FESE Response to the ESMA Consultation Paper on ESMA's Opinion on the Trading Venue Perimeter

Brussels, 29th April 2022

Q1: Do you agree with the interpretation of the definition of multilateral systems?

FESE believes that the primary aim of ESMA's Opinion on the Trading Venue Perimeter should be to provide clarifications on the definition of "multilateral system" in MiFID II for the purposes of supervisory convergence. The interpretation should take into account the need to ensure proper enforcement of the regulatory framework. There should not be room to artificially circumvent the framework. At the same time, there needs to be room for healthy innovation to ensure competition on a level playing field. It is important to strike the right balance between competing objectives of the MiFID II/R regime, for example:

1. On the one hand, it is important to promote fair and orderly trading, market integrity, and a level playing field.
2. On the other hand, the perimeter should not be excessively burdensome and cover market conduct that does not involve trading.
3. In addition, as national competent authorities will rely on the upcoming Opinion, ambiguities that could lead to undue extensions of the perimeter should be avoided.
4. ESMA should, when looking at individual cases, be careful to consider all the elements of the definition of a multilateral system and not just selected parts of it.

For this specific question, we alert ESMA to not apply an interpretation of "system"/"facility" that is too broad. Specifically, by including any set of contractual agreements and standard procedures, ESMA needs to avoid the risks to also include innovative mechanisms that are neither intended to be considered nor operate as multilateral systems within the perimeter. In contrast, we think that BaFin has provided a definition of what constitutes a "system" which we strongly support because it adequately reflects what is at the core of a trading system. According to BaFin, a system is "an objective set of rules governing membership, the admission of financial instruments to trading, trading between members, notifications of completed transactions, and transparency obligations.[1] In the end, there should remain a regulatory differentiation between a technological platform and a full-fledged marketplace.

The same argument applies to "ability to interact". The broad interpretation of these definitions may in certain cases have the undesirable consequence of including facilities in which there is no genuine trade execution or arranging taking place (which goes against Recital 8 of MiFIR). While it is important to ensure that all multilateral systems are properly supervised, it is important to provide legal certainty in respect of systems that are not intended to provide this functionality. In respect to paragraphs 22-23 and 27-28, it would be useful to provide more considerations on the negative scope of the "able to interact" criterion, such that market participants have more clarity on what is excluded from the perimeter. In particular, the notions "genuine trade execution", "genuine

arranging" and "genuine interaction" should be clarified, as well as "functioning of the arrangement" and the role of third-party systems. The lack of clarity is poised to inhibit operators from exploring innovative arrangements that should fall outside the perimeter.

Finally, we believe that Paragraph 12 should make explicit that the set of rules should be mandatory (i.e. imposed by the market operator) in order to qualify as a "multilateral system". In Paragraphs 13 and 14, ESMA refers to the MiFID II service of reception and transmission of orders (RTO) and the link to multilateral systems, stating that "a clear distinction should be made between RTO and the operation of a trading venue". We agree with that statement, however, some added clarity would be helpful on how to clearly distinguish RTO from a multilateral system.

[1] Own translation of https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_091208_tatbestand_multilaterales_handelssystem.html

Q2: Are there any other relevant characteristics to a multilateral system that should be taken into consideration when assessing the trading venue authorisation perimeter?

In general, we believe the consideration of additional characteristics risks narrowing the scope of multilateral systems which has been defined by MiFID II, with the risk that some systems that should be treated as multilateral and therefore regulated as a trading venue would fall outside of the regulatory perimeter.

In addition, we suggest it should be highlighted that any systems that are deemed multilateral and are required to be authorised as trading venues must be subject to similar obligations. In particular, system operators must provide the appropriate real-time pre-trade transparency data reflecting the true trading interests available. We are aware of trading venues that in our view do not publish the required information. Therefore we suggest that more needs to be done in relation to the monitoring and consistent enforcement of all trading venues across the EU to ensure they are subject to and fully comply with the same requirements.I

Regarding the delineation between multilateral and bilateral systems, FESE believes more descriptions of the system's activities would be beneficial for enforcement aspects. This should include systematic internalisers (SIs). In principle, we suggest introducing a requirement for investment firms to seek authorisation as an SI. Such a process would include providing information on the condition of executing orders, a description of the functioning of the SI, interactions between SIs and trading venues, compliance with best execution requirements, etc. SIs in their capacity of systems executing significant volumes must be monitored in order to guarantee that they work on a bilateral basis and comply with the tick size regime. It should be ensured that SIs cannot differentiate the type of flow they receive to gain an unfair advantage for their own benefit. Such profiling can be done by using different streams or particular flags attached to the flow received by SIs. The inconsistent flagging of SI trades should also be considered in view of this.

