcing or procuring software or hardware used in algorithmic trading), (iv) management of material changes in algorithmic trading, (v) business continuity arrangements for algorithmic trading systems, and (vi) real-time monitoring of algorithmic trading activity.

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Given the role that SIs play in today's equity markets, as recently illustrated by ESMA[1], we consider it necessary to address the risks attached to OTC algorithmic trading at the SI level, especially from the point of view of investor protection. Investors need to be able to trust that effective risk controls are in place to mitigate and address those risks in an appropriate and effective manner, in particular during stressed markets conditions. Furthermore, given that the business activities of SIs are to a large extend opaque, investors need the confidence that SIs follow regulatory standards.

[1]ESMA. "ESMA Annual Statistical Report - EU Securities Markets." Paris, 2020. See also research on HFT in the OTC space: Gomber, Peter, and Martin Haferkorn. "High-Frequency-Trading: High-Frequency-Trading Technologies and Their Implications for Electronic Securities Trading." Business and Information Systems Engineering 5, no. 2 (April 2013): 97–99. https://doi.org/10.1007/s12599-013-0255-7. Aramian, Fatemeh, and Lars L. Nordén. "High-Frequency Traders and Single-Dealer Platforms." SSRN Electronic Journal. Elsevier BV, January 7, 2020. https://doi.org/10.2139/ssrn.3738608.

Q10: Do you agree with ESMA's proposals above? Please elaborate.

FESE agrees with ESMA's proposal to remove the obligation for DEA clients that are dealing on own account to be authorised as investment firms because it would ensure equal treatment of EU and non-EU firms. It is key that a level playing field exists in the EU on such a trading arrangement. We believe that the requirement for DEA Tier 1 clients dealing on own account to establish a branch and authorisation in the country of the trading venue can have a negative impact on trading and therefore on the liquidity of national products.

In addition, FESE concurs with ESMA that the MiFID II/MiFIR requirements imply full responsibility of a DEA provider for the DEA order flow and provide a meaningful and appropriate framework for controlling any risks related to DEA access to a trading venue to deal only on own account. Therefore, an additional requirement for authorisation of DEA clients does not seem necessary.

However, FESE does not support ESMA's proposal to extend the definition of DEA clients to Tier 2 DEA clients as we concur with point 47 in the consultation paper that Tier 2 DEA clients would, in most cases, not technically be in possession of the venue's trading code and hence would not have DEA for the purpose of Article 2(1)(d) of MiFID II. Further, we would be cautious about amending Article 17(5) of MiFID II in order to provide the number and names of DEA clients annually. As per our answers to previous questions, trading venues do not have a contractual relationship with DEA clients and hence have no access to such information.

Q11: Do you agree with ESMA's proposal? Please elaborate.

N/A

Q12: Do you see merit in ESMA developing a template for notifications to NCAs under Articles 17(2) and 17(5) of MiFID II? If not, please justify your position.

FESE sees merit in a template for notifications to NCAs by investment firms for the provision of DEA and engagement in algorithmic trading as a means to achieving a more convergent approach. Nevertheless, to the level of detail of such notifications, we would like to highlight that the information outlined under point 84 of the consultation paper appears sufficient.

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Q13: Do you agree that it would be useful to clarify that notifications should be done 'without undue delay'?

FESE agrees with ESMA's proposal. While submitting notifications without undue delay is widely acknowledged by market participants, a clarification on the timing might be beneficial for a more convergent supervisory practice.

Q14: Do you agree with ESMA's approach for the exchange of information between NCAs? If not, please justify your position.

N/A

Q15: What is your view on clarifying the definition of algorithmic trading? If you deem it beneficial to refine the definition and account for further types of algorithms or algorithmic trading strategies, please provide your suggestion as well as underlying rationale.

FESE would prefer the current definition to remain unchanged. Further clarification and differentiation of the definitions may only result in omitting certain types of algorithms.

Q16: Do you think there should be specific requirements for different type of algorithms or algorithmic trading strategies in RTS 6? Please explain.

In line with our answer to the previous question, we believe that the current requirements are adequate as they stand.

Q17: What is your experience with testing environments? Are they used frequently? If not, why? Do you see a need for any improvements?

N/A

Q18: Do you agree that the definition of "disorderly trading conditions" should be clarified? If yes, how would you define such trading conditions?

