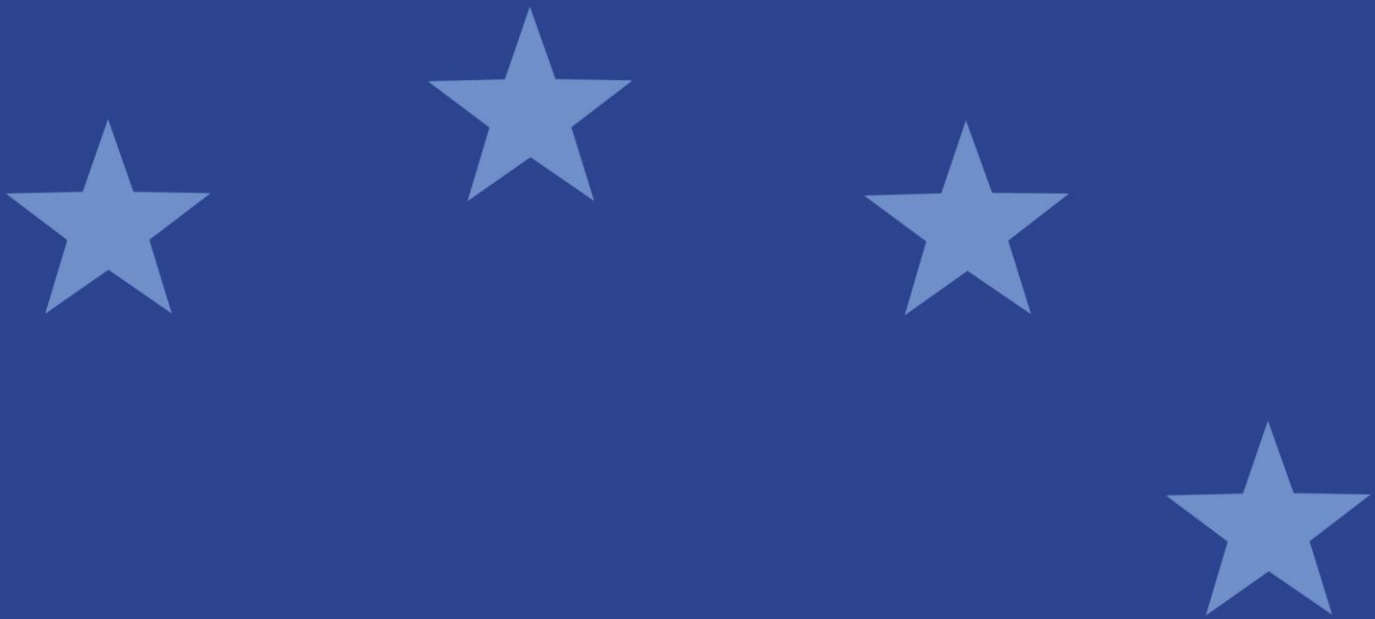




European Securities and  
Markets Authority

# **Reply form for the Consultation Paper on MiFID II/ MiFIR review on the functioning of Organised Trading Facilities (OTF)**



## Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **25/11/2020**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading 'Your input - Consultations'.

### Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_FOTF\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_FOTF\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_FOTF\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA's website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading "Your input – Open consultations" → "Consultation on the functioning of the Organised Trading Facility regime").

## **Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

## **Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading [Legal Notice](#).

## **Who should read this paper**

This document will be of interest to (i) alternative investment fund managers, UCITS management companies, EUSEF managers and/or EuVECA managers and their trade associations, (ii) distributors of UCITS, alternative investment funds, EuSEFs and EuVECAs, as well as (iii) institutional and retail investors investing into UCITS, alternative investment funds, EuSEFs and/or EuVECAs and their associations..

