EVIA European Venues & Intermediaries Association

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Mr Tilman Lueder
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DG Financial Stability, Financial Services and Capital Markets Union
European Commission
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By Email

Dear Tilman

The members of the European Venues & Intermediaries Association were pleased that the Commission was able to release its MiFID II Review proposals at the end of last year. Having taken the opportunity to review and consider them, EVIA is supportive of several elements which will advance the CMU project and more effectively implement the MiFID II package. In particular:

- A consolidated tape lays the tracks for better data and process standardisation across the range of MiFID II financial instruments.
- The legislative cleaning up of some of the MiFID "Quick Fix" Covid Measures, especially the comprehensive removal of the convoluted, ill-defined, and under-employed "Best Execution" requirements.
- The removed licensing requirements for persons dealing on own account on a trading venue by means of DEA.
- The prospective alignment of data standards and reporting obligations between markets regulations and across EU competent authorities.

That said, there are a number of areas which we would highlight as concerns:

**Stakeholder Input**

The procedure followed by the Commission has not given stakeholders a reasonable opportunity to provide input ahead of the comitology stage. There are a number of areas within the proposals that would benefit from industry comment, including proposals that do not meet the expectations of market participants and areas where the drafting does not adequately capture either the policy intent or the full breadth of use-cases and potential impacts. The proposals expressly note that certain areas of implementation remain unresolved, particularly those relating to practical models, yet there has been no procedure for public input.

We would urge that a formal public consultation be launched to ensure that the co-legislators have the best information available about the impacts of the proposals on different market areas. This has a political dimension, but it is also essential to ensure that the practical sides of these reforms are properly discussed and understood.

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**Trading Venue Perimeter – Definition of a "Multilateral Trading System"**

For some time, EVIA members have raised concerns about competing firms being allowed to avoid setting up as trading venues or avoid regulation for arranging or providing for the Receipt and Transmission of Orders, despite undertaking the same or similar activities in the wholesale secondary markets. Concerns have been raised also about technology being deployed by dealers to connect the trading interests in their OMS/EMS systems in a way that meets the definition of a multilateral trading systems; effectively, avoiding trading venue organisational requirements and the other regulatory obligations that attach to their operators.

EVIA members have appreciated that these issues have been taken seriously by the EU. Last year's OTF Review specifically raised the need to clarify the rules and improve supervision. Despite resistance from those organising networked trading systems using their internal OMS/EMS systems, ESMA took the action to provide guidance on the application of the rules to such systems. While we await the conclusion of the work on their Opinion, we appreciate the Commission's proposal to relocate the definition of a multilateral trading system to MiFIR. However, by itself, it does not resolve the problems of supervisory forbearance that have allowed systems to proliferate on the edge of the regulatory perimeter. We support ESMA's proposals to address the self-serving interpretations that have been applied by certain firms in order to avoid the requirement to seek authorisation as a trading venue or other system. It cannot be that some market participants implement the MiFID II rules and take on the burdens of operating trading venues or other systems, while others shirk those requirements, despite operating functionally similar businesses. The principle of "same business, same rules" needs to be made effective across the Union.

Evidence of the need to make this clear arises from the flow of trading activity from regulated trading venues and other regulated systems to unregulated systems. These systems are able to attract trading interests because they have no comparative regulatory costs or compliance obligations. Arguments that they are "fintech's" which require special treatment to foster innovation are clearly at odds with the need to ensure that markets are regulated consistently. While we welcome technical innovation, no one should be building businesses that evade the regulatory rules and architecture that is intended to ensure the stability, safety, and visibility of organised markets.

It should be recalled that the OTF was created as an expansive and technology-neutral category precisely to allow emerging and developing business models to be accommodated. The corollary to a wider perimeter, one which facilitates the oft-mentioned CMU objectives of diversity, depth, liquidity, and inclusion, is the capacity for more flexible supervision. This is necessary to accommodate the inclusion of facilities conducting purely arranging activities.