FESE agrees that a clarification of "disorderly trading conditions" would be beneficial. FESE believes that "disorderly trading conditions" should refer to a market situation where the maintenance of a fair, orderly, and transparent execution of trades is compromised. While we do not think that a Level 1 change is required, we support including a consistent definition of the term across RTS 6, RTS 7, and RTS 8.

Q19: Do you agree that ESMA should provide additional guidance on the expectations concerning the checks and testing to be done, in particular for testing on disorderly trading conditions?

FESE does not believe that additional guidance on the expectations concerning the checks and testing to be done is necessary. The needs for testing facilities are very heterogeneous depending on an investment firm's trading behaviour. Pre-defined expectations on testing and checks might not cover the heterogeneity of algorithms and strategies applied by market participants.

Q20: Would you agree that it could be beneficial if ESMA develops a prescribed format for the self-assessment foreseen in Article 9 of RTS 6?

N/A

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Q21: Do you agree with the changes proposed to the self-assessment of Article 9 of RTS 6?

N/A

Q22: Would you propose any other targeted legislative amendments to RTS 6? Please include a detailed explanation of the proposed amendment and of the underlying issue that this amendment would aim to tackle.

N/A

Q23: Do you agree with ESMA's proposal to harmonise and create a clear structure for the performance of the self-assessment?

FESE believes that the current format and approach to performing self-assessments, which is shared with the relevant NCAs, has worked well. Nevertheless, should a harmonised structure be provided in the future, we would like to highlight that additional operational and compliance-related burdens should be avoided and that trading venues should be granted sufficient time to implement any new approach.

Q24: Do you agree with limiting the self-assessment to every two years and to require trading venues to share it with their relevant NCA?

FESE supports the proposal by ESMA to limit the self-assessment to every two years. FESE Members are already required to share their self-assessments with the relevant NCAs since the implementation of MiFID II. Hence, it is reasonable to continue sharing them.

Q25: Do you agree with ESMA's analysis about the overlapping requirements between RTS 6 and 7? Are those overlaps considered beneficial, should they be removed or are there any gaps? Are there any further points that should be clarified?

FESE agrees with ESMA's analysis and regards the overlaps as beneficial. They clearly outline the responsibilities of investment firms and trading venues respectively to allow for proper testing. We believe that trading venues' primary tools and ability to curb or prevent disorderly trading are through the use of appropriate price collars and mechanisms to manage volatility, whereas the ability to test and certify the soundness of algorithms should reside with the investment firms that deploy the algorithms.

Q26: What is your view with regards to the testing of algorithms requirements? Do you agree that more robust testing scenarios should be set?

FESE does not see the need for further clarification of testing scenarios as the current requirements are sufficient. Participants of trading venues are very heterogeneous due to their individual business models and trading strategies; therefore, a pre-defined testing approach would not reflect this heterogeneity. Taking into account this heterogeneity, trading venues provide simulation environments so participants can address their individual test cases.

We would like to highlight that the testing requirements for algorithms that are most of the time deployed by participants on multiple trading venues will not, by itself, enable markets to get a higher level of security. Pre-trade risk management at the level of participants, and to some extent trading venues, is a more efficient method of preventing incidents by offering to the market the tools to monitor and react in real-time to issues arising out of algorithmic trading.

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Q27: Are the testing environments available for the testing of algorithms appropriate for this purpose?

FESE believes that testing environments are appropriate. Taking into account the heterogeneous needs of market participants, trading venues provide simulation environments so participants can address their individual test cases in a realistic trading environment.

Q28: Do you agree with ESMA's analysis that the circuit breaker mechanism achieved its objective to avoid significant disruptions to the orderliness of trading?

FESE agrees with ESMA's analysis that "trading venues proved to be broadly resilient, despite the surge in trading activity, message traffic and market movements. Circuit breakers were widely and efficiently used and trading capacity was tested by volumes reaching all-time highs, with few operational issues." Hence, they achieved the objective of protecting markets against episodes of extreme volatility affecting particular instruments or the whole market.

Q29: Do you agree that the requirements under Article 48(5) of MiFID II complemented by RTS 7 and the guidelines on the calibration of circuit breakers and publication of trading halts under MiFID II remain appropriate? If not, what regulatory changes do you deem necessary?