## General information about respondent

Name of the company / organisation	FIA EPTA (European Principal Traders Association)
Activity	Other Financial service providers
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	Europe

## Introduction

*Please make your introductory comments below, if any*

<ESMA\_COMMENT\_FOTF\_1>

The FIA European Principal Traders Association (FIA EPTA) represents 29 independent European Principal Trading Firms (PTFs) that deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of instruments, including shares, options, futures and ETFs. As market makers and liquidity providers, our members contribute to efficient, resilient, and high-quality secondary markets that serve the investment and risk management needs of end-investors and corporates throughout the EU.

FIA EPTA supports transparent, robust, and safe markets with a level playing field and appropriate regulation for market participants. We consistently support the aim of the market structure reforms laid out in MiFID II/MiFIR and welcome the opportunity to respond to this consultation on consultation paper on MiFID II/ MiFIR review on the functioning of Organised Trading Facilities (OTF).

Our members are aware of various systems and market practices which seem to conflict with MiFID II expectations for multilateral systems. Some of these systems are in fact multilateral but claim not to be. Others, by contrast, claim to be multilateral but act as de-facto bilateral systems. In both cases, this distorts the level playing field and we note that in some cases these systems also raise non-discriminatory access and investor protection concerns. We would strongly welcome regulatory and supervisory convergence measures by ESMA in relation to such systems in order maintain the level playing field in European financial markets.

FIA EPTA members would welcome the opportunity to provide further background information to ESMA on these and the other issues raised in our response.

<ESMA\_COMMENT\_FOTF\_1>

## Questions

**Q1: What are your views about the current OTFs landscape in the EU? What is your initial assessment of the efficiency and usefulness of the OTF regime so far?**

<ESMA\_QUESTION\_FOTF\_1>

[TYPE YOUR TEXT HERE ]

<ESMA\_QUESTION\_FOTF\_1>

**Q2: Trading in OTFs has been fairly stable and concentrated in certain type of instruments throughout the application of MiFID II. How would you explain those findings? What in your view incentivizes market participants to trade on OTFs? How do you see the OTF landscape evolving in the near future?**

<ESMA\_QUESTION\_FOTF\_2>

[TYPE YOUR TEXT HERE ]

<ESMA\_QUESTION\_FOTF\_2>

**Q3: Do you concur with ESMA's clarifications above regarding the application of Article 1(7) and Article 4(19) of MiFID II? If yes, do you agree with the ESMA proposed amendment of Level 1? Which other amendment of the Level 1 text would you consider to be necessary?**

<ESMA\_QUESTION\_FOTF\_3>

Yes, FIA EPTA members agree with ESMA's clarifications that the requirement to be authorised as a trading venue should be solely dependent on whether a system fits the definition of a multilateral system. Whether or not the system or facility meets the definition of a regulated market, MTF or OTF should not preclude it from requiring to be authorised and, in the process of being authorised, the system should make any changes required to meet the definition of that trading venue.

In addition, FIA EPTA members concur that systems where trading interests can interact but where the execution of transactions is formally undertaken outside the system still qualify as multilateral systems and should require authorisation. One example of this are inter-broker dealer systems that allow for negotiation and pre-arranging of trades in listed derivatives that are then crossed/executed on the regulated derivatives market. These systems not only bring buying and selling interests together but facilitate trade agreement and as such should be subject to the same rules as other trading venues.

FIA EPTA members agree with ESMA's proposed amendment to move the restriction set out in Article 1(7) of MiFID II into MiFIR and that the restriction is worded as a prohibition. FIA EPTA members also agree that it would be crucial that ESMA publish an ESMA Opinion clarifying the boundaries of a trading venue's authorisation as a short term solution in order to prevent certain trading systems from continuing to operate in a way that is not in accordance with the definitions of regulated market, MTF or OTF while the Level 1 changes are being effected.