Of course, subject to the DTO, bilateral trading between firms should not be treated as requiring a trading venue. Firms should be free to contract between themselves on a one-to-one basis. What is impermissible is that firms should be acting as intermediaries on a regular basis—whether by linking through IT to match client trading interests or bringing together different clients to interact inside a system—without organising as trading venues. This could be addressed easily in the legislation by amending the definition of a "multilateral system" to make it clearer that the use of a system or system components which allows third-party trading interests to interact falls within the meaning of a "system or facility." This would give legal force to the interpretation that ESMA has recognised is best aligned to the policy intention.

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**Trading Venue Perimeter – Limitation of the OTF to Non-Equities**

EVIA members were disappointed that steps have not been taken to adjust the OTF boundary to include cash equities traded as part of strategy (also called package) trades. The trading of equity derivatives has been made more complicated by the MiFID II legislation, because it prevents the cash equity leg from being executed on an OTF. The result has been the proliferation of on-venue and off-venue models for the arrangement and execution of this class of derivatives. We would encourage this to be revisited with the aim of providing a greater degree of flexibility for the execution of such transactions or elements of them on OTFs. We do not believe that such a reform would encourage market fragmentation, so ought to be considered on a limited basis.

**Consolidated Tape – Pre-Trade Transparency**

EVIA members were also disappointed that the opportunity was not taken to adjust the pre-trade transparency regime to better reflect the reality of trading in the European markets. We would strongly urge a refinement of the pre-trade transparency regime in favour of a post-trade consolidated tape, which would be helpful to the market and avoid the production of unnecessary data.

EVIA members were also disappointed at the proposal to remove the pre-trade SSTI waiver without a corresponding adjustment to the LIS threshold. The SSTI waiver has not been relied upon as much as it might, because there are other considerations, such as the liquidity assessments applied to certain non-equities, that have taken priority. As liquidity calculations change and more instruments are subject to the transparency requirements, the value of the SSTI waiver in the cases of RFQ or voice trading systems would naturally increase. The removal of the SSTI waiver would subject a set of trades to the transparency requirements unless the LIS thresholds were adjusted to accommodate them. This appears not to have been examined for the purposes of the MiFID II Review, but it is precisely the kind of issue that market participants ought to have been invited to provide input on in a public consultation.

**Consolidated Tape: Revenue Model Means Expropriation without Compensation**

EVIA members welcome the proposals for a set of consolidated tapes, organised by asset class; however, the consolidated tape proposals include a distorted and unfair revenue model. While it will be compulsory for trading venues, investment firms and SIs to contribute market data, compensation only appears to be provided to regulated markets for the equities consolidated tape. MTFs, OTFs and other contributors are excluded from the revenue share model, although their data sales businesses will be impacted by the publication of the equities consolidated tape. Even then, the revenue share will be distributed to regulated markets based upon the proportion of pre-trade transparent liquidity in shares displayed by them, which excludes block trading. The result is a transfer of value from a community of contributors to a narrow set of regulated markets, which is a form of expropriation without compensation. That clearly offends European Union principles and human rights legislation.

We note that there is no provision for compensation to be paid to contributors in the non-equities segment at all. It is unclear to us whether that is a gap in the drafting to be filled or whether it is intentional. In the latter case, and in any case where the model of the equities consolidated tape is applied to bonds and derivatives, the problem remains that value will be transferred to the operator of the consolidated tape at the expense of the community of contributors. We would also characterise this as expropriation without compensation. We would be forced to consider a challenge to such an arrangement, should the final legislation not fairly address the interests of contributors.

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**Consolidated Tape: "Reasonable Commercial Basis" for Data Costs**

The proposed framework basis for ESMA to specify content, format and terminology of data costs presupposes that a readily available data cost price is available. Clearly this is not the case for trading venues where the data is consequent to the ongoing activity of the venues and the costs are variable based upon factors like trade complexity.

**Consolidated Tape: Inefficient and Ineffective Structure**

EVIA members are concerned that the appointment of a private sector consolidated tape provider (CTP) for each relevant asset class will lead to unhelpful outcomes. For example, different CTPs could operate with different requirements, which would force data contributors to adapt to multiple specifications. Another concern would be incumbent data vendors becoming CTPs in order to secure a commercial advantage because of the compulsory contribution requirements and the possibility to develop advanced products using the (currently, in the proposals, free) data.