FESE agrees that current requirements at Level 1 up to Level 3 are adequate and sufficient and would not recommend changing them. This regulatory setup, combining a comprehensive legal framework and market operators' discretion on the actual design of the mechanisms, results in a market environment that effectively contributes to ensuring price quality and financial stability. We do not, therefore, think that further requirements are necessary; FESE does not support the proposal for interlinking markets, which would require trading venues to halt or constrain trading in case of significant price moves on related markets.

Q30: Do you agree that the co-location services and fees structures are fair and non-discriminatory? Please elaborate.

FESE agrees that, as per Article 48 of MiFID II and RTS 10, co-location services and fees are transparent, fair, and non-discriminatory. FESE Members provide information about services and related prices in a transparent manner and publicly on their websites.

This requirement should also apply to third-party service vendors and proprietary trading platforms since these enable the operator (which, at the same time, routes client orders and deals on own account) to benefit from advantageous proximity to its server, without giving the same possibility to the other participants active on the platform.

Q31: Do you think that the disclosures under RTS 10 made by the trading venues are sufficient or should they be harmonised among the different entities? Please explain.

FESE generally agrees with the compliance assessment of fee structures and related disclosures by the trading venues conducted by ESMA and NCAs. FESE believes that disclosures of services as set out by RTS 10 are sufficient and services and related prices are publicly available on trading venues' websites. FESE does not believe that harmonisation among different entities would be required. Rather, trading venues should have some discretion for individual descriptions of services and related fees as they might offer different services.

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Q32: Do you agree with ESMA's proposal to set out the maximum OTR ratio, calibrated per asset class?

FESE welcomes ESMA's efforts to ensure a consistent level of protection across trading venues. However, we see many pitfalls in an approach where a one-size-fits-all regime is set for OTR per asset class and therefore we do not agree with ESMA's proposal. We believe that the maximum allowed OTR should be based on an assessment related to trading venue and member's system capacity, latency problems, excessive market data flows, etc. to safeguard orderly and sound trading activity.

Any OTR must ensure the highest level of market integrity and must be relevant to the instrument that is being traded. Each trading venue must be allowed to set the OTR per instrument based on its knowledge of the local market and trading data in order to ensure that the ratios are relevant and kept up to date. Any methodology to calculate these ratios must take into consideration the specific type of instrument as well as other market specifics, such as the liquidity of the platform. The ratio does not have to be the same, even for the same financial instruments, on all the platforms where the instrument is traded, considering that each market has its own characteristics.

Therefore, FESE believes that the determination of maximum OTR should remain within the responsibility of each trading venue.

Q33: Do you agree that the maximum limits are not frequently exceeded? Please explain any potential underlying issues in this respect that should be recognised.

FESE agrees that maximum limits are not frequently exceeded and we do not perceive underlying issues in this specific area. This view is the result of a profound analysis of the trading activity of all trading participants per asset class. Maximum limits are set in a way that penalises outliers but does not artificially affect regular trading activity, thereby ensuring market integrity and system resilience in line with the objective of the OTR regime. In addition, trading venues have installed additional layers of defence warning and slowing down participants reaching the limits. Further, trading participants themselves, mindful of the consequences of any breach, often monitor and control their message flow to avoid exceeding the limits.

However, we do see some underlying issues in the current OTR regime. These relate to the counting methodology: it appears that there are different interpretations of the Annex to RTS 9 on how certain types of order modifications are counted. For cases when original order volume is reduced, it appears some venues treat this as one order, and others treat it as two. Until these discrepancies are resolved, a common approach as proposed by ESMA might lead to an unlevel playing field.

Q34: Do you agree with the consequences as described of exceeding the maximum limits or should there be a more convergent approach? Please provide any comment or suggestion regarding the procedures in place by trading venues in case of a member exceeding the prescribed limit.

FESE agrees with the described consequences; however, we do not think that there is a need for a more convergent approach. The consequences of exceeding the maximum OTR limit depend on the implementation of national law and are implemented in the respective trading venue rules. A violation of the maximum OTR limit might trigger sanctioning procedures, including warnings, penalties, or the temporary exclusion from trading. In addition, as mentioned in the previous question, trading participants themselves continuously monitor and control their message flow to avoid exceeding the limits, being mindful of the consequences of any breach.