One additional point that FIA EPTA members would like to raise for ESMA's consideration is that regulated markets, MTFs and OTFs should be required to maintain the multilateral nature of the venue. FIA EPTA members are aware of instances of trading venues that operate a single market maker trading model whereby bilateral matching is masking as multilateral trading. This is of significant concern as the fair value price is set by one participant without competition, although, investors believe they are trading

on an openly transparency multilateral system which raises non-discriminatory access and investor protection concerns. Two examples of this are as follows,

- a. FIA EPTA members are aware that in Germany there are smaller retail focused exchanges (RMs and MTFs) where retail orders are matched bilaterally against only the one market maker who is the exclusive counterparty to the retail orders. Hence, these systems appear to be de-facto BCNs or SIs masquerading as RMs or MTFs. Such systems are further oftentimes characterised by payment-for-orderflow (PFOF) practices whereby the retail broker, in exchange for steering its clients' orderflow to a specific system, receives a monetary inducement from the relevant market maker on that system who will be the exclusive counterparty to the retail investors' orders. In other instances, the broker passes on the trades exclusively to a market maker which is part of the same group as the broker, suggesting de-facto internalisation. These practices appear to not be in line with MiFID II requirements for multilateral systems, non-discriminatory access to trading venues, best execution and inducements.
- b. Markets for structured products such as warrants, turbos, sprinters, speeders and CFDs which are listed and traded on multilateral venues but which essentially have a closed market structure where quotes are provided by, and retail orders matched against, only one market maker which is affiliated with the issuer of the product. Such a market structure inhibits competition and compromises fair price discovery. As the pricing of such structured products is in the hands of single, affiliated market makers, those are at an undue advantage by having more time and full discretion to set spreads and pricing rules in the absence of competition by other liquidity providers. We also observe the relevant venues creating an ecosystem which additionally advantages issuers or their associated market makers by providing them a last-look functionality and/or blocking automated trading. This prevents competition for order execution and further detracts from the multilateral character of the system. These practices raise considerable investor protection concerns. The closed and de-facto bilateral market structure for these products objectively raises trading costs and creates unnecessarily greater losses for retail investors compared to other types of listed derivatives with a healthy level of competition among liquidity providers. Retail investors pay more and are worse off trading these products than with e.g., listed options with a similar risk profile. |

<ESMA\_QUESTION\_FOTF\_3>

**Q4: Do you agree with ESMA's two-step approach? If not, which alternative should ESMA consider?**

<ESMA\_QUESTION\_FOTF\_4>

|Yes, FIA EPTA members agree with ESMA's two-step approach and would be in favour of ESMA publishing an Opinion on the circumstances under which systems are required to seek authorisation as a trading venue in the short term in order that unauthorised trading systems cannot continue to operate while an amendment to Level 1 is being worked on. |

<ESMA\_QUESTION\_FOTF\_4>

**Q5: Do you agree with ESMA's proposal not to amend the OTF authorisation regime and not to exempt smaller entities? If not, based on which criteria should those smaller entities potentially subject to an OTF exemption be identified?**

<ESMA\_QUESTION\_FOTF\_5>

|Yes, FIA EPTA members agree that the size of an entity should not be included as a determining factor in the requirement to seek authorisation as a trading venue. All entities, regardless of size, that operate in a multilateral fashion should be treated equally to ensure a level playing field. |

<ESMA\_QUESTION\_FOTF\_5>

**Q6: Which provisions applicable to OTFs are particularly burdensome to apply for less sophisticated firms? Which Level 1 or Level 2 amendments would alleviate this regulatory burden without jeopardising the level playing field between OTFs and the convergent application of MiFID II/MiFIR rules in the EU?**

<ESMA\_QUESTION\_FOTF\_6>

[TYPE YOUR TEXT HERE ]

<ESMA\_QUESTION\_FOTF\_6>

**Q7: Do you consider that ESMA should publish further guidance on the difference between the operation of an OTF, or other multilateral systems, and other investment services (primarily Reception and Transmission of Orders and Execution of orders on behalf of clients)? If yes, what elements should be considered to differentiate between the operation of multilateral systems and these other investment services?**

<ESMA\_QUESTION\_FOTF\_7>

[TYPE YOUR TEXT HERE ]

