



FESE response to the ESMA Consultation Paper on MiFIR report on Systematic Internalisers in non-equity instruments

17th March 2020, Brussels

Introduction

FESE welcomes the opportunity to respond to the ESMA Consultation Paper on 'MiFIR report on Systematic Internalisers (SIs) in non-equity instruments'. In particular, we would like to address the question on the potential unlevel playing field between SIs and multilateral trading venues.

We believe that there seems to be gaps in the application and enforcement of the SI legislative framework to the detriment of transparent trading. The analysis on the evolution of the EU non-equity market structure hints to the fact that policy measures to bring trading out of the dark have not been as successful as had been originally expected. Bonds and derivatives markets with deep pools of high-quality liquidity are a crucial component of healthy ecosystems and are an important contributor to competitive, transparent and stable EU financial markets. Ensuring transparency in these markets requires tailored rules that balance the need for enhanced transparency whilst recognising the nuanced work of such markets. Based on this, we believe more needs to be done to ensure the transparency objectives of MiFID II and the G20 mandate are fulfilled. FESE therefore calls for increased reflection on the appropriate application and subsequent enforcement of existing rules.

Furthermore, for certain instruments, such as bonds and securitised derivatives, we would recommend using the 100,000 EUR denomination threshold to delineate lit (RM, MTF and OTF) trading from dark (OTC and SI) trading. Limiting trading at and below the 100,000 EUR threshold to transparent multilateral venues would reduce market fragmentation and increase liquidity and pre- and post-trade transparency, in particular for retail investors.

Q1 - Do you consider that there is a need to clarify what a "firm quote" is? If so, in your view, what are the characteristics to be met by such quote?

N/A

Q2 - (For SI clients) As a SI client, do you have easy access to the quotes published, i.e. can you potentially trade against those quotes when you are not the requestor? Do you happen to trade against SIs quotes when you are not the initial requestor? How often? If it varies across asset classes, please explain.

N/A

Q3 - What is your overall assessment of the pre-trade transparency provided by SIs in liquid non-equity instruments? Do you have any suggestion to amend the existing pre-trade transparency obligations? If so, please explain which ones and why.

N/A

Q4 - (For SI clients) do you have access to quotes in illiquid instruments? If so, how often do you request access to those quotes? What is your assessment of the pre-trade transparency provided by SIs in illiquid instruments?

N/A

Q5 - (For SIs) Do you disclose quotes in illiquid instruments to clients upon request or do you operate under a pre-trade transparency waiver? In the former case, how often are you requested to disclose quotes (rarely, often, very often)? Does it vary across instruments / asset classes?

N/A

Q6 - Do you consider that there is an unlevel playing field between SIs and multilateral trading venues active in non-equity instruments, in particular with respect to pre-trade transparency? If so, please explain why and suggest potential remedies.

As highlighted by ESMA in the consultation paper, based on our observations there seems to be gaps in the application and enforcement of the SI legislative framework to the detriment of transparent trading. We agree with the fact that there needs to be more clarity on whether there is a risk of an unlevel playing field between SIs and multilateral trading venues.

The objective of MiFID II / MiFIR was to bring OTC multilateral trading (i.e. broker crossing networks or BCNs) to lit multilateral trading venues in an attempt to increase transparency and improve price formation and investor protection.

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.

It has been observed that BCN trading volumes under MiFID I have shifted to SI reported trading instead of moving to multilateral trading venues. This indicates that the objectives of MiFID II/R are not met and, in stark contrast with the spirit of the legislation, the complexity of markets has increased as well as the fragmentation of liquidity.

The analysis on the evolution of the EU non-equity market structure hints to the fact that policy measures to bring trading out of the dark have not been as successful as originally expected. Bonds and derivatives markets with deep pools of high-quality liquidity are a crucial component of healthy ecosystems as well as an important contributor to competitive, transparent and stable EU financial markets. However, ensuring transparency in these markets requires tailored rules that balance the need for enhanced transparency whilst recognising the nuanced working of such markets. Based on this, we believe more needs to be done to ensure the transparency objectives of MiFID II and the G20 mandate can be fulfilled. FESE therefore calls for increased reflection on the appropriate application and subsequent enforcement of existing rules.

As such, FESE highly recommends that ESMA reviews how SIs operate, for instance whether the rules on clients' access to quotes are enforced in a truly objective and non-discriminatory way. ESMA should also get more clarity into the kind of transactions SIs report,

as a matter of urgency. Furthermore, ESMA should investigate the different SI models to ensure their compliance with MiFID II / MiFIR given its important role in detecting weaknesses in the enforcement framework.

Furthermore, for certain instruments, such as bonds and securitised derivatives, we would recommend using the 100,000 EUR denomination threshold to delineate lit (RM, MTF and OTF) trading from dark (OTC and SI) trading.

For bonds, trading is still opaque and there was no increase in transparency triggered by MiFID II / R compared to MiFID I. Prohibiting trades in instruments with denominations below 100,000 EUR to be executed via SIs could trigger a shift of (retail) bond trading to lit venues (RMs, MTFs and OTFs) compared to the current market structure where the major part of bond trades are executed in the dark ((1) OTC between banks or (2) between retailers and SIs). Trading at and below the 100,000 EUR threshold on transparent multilateral venues would reduce market fragmentation and increase liquidity and pre- and post-trade transparency, in particular for retail investors. We suggest that this level applies to both non-liquid and liquid products.

The delimitation based on the 100,000 EUR denomination threshold would be consistent with the threshold used for the wholesale disclosure regime defined by the Prospectus Regulation. Furthermore, this threshold would also be in line with the one currently used for the calculations to determine whether a bond is liquid or not.

For securitised derivatives, this delimitation would simplify the fragmented execution landscape.

We expect that investors - especially retail investors - would profit from the change as it would allow for a better interaction on multilateral markets.

Q7 - (for SIs who are also providing liquidity on trading venues): What are the key factors that determine whether quote requesters (your clients) want to receive the quote through the facilities of a trading venue or through your own bilateral trading facilities?

N/A

Q8 - What is your view on the proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments under Article 16(6) and 18(7)?

N/A

Q9 - Do you consider that the requirements in relation to SI quotes in illiquid non-equity instruments (Article 18(2)) are appropriate? What is your preference between the options presented in paragraph 52 (please justify)?

N/A

Q10 - What is your view on the recommendation to specify the arrangements for publishing quotes?

N/A

Q11 - Do you have any comment on the analysis of Bond data and the relation with the SSTI thresholds as presented above?

N/A

Q12 - Do you have any comment on the analysis of derivatives data and the relation with the SSTI threshold as presented above?

N/A

Q13 - What is your view on the influence of the SSTI thresholds on the pre-trade transparency framework for SI active in non-equity instruments? Are there any changes to the legal framework that you would consider necessary in this respect?

N/A

Q14 - What is your view on the best way for ESMA to fulfil the mandate related to whether quoted and traded prices reflect prevailing market conditions and in particular: (1) the source of data for the SI quotes/trades (RTS 27, APA); (2) the source of market data prices; and (3) the methodology to compare the two and formulate an assessment?

N/A