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Q35: Do you agree with the need to improve the notification process in case of IT incidents and system outages? Beyond the notification process between NCAs and ESMA, which improvements could be done regarding communication of incidents to the public?

FESE Members play an important role in supporting the stability of the financial system and are taking several measures to build up their resilience to protect their systems.

In line with the MiFID II/MiFIR requirements, FESE Members have established well-functioning procedures of communication to customers and notification to the respective NCAs in case of IT incidents or outages. Therefore, we do not believe that there is a need for streamlining the notification procedures from trading venues to NCAs and ESMA via additional guidance.

In this context, FESE welcomed the recent proposal from the European Commission for a Regulation on Digital Operational Resilience for the Financial Sector (DORA) which already aims at introducing a consistent and streamlined approach for the financial sector as regards IT incident classification, notification towards authorities, and communication to customers and the public. This also includes the establishment of information and coordination procedures between relevant authorities at the national and EU level. Such cooperation between Member States would increase the efficiency and efficacy of the overall ecosystem resilience.

Therefore, FESE supports the harmonised reporting process to NCAs established by DORA which improves efficiency and aims at swiftly addressing critical incidents. However, a shift to a centralised reporting structure, while seemingly an attractive option because of the uniformity, might introduce issues due to lack of familiarity and understanding of local markets. Any proposal should carefully consider the possible market impact, as well as factoring in the differences between trading venues. Disproportional regulatory approaches should be avoided.

Q36: Do you believe any initiative should be put forward to ensure there is more continuity on trading in case of an outage on the main market, e.g. by requiring algo traders to use more than one reference data point?

No, FESE does not see the need for the proposed initiative. As there is a close to 100% system performance of main markets, we do not see a reason for concern for the price formation process.

FESE considers that the decision to use more than one reference data point is the one of the market participant and shall not be a regulatory requirement as it involves costs and could drive to unforeseen consequences on the market structure.

We would rather be cautious of any unforeseen consequences of requiring algorithmic traders to use more than one reference data point. By forcing algorithmic traders to include different sources of information, the underlying assumption is that regulated markets, other venues, and potentially SIs are set on the same level in terms of price formation and information and can easily switch from one to the other. FESE considers that declines in trading following outages are linked to the importance of price formation. Despite the ability to trade on alternative venues, the low confidence of traders in the price formation on alternative venues may deter them from trading on those markets during the outage period. The height of volatility in the COVID-19 crisis is a good example of the importance of transparent markets and the flight to execution quality in the event of market turmoil. It proved once more that there was a need from investors to trade on regulated markets when looking at the migration of volumes from dark, SI, and OTC trading to lit regulated markets.

Trading venues systems are reliable, monitored in real-time, dimensioned, and scalable to the order flow's needs. In addition, as per Articles 47 and 48 of MiFID II, trading venues have in place effective systems, procedures, and arrangements to ensure their systems

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are resilient and can guarantee orderly trading under conditions of severe market stress. While price formation occurs across a range of venues, such alternative venues do not make investments in the full range of activities necessary to contribute to the core price formation process, but rather use the data provided by trading venues to run their own commercial business models. We believe it is important that regulators and policymakers consider the range of price formation delivered by trading venues. Any initiatives on the continuity of trading would not remedy the underlying problems around market fragmentation and the different levels of contribution to the price formation process.

Q37: Do you agree with the view that the tick size regime had overall a positive effect on market depth and transaction costs?

FESE cannot express any opinion regarding the benefits of the tick size regime. This would require that all our Members conduct an analysis similar to the one done by the AMF. We would, however, reiterate the fact that a tick size regime is key to avoiding a race to the bottom, and we underline that this was the main motivation for the implementation of the FESE tick size regime by many European exchanges in 2009.

Q38: Is there any further issue you would like to highlight regarding tick size regime?