<ESMA\_QUESTION\_FOTF\_7>

**Q8: Do you consider that there are networks of SIs currently operating in such a way that it would in your view qualify as a multilateral system? Please give concrete examples.**

<ESMA\_QUESTION\_FOTF\_8>

[The term 'networks of SIs' has been used to define the case where an SI is directly connected to a number of other SIs with the concern that the SI is entering into riskless principal back-to-back transactions resulting in the SI de facto operating as a multilateral system. FIA EPTA members do not believe that there are SIs directly connected to one another. Rather there are arrangements in place where an investment firm, that also separately operates an SI in an affiliated entity, has links to a number (or network) of SIs.

The typical set up since the introduction of MiFID II is that investment firms/international banks who are execution service providers have connections to a number of electronic liquidity provider (ELP) SIs, their own bank SI and the major trading venues across Europe. Upon receipt of a client order, the order management system polls the SIs for quotes (sometimes routing the order to their own SI first before polling the external SIs). Dependent on the responses, plus the current view of the liquidity offered in the lit books, the system then selects the most appropriate routing option dependent on best execution parameters.

However, FIA EPTA members are aware of at least one investment firm acting as an execution service provider (an international bank that also runs an affiliated bank SI) that facilitates the interaction of client orders with other client orders. It has a process of reviewing client orders upon receipt (in parallel with routing orders to its own SI) to determine if there is a match and if a cross can be achieved either by,

- i. Submitting the trade to a trading venue under a pre-trade transparency waiver (negotiated trade / LIS) or as a non-pricing forming trade where applicable;
- ii. Submitting both sides to a periodic auction system for execution.

In this case, the Investment firm is operating what appears to be a multilateral automated crossing system akin to pre-MiFID II Broker Crossing Networks (BCNs) for agency-type business in equities. FIA

FIA EPTA members believe these “shadow BCNs” qualify as multilateral systems, with the execution of the transactions formally undertaken outside the system, and warrant a review by ESMA. |  
<ESMA\_QUESTION\_FOTF\_8>

**Q9: Do you agree that the line differentiating bilateral and multilateral trading in the context of SIs is sufficiently clear? Do you think there should be a Level 1 amendment?**

<ESMA\_QUESTION\_FOTF\_9>

|FIA EPTA members consider that the definitions and guidance differentiating bilateral and multilateral trading in the context of SIs is sufficiently clear. However, our members are aware, through public sources, of various systems and market practices which seem to conflict with MiFID II expectations and would encourage ESMA to ensure supervisory convergence and a level playing field across the Union. |  
<ESMA\_QUESTION\_FOTF\_9>

**Q10: What are the main characteristics of software providers and how to categorise them? Amongst these business models of software providers, which are those that in your view constitute a multilateral system and should be authorised as such?**

<ESMA\_QUESTION\_FOTF\_10>

|There are a number of third-party service providers (ISVs) that offer order management services providing connectivity to a range of trading venues and intelligent handling of orders. These order management services, in general, do not facilitate the interaction of buying and selling trading interest in their systems. However, there are some that FIA EPTA members are aware of that do appear to meet the definition of a multilateral system although these providers state that they simply facilitate a network of communication/connections. Retail Service Providers (RSP) are an example of this where retail orders placed are announced to the RSP network of market makers. The market makers respond with firm quotes and the investors decide whether to confirm or reject the quote via the system. The trades are then submitted subject to the rules of a trading venue (typically the LSE) under an appropriate pre-trade transparency waiver i.e., formalised on an authorised venue. Such system operators offer a comprehensive handling of all elements of pre- and post-trade requirements while categorising themselves as purely a trading connectivity solution providing support for pre- and post-trading services. FIA EPTA members believe that as these systems that broadcast trading interests with clients being able to interact within the system or through the software are, as pointed out by ESMA in the consultation paper, likely to constitute a multilateral system in the MiFID II sense. |  
<ESMA\_QUESTION\_FOTF\_10>