We would prefer a public sector or parastatal solution which is structured to ensure consistency and fairness. Alternatively, any private sector appointment must be on the basis that the rights and interests of the data contributors are appropriately recognised and respected. In either event, every effort should be made to avoid adding to the costs of contributing to each CTP; recognising that contributors may well be submitting data for multiple CTPs. Otherwise, the risk is that contributors will be forced to incur costs to submit data to each of the CTPs, while their own data sales are being appropriated to a utility driven by the private profit motive.

**Consolidated Tape: Failure to Remove the Hurdles and Barriers Hampering Derivatives Transparency**

Whilst the Commission has acknowledged that reliance upon the ISIN poses the principal barrier to transparency in the OTC derivatives markets, largely as a consequence of deploying the RTS 23 data schema over RTS2 reference categorisation,EVIA members are disappointed that it has not deployed common data elements to facilitate the standardisation of those instruments under the clearing and trading mandates, whilst also harmonising with EMIR data reporting standards.

**Derivatives Trading Obligation – Application to Certain Firms**

EVIA members welcome the Commission's proposal to grant discretionary relief from the derivatives trading obligation (DTO) to individual investment firms, on the application of the relevant NCAs, provided that they are market makers in a derivative subject to the EU DTO. We are concerned, however, about the additional requirement to regularly receive RFQs from counterparties outside the EU/EEA who do not otherwise have membership of a trading venue within the EU/EEA where they could have traded the instrument. This last provision is unhelpful, because there isn't a link between membership of an EU/EEA trading venue and liquidity – the idea that two counterparties would have met and contracted on a trading venue is purely theoretical if that is not where the liquidity is in practice.

We would recommend that the second condition be removed or qualified to remove the reference to a trading venue within the EU/EEA where a third country firm could have traded the relevant instrument. The reason is that there are multiple trading venues in the EU that are open to trading in all manner of instruments, including those subject to the DTO, but they are not necessarily available to the third

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country market participant or active sources of liquidity. The condition would undermine the policy intention.

We also note that the meaning of a "market maker" in MiFID II is quite specific, while the use of the term in this context appears to be intended to be more general. We would urge the Commission to clarify the intention.

**Derivatives Trading Obligation – Suspension of the Clearing Obligation**

EVIA members support the Commission's proposal to create a mechanism for ESMA to request that the DTO be suspended to match a suspension of the clearing obligation. However, we would like to raise a concern about the requirement for secrecy that has been included in the proposal. In our view, policy-making on questions around the DTO should be transparent.

**Payment for Order Flow (PFOF)**

EVIA members note that the Commission proposes to bar PFOF in the following terms:

"Investment firms acting on behalf of clients shall not receive any fee or commission or non-monetary benefits from any third party for forwarding client orders to such third party for their execution."

In the materials, this text is introduced as being focused on retail flows, but the drafting above is considerably broader and would apply to any client relationship. If the policy intention is to apply this restriction to retail flows, then the text needs to be amended to make that clear. We suggest that it also ought to be drafted to distinguish between inducements to attract flow to trading venues, which creates a conflict of interest between the intermediary and the investor, and payment of fees for the receipt and transmission of orders between, for example, introducing brokers and executing brokers where the introducing broker does not have an exchange membership and arranges for a trading interest to be transmitted for execution.

**Double Volume Cap**

EVIA members note that the Commission proposes to amend the double volume cap on the dark trading of equities, so that it becomes a single volume cap. The proposals would remove the first cap, which applies to individual trading venues and retain the second, which applies to the overall level of dark trading in the Union. However, it is also proposed to reduce the second cap to 7% of trading, down from 8%. We support the removal of the first cap, but the reduction of the second cap to 7% will only favour the incumbent regulated markets. We would support maintaining the current 8% cap.

**Reference Price Waiver**

EVIA members note that the Commission proposes to limit the use of the reference price waiver by MTFs by instituting a minimum threshold trade size for use of the waiver. We understand that this is to prevent MTFs from executing small trade sizes under the waiver. This approach is problematic for the trading of cash equities and we would urge that the reference price waiver is not amended in any way that leads to distortions of the level playing field between venues.

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We trust that this input is helpful but remain at your disposal in case of any questions or comments.

With kind regards,

Yours sincerely

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