FESE Members have observed that the Level 3 Guidelines in respect to frequent batch auctions (FBAs), for example, are applied differently across jurisdictions. The FCA has declared that "Transactions executed off-tick at the mid-price are permissible when required by the auction algorithm used by the FBA"; this means that pegged orders to the midpoint are allowed unconditionally and that executions can take place at subticks[1]. On the contrary, in compliance with the ESMA guidelines, some EU NCAs have forbidden midpoint order pegging. Although we understand that Level 3 regulation is not mandatory, we believe that, in order to avoid any future distortion within the EU, (which would be detrimental and anti-competitive), the Level 3 measures should be moved to Level 2. Furthermore, we would also encourage policymakers to look into how the tick size regime is being applied at the SI level in practice.

On a more technical level, and referring to the FITRS database, we would also like to recall that:

- The most relevant market in terms of liquidity (MRMTL) can only be a trading venue, as per Article 4 of RTS 1. We have overtime observed numerous instances where SIs have been selected as MRMTL by ESMA. We would suggest ESMA implements checks to verify, based on the MIC code, that the MRMTL is a trading venue.
- The first day of trading entered by trading venues must be a correct date and checked by ESMA. We have observed that some venues have reported the first day of trading for an instrument as being one week before the IPO.
- We would request that ESMA publishes the field "Calculation Time" for the different MiFID II parameters in the full ECR files and delta files, in the same way as they are provided on the ESMA registration website. This information is crucial and allows trading venues to select the correct information to use in their systems when more than one set of data is published for the same calculation period (which is particularly relevant in case of half-year updates).

[1] FCA. "Supervisory Statement on the Operation of the MiFID Markets Regime after the End of the EU Withdrawal Transition Period." London, 2020.

Q39: Do you agree with the proposal not to amend the tick size regime for third country shares? Please explain.

FESE appreciates that RTS 11 was amended to allow tick size adjustments for non-EU shares and that this was done very quickly after MiFID II entered into force. While we recognise the argument provided by ESMA that illiquid shares (less than one transaction per day) shall not be eligible to the adjustment, we would still point at the inconsistency between the definition of third-country shares (shares with their main pool of liquidity located outside of the EU) and the definition of non-EU shares (shares without an EU ISIN) suggested by ESMA[1]. Acknowledging the wording difference, we would still consider that any shares considered as non-EU should be eligible for an adjustment of their tick size. This would remove the "more or equal to one transaction per day on average" criterion. The criterion of the main pool of liquidity located outside the EU would still remain as it would guarantee that the tick size regime applying to those non-EU shares reflects one of the dimensions in RTS 11, namely the liquidity of the instrument.

The case of Brexit does illustrate the limitation, indeed, of the "main pool of liquidity located outside the EU" combined with the "less than one transaction per day on average" criteria. On 1st January 2021, the EU had to redistribute the status of competent authority and most relevant market in terms of liquidity for more than 4,270 instruments from the UK to an EU country. This meant recalculating MiFID II parameters including the Average Daily Number of Transactions (ADNT) for the determination of tick sizes. For more than 2,750 instruments this meant that the level of liquidity of the instrument – with the MRMTL located in the UK – could not be matched with the existing level of liquidity on any trading venue in the EU. Another 1,000 instruments where the main pool of liquidity is located outside of the EU saw an increase in their tick size without the possibility of being adjusted in March 2021, as a result of an EU ADNT now below one.

Regarding the specific case of Brexit, we would urge ESMA to consider this year a recalculation of the MRMTL and the ADNT mid-2021, based on the first six months of this year, and to apply this until the next yearly calculations (April 2022). This would allow some realignment with the current flow dispersion and redistribution in the EU, and the switch in market shares observed in January 2021 from UK venues to their entities in the EU. This would also allow for EU shares to reflect their real level of liquidity in the EU 27, while adjusting third country shares to their level of liquidity outside of the EU thanks to an ADNT above one.

[1] ESMA. "MiFID II/ MiFIR Review Report on the Transparency Regime for Equity and Equity-like Instruments, the Double Volume Cap Mechanism and the Trading Obligation for Shares." Paris, 2020.

Q40: Do you agree with the proposal to widen the scope of the tick size regime to all ETFs? Would this pose challenges in your view? Please explain.