Q3: In your experience, is there any communication tool service that goes beyond providing information and allows trading to take place? If so, please describe the systems' characteristics.

Q4: Are you aware of any EMS or OMS that, considering their functioning, should be subject to trading venue authorisation? If yes, please provide a description.

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We agree with ESMA that OMS should not be considered as multilateral systems as they do not bring together, nor allow for the interaction of, multiple third-party buying and selling interests.

In contrast, an EMS, while facilitating order execution by offering an overview of liquidity and prices on various venues, may sometimes be considered a multilateral system. As rightly mentioned in ESMA's examples, EMS which would allow for firms to send RFQs to multiple players, allowing for an interaction within the system, should fall under the definition of a multilateral system and be subject to an authorization requirement. This would allow to level the playing field between EMS and trading venues that may also operate an RFQ system, since the function and goals of those systems are similar.

Other EMS types where their functionality does not allow for trading interests of different parties to interact with each other without involving a trading venue should be excluded from the definition of a multilateral system.

However, it needs to be carefully considered that regulating electronic systems like EMS on the one side but not regulating chat and telephone business in the same way may result in adverse impacts, hindering electronification and transparency by pushing volume into unregulated and opaque voice and chat systems.

Q5: Do you agree that Figure 4 as described illustrates the operation of a bilateral system operated by an investment firm that should not require authorisation as a trading venue?

We agree with ESMA that such a system should be considered bilateral, may hence qualify as an SI and does not require authorisation as a trading venue.

Q6: Do you agree that a "single-dealer" system operator by a third party, as described in Figure 5, should be considered as a multilateral system? If not, please explain.

Q7: Do you agree that systems pre-arranging transactions that are formalised on a trading venue, even when arranged in a multilateral way, should not be required to be authorised as trading venues? Do you agree with the justification for such approach?

Trading venues have no systematic insights into negotiations taking place outside their systems, as only the resulting orders of these negotiations are formalized on the trading venue and executed. It is in most of the cases not visible to the trading venue via which system the specific buying and selling interests emerge and were negotiated to ultimately find their way into the exchange trading venue system to be executed. Thus, trading venues mostly do not have any contractual relationships with systems used to pre-negotiate buying and selling interests/orders for formalization and execution into their system. In most of the cases, the trading venues observe a member entering the information in their system and not a potential system that might have been used for the negotiation.

In light of the above, it should be carefully considered if the proposed exemption in chapter 4.3. should indeed be pursued. This proposal would manifest a status where price (pre-)formation is taking place via partially opaque platforms bringing together multilateral trading interests, as these would be exempted from the requirement of being regulated as a trading venue.

If it is nevertheless deemed necessary to exempt such price formation platforms from the scope of the multilateral system definition, it should be avoided to consider pre-arranging platforms as an extension of trading venues (or trading venues as an extension of pre-

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arranging platforms). As explained, there is generally no contractual relationship between both.

The trading venue also does not outsource the arranging of transactions to the pre-arranging firm. Pre-arranging a trade prior to its conclusion on the trading venue is not necessarily part of the trade conclusion. Trades are only concluded by registration on a trading venue in accordance with its rules, which do not require any pre-arranging. As the trading venue therefore does not have to pre-arrange any trade, it may not outsource such a task (which it never had).

Neither does the pre-arranging firm outsource the trade conclusion to the trading venue. The pre-arranging firm is at no point in time mandated to execute trades and therefore cannot outsource this task (which it never had). Trade conclusion is exclusively and originally the task of the trading venue.

Therefore, contrary to ESMA's proposal in paragraph 80, we deem it to be the sole responsibility of the pre-arranging firm to comply with its regulatory and legal obligations applicable to the pre-arranging of transactions and catering to the exchange/ trading system, while it is the sole responsibility of the trading venue to ensure legal and regulatory compliance of the process of order entry, execution, and trade formalization on the trading venue under its rules. Such allocation of responsibilities should not be disrupted by a special mandatory agreement between the trading venue and the pre-arranging firm.

In addition, for MiFID II/R provisions that do not relate to a particular trade, but to trading as a whole (like provisions on non-discriminatory access), it would remain unclear which trading venue (and to what extent) would have to ensure compliance, if a firm formalized all trades on a trading venue but not always on the same one.

Q8: Are there any other conditions that should apply to these pre-arranged systems?

Q9: Are there in your views any circumstances where it would not be possible for an executing trading venue to sign contractual arrangements with the pre-arranging platforms? If yes, please elaborate.

We believe each trading venue should decide the contractual arrangements it has with its own participants and whether it is appropriate to have a dedicated contractual relationship with pre-arranging platforms.

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