**Q11: Do you agree with the approach suggested by ESMA regarding software providers that pre-arranged transactions formalised on other authorised trading venues? Do you consider that this approach is sufficient to ensure a level playing field or do you think that ESMA should provide further clarifications or propose specific Level 1 amendments, and if so, which ones?**

<ESMA\_QUESTION\_FOTF\_11>

|Yes, FIA EPTA members agree with the approach that the concept of multilateral systems should also apply to software providers and believe this is sufficient to ensure a level playing field. The ESMA Opinion clarifying the boundaries of a trading venue’s authorisation should also make it clear that the fact that the ultimate execution of transactions is concluded outside the system cannot be used to demonstrate that the system is not multilateral and is outside of the requirement to seek authorisation as trading venue. |



&lt;ESMA\_QUESTION\_FOTF\_11&gt;

**Q12: Do you agree with the principles suggested by ESMA to identify a bulletin board? If not, please elaborate. Do you agree to amend Level 1 to include a definition of bulletin board?**

&lt;ESMA\_QUESTION\_FOTF\_12&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_12&gt;

**Q13: Are you aware of any facility operating as a bulletin board that would not comply with the principles identified above?**

&lt;ESMA\_QUESTION\_FOTF\_13&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_13&gt;

**Q14: Market participants that currently operate such systems are invited to share more detailed information on their crossing systems (scale of the activity, geographical coverage, instruments concerned, etc...), providing examples of such platforms and describing how much costs & fees are saved this way as opposed to executing the relevant transactions via brokers or trading venues.**

&lt;ESMA\_QUESTION\_FOTF\_14&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_14&gt;

**Q15: Do you consider that internal crossing systems allowing different fund managers within the same group to transact between themselves should be in scope of MiFID II or regarded as an investment management function covered under the AIFMD and UCITS? Please explain. In your view, should the regulatory treatment of these internal crossing system be clarified via a Level 1 change?**

&lt;ESMA\_QUESTION\_FOTF\_15&gt;

[TYPE YOUR TEXT HERE ]

**Q16: Do you agree with the interpretation provided by ESMA regarding how discretion should be applied and do you think the concept of discretion should be further clarified?**

&lt;ESMA\_QUESTION\_FOTF\_16&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_16&gt;

**Q17: For OTF operators: Do you apply discretion predominantly in placement of orders or in execution of orders? Does this depend on the type of trading system you operate? Please explain.**

&lt;ESMA\_QUESTION\_FOTF\_17&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_17&gt;

**Q18: For OTF clients: Do you face any issue in the way OTF operators exercise discretion for order placement and order execution? If so, please explain. Does it appear to be used regularly in practice by OTF operators?**

&lt;ESMA\_QUESTION\_FOTF\_18&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_18&gt;

**Q19: Do you think ESMA should clarify any aspect in relation to MPT or that any specific measure in relation to MPT shall be recommended?**

&lt;ESMA\_QUESTION\_FOTF\_19&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_19&gt;

**Q20: In your view what is the difference between MPT and riskless principal trading and should this difference be clarified in Level 1?. In addition, what, in your view, incentivizes a firm to engage in MPT rather than in agency cross trades (i.e. trades where a broker arranges transactions between two of its clients but without interposing itself)?**

&lt;ESMA\_QUESTION\_FOTF\_20&gt;

[TYPE YOUR TEXT HERE ]

&lt;ESMA\_QUESTION\_FOTF\_20&gt;

**Q21: Do you agree with ESMA's proposal to clarify that the prohibition of investment firms or market operators operating an MTF to execute client orders against proprietary capital or to engage in matched principal trading only applies to the MTF they operate, in line with the same wording as applicable to regulated markets?**

&lt;ESMA\_QUESTION\_FOTF\_21&gt;



[TYPE YOUR TEXT HERE ]

<ESMA\_QUESTION\_FOTF\_21>