FESE would support a harmonised approach across all ETFs which could translate into having all ETFs subject to a tick size regime. However, the current tick size regime defined in RTS 11 was calibrated to match the liquidity profile of equities. This approach does not fit ETFs which track a broad range of underlying markets, including fixed income markets. We think it is then crucial that ETFs are assigned to liquidity bands reflecting adequately the liquidity level for the relevant instrument; we would then urge the regulators to consider not only the highest liquidity band in Annex RTS 11 but also (a) new liquidity band(s), which would be more granular. Tick sizes excessively large would mean higher transaction costs for market participants and undoubtedly a flight to markets that are not following the tick size rules, namely OTC markets, which already account for a significant share of the ETFs' flow.

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Q41: Do you agree with the proposal not to widen the scope of the tick size regime to non-equity instruments? Please explain.

FESE agrees with ESMA's proposal not to extend the tick size regime to non-equity instruments. We find this extension unnecessary considering the particular characteristics of these instruments and the microstructure of the different markets in which they may be traded, making it difficult to apply standardised measures such as the tick size.

Q42: Do you agree with ESMA findings and assessment of the current MiFID II market making regime?

FESE agrees with ESMA's analysis that the MiFID II/MiFIR market-making regime has contributed to clarity and a more stringent framework. However, FESE believes that because of adverse selection no incentives will outweigh the risk in stressed markets. Therefore, incentives might have an insignificant impact on market-making behaviour during stressed market conditions. Market conditions rather than incentives drive market-making behaviour.

Q43: What do you think of ESMA proposals and suggested amendments to RTS 8? In your view, what other aspects of the market making regime require to be amended and how?

While some exchanges already focus on continuous trading for measuring market-making performance, FESE Members believe that there is also added value for derivatives markets beyond continuous trading. Therefore, there should be some discretion for trading venues to decide, depending on what makes sense for their markets and ecosystem. We do not support, however, the proposal to expand the obligation to have market-making schemes for all instruments and types of trading systems. Trading venues should have discretion to assess for which instruments and markets such schemes are suitable and can help to increase liquidity.

Further, FESE does not support the proposal to have incentives for non-liquid markets. Trading venues should be able to decide whether incentives for non-liquid markets make sense to foster liquidity, or whether fee rebates only for the best liquidity providers would be appropriate for their market. The latter, however, should not be mandatory. In addition, FESE does not agree with limiting fee rebates for the best liquidity provider, in particular for illiquid instruments. To foster liquidity in less liquid instruments, trading venues should be able to offer any type of incentive scheme to all market makers. Rather, FESE recommends removing the obligation for trading venues to offer market-making schemes, as these have proven to be ineffective, especially in stressed market conditions (please see also our answer to Q42).

Q44: What are market participants views regarding the flexibility left in the MiFID II market making regime? Would you agree with ESMA further clarifying certain relevant concepts? If yes, which ones?

FESE believes that market-making schemes and incentives should be set generally without any distinction between different market conditions. Compensation of market risks in stressed market conditions by means of setting incentives stands in contrast to trading venues' neutrality to ensure fair and orderly price finding as they should not be exposed to market risks linked to trading strategies. As stated by ESMA, discretion is essential for allowing trading venues to adapt the rules to the nature and scale of their activity and, consequently, be proportional. Therefore, the discretion to define the market-making agreement and scheme should remain with the trading venues and we do not see the need for further clarification.

Q45: Could you please describe how Primary Dealers agreements are designed (number of designated Primary Dealers, transparency about investment firms having signed such agreements, typical obligations contained, etc…). Do you consider that Primary Dealers should be exempted from the Article 1 of RTS 8? Do you consider that this can introduce a regulatory loophole?

N/A

Q46: Do you think that venues which introduced asymmetric speedbumps provide enough information regarding the mechanism used? If not, what additional information would be useful to disclose to market participants?

FESE believes that venues that introduced asymmetric speedbumps have provided and are providing appropriate and sufficient information to all stakeholders involved in the process. Generally, FESE welcomes the dialogue with regulators on the topic of speedbumps and is happy to provide empirical insights based on the recent findings of its Members' mechanisms.

Q47: Reflecting on those mechanisms which allow liquidity providers to provide quotes that can be filled only against retail order flow, do you think that such mechanisms are beneficial in terms of market quality? Is there any specific aspect that you think should be further taken into account, also considering the type of instruments traded? Please specify the venue of reference and the type of arrangement discussed.

FESE considers that such mechanisms are beneficial in terms of market quality so long as the retail investor is not disadvantaged in comparison to the institutional investor.

Some exchanges offer retail quotes at or above the European Best Bid Offer (EBBO) in a model where those orders compete in the overall order book, thus allowing competition and an attractive price for retail investors. Indeed, such models aim at offering the best price available on the market to the retail investor in a system that remains competitive.

This is in contrast to other models that implement solutions which allow liquidity providers to provide quotes that can be filled only against retail order flow.

FESE would like to draw attention to such arrangements which are often referred to as payment for order flow and welcomes the recent announcements by ESMA and the Commission to assess these arrangements and their compliance with MiFID II rules on inducements, conflicts of interest and best execution.

Returns from payment for order flow should be prohibited or the profit resulting from this should always be passed on to the client. New trading models involving retail order flow should be assessed against the requirements set for regulated markets, with particular consideration given to their contribution to efficient price formation and compliance with the MIFID II transparency requirements. A review should be undertaken of payment for order flow models with a view to ensuring that Best Execution requirements are met.

Q48: Do you think that venues which introduce asymmetric speedbumps should set tighter market making requirements? Please explain why and how tight those new requirements should be.

FESE does not support the idea that venues which introduce asymmetric speedbumps should set tighter market-making requirements. An asymmetric speedbump does not allow liquidity providers uniformly to quote tighter at any cost but is rather an instrument to stimulate competition. The respective liquidity providers must invest in their IT infrastructure to ensure reaction capabilities. However, even in a product with an asymmetric speedbump there are multiple liquidity providers that are not able to utilise the respective millisecond reaction time. Their business offering is to offer prices at a

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magnitude others cannot offer rather than to provide tight prices. Tightening the market-making requirements when trading venues introduce asymmetric speedbumps would therefore only increase entry barriers for new market participants.

Q49: Do you agree on the conclusion that speedbumps might not be a well-suited arrangement for equity markets? If yes, do you think that such arrangements for equities should be prohibited in Level 1? Please explain.

Although speedbumps can work for derivatives and options markets, equity markets have not benefitted in the same way. However, FESE does not support the suggestion that such arrangements shall be prohibited for equity markets without evidence of any detrimental effect of speedbumps on European equity markets. The current legal framework ensures a well-calibrated balance between allowing for innovation and the imperatives of market integrity and investor protection.

Q50: Do you think that the introduction and functioning of speedbumps should be further regulated? If yes, which specific requirements would you like to be included in EU legislation?

FESE does not see the need for uniformly regulating speedbumps. Currently, the number of trading venues that have introduced speedbumps or are planning to do so is rather limited and hence there is little evidence and academic research on their performance and long-term effects that would require uniform regulation. We would therefore welcome continued dialogue between the respective NCAs, and trading venues that have introduced or are going to introduce speedbumps in the future. We would be happy to provide further information also to ESMA and other interested stakeholders.

Q51: Is there any specific issue you would like to highlight about speedbumps?

FESE believes that asymmetric speedbumps could, under certain circumstances, help level the playing field by protecting passive liquidity strategies against latency arbitrage. There is also a misconception that high-frequency traders are speculators who move markets to extremes. In fact, the vast majority of HFT involves looking for very small arbitrage opportunities, as between futures and cash markets or between the prices of exchange-traded funds and their net asset values. These actions increase market efficiency by tightening bid-ask spreads and reducing transaction costs for all market participants.

Q52: What are your views on the relative timing of private fill confirmations and public trade messages? If you are a trading venue, please provide in your answer an explanation of the model you have in place.

FESE Members have carefully considered and implemented the synchronisation of the private fill confirmations and public trade messages. We, therefore, believe that, as long as the information on the sequencing of the public and private feeds is transparent and accepted by all participants, the sequence should be at the discretion of each trading venue.

Q53: Do you consider information on the sequencing of these two feeds at trading venues to be easily available? If you are a trading venue, please provide a link to where this information can be found publicly.

Yes, as FESE Members provide information on the sequencing of data feeds on their respective websites.

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Q54: Do you think there should be any legislative amendments or policy measures in respect of these feed dynamics?

FESE does not see the need for legislative changes or policy measures in relation to the sequencing of data feeds. FESE believes that trading venues should have discretion to determine the design of their infrastructure, in adherence with current MiFID requirements on ensuring sequencing of data feeds is publicly available to market participants.

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