Svensk Värdepappersmarknad
Swedish Securities Markets Association

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SSMA's response to ESMAs consultation re. opinion on trading venue perimeter

The Swedish Securities Markers Association (SSMA) welcomes the opportunity to respond to ESMAs consultation re opinion on trading venue perimeter.

General comments

- The SSMA understands that a policy objective behind ESMAs opinion is to handle the criticism put forward by some trading venues following the implementation of MiFID II regarding an "unlevel playing field" between different types of trading. As a startingpoint we therefore want to underline that we support the principle that EU rules should be neutral and not favor one business model at the expense of another. In fact, from a CMU perspective it is important to ensure that the MiFID II framework allows different types of trading to co-exist on EU capital markets in order to serve different clients needs. These needs can vary depending on type of client (retail and professional) and type of financial instrument (liquidity and transaction size). Restricting clients access to various execution alternatives reduces the ways market impacts can be managed which could result in higher trading costs for end-investors e.g. wider spreads.

- The SSMA has very strong concerns with some of the examples in the opinion regarding what is to be classified as a "multilateral system". If we read the proposal correctly, ESMA's interpretation seems to limit the possibility of investment firms to carry out certain types of execution services to their clients in accordance with their licenses and the level 1 text. We find this very problematic. By limiting investors choice, EU markets will become less attractive and many clients, in particular professionals which themselves are subject to best execution requirements, will then have to turn to markets outside the EU that offer more flexible execution, e.g. UK. We also see a clear risk that smaller investment firms which do not have the option to become a trading venue or SI will be put out of business. It is important that ESMA in its forthcoming work takes these concerns seriously and consider what is really the end objective with these proposals.

- The opinion seems to suggest (for example in paragraph 24 and its interpretation of Robeco and other vs. AFM) that an investment firm bringing together two trading interests in a way that leads to a contract is in scope of the definition of a multilateral

system. We strongly disagree with such interpretation. According to the level 1 text, a multilateral system is "**a system in which multiple third party trading interest are able to interact".** In this definition, *third parties* must be understood as a party separate from the one operating the system. The investment firm itself is not a third party and, unless the firm match orders on a matched principle basis, does not represent a *trading* interest. Moreover, the term *multiple* indicates that the number of trading interests in question must be at least three (article 18.7 MiFID II). In addition, those multiple third party trading interests should be able to *interact,* i.e. with each other. The operator of *a system* is someone who is providing a "many to many" market place. Further clarification how ESMAs proposal relates to each criteria and the binding level 1 text is needed.

- The SSMA understands that ESMAs intention is to clarify the scope of multilateral system. However, it is important to recognize that the binding level 1 and level 2 framework do in fact allow investment firms to offer OTC execution services to their clients under certain conditions. ESMAs draft opinion give rise to several questions in this respect.

  - Firstly, the investment service execution of client orders include "acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients". In order for this license to have any meaning it must allow firms which receive orders, when needed in a specific case, to reach out to potential counterparties in a sense bringing together two or more trading interests. Is the intention of ESMA really to re-label this activity of order execution as a "multilateral service" which require license to operate an MTF or OTF? If so, what types of activities are then allowed when firms "act to conclude"? The rulebook must be technology neutral i.e. it should not matter whether a system is manual or electronic.

  - Secondly, we note that in some part of the consultation paper, ESMA seems to view transactions with a SI as the only possible OTC-transactions outside a trading venue (for example in paragraph 27 and paragraphs 66-70). This needs to be modified so that there are no misunderstandings. An investment firm can execute client orders against its own account without being an SI. This follows directly from the mandatory SI regime according to which firms shall measure the extent of its OTC trading on clients behalf in order to determine if it meets the level 2 thresholds in order to be "organized, frequent and systematic". In order to perform these calculations the firm must of course be able to trade against own account OTC. This is also clear in the Commissions delegated regulation (EU) 2017/575 (RTS 27) which obliges, apart from SIs, market makers and other liquidity providers to publish a report including their transaction executed OTC.

- Thirdly, the absence of a trading obligation for certain financial instruments strongly indicates that execution OTC is allowed for these instruments. We want to underline the difference between equity and non-equity markets. Bonds and most derivatives are often illiquid and trade in very large sizes and it is therefore difficult to organize trading on a venue. For the investors it is important not to limit investors access to OTC markets in the EU.

- In the consultation paper, SSMA also notes that ESMA use the term "bilateral systems", to define e contrario what a multilateral system is. This is not supported by the directive text. Recitals 17 and 112 of MiFID explain that bilateral transactions between a firm and its counterparties is to be taken into account when assessing if a firm acts a SI. This does not mean that firms cannot execute transactions OTC in other capacities. Recital 17 of MiFID does emphasize that a systematic internaliser cannot bring together third party buying and selling interests in functionally the same way as a trading venue, meaning such a business should be authorised as a trading venue. What is meant by, "functionally the same", is not answered by recital 17.

- The SSMA is also concerned with the effects that ESMAs extensive interpretation may have on innovation and fintech. We also want to underline that EMS passes the client through to a trading protocol. This activity does not meet the criteria for being a multilateral system i.e. arranging transactions between multilateral third party interests which can interact with each other.

- It is important to remember the basic and significant differences between most on-venue trading and most other trading. While on-venue trading is often characterized by a high number of transactions in standardized instruments with high participation it makes acute the need to regulate issuer and trading transparency, listing processes etc. For many OTC markets, the need is not the same and/or the regulation not possible. The distance between ESMA's view and the platforms matching hundreds or thousands of clients' orders historically viewed as trading venues, is astonishing. The expansive view adopted by ESMA in its consultation may include trading for which trading venue regulation does not make sense. ESMA's objective in this consultation should perhaps be to protect what little is left of the flexibility necessary for both firms and clients.

- As mentioned above, the SSMA considers that ESMA's proposals constitute a significant deviation from the wording of the level 1 text and existing market practice. In our view, it is not reasonable that this type of substantial changes to the current EU market structure is introduced by way of a level 3 opinion. Moreover, we note that many of the topics in the opinion are already considered by the Commission in the context of the MiFIR review. We therefore question if this initiative is appropriate at this point in time, in particular considering the UK withdrawal from EU. From a level playing field perspective it should be noted that UK

investment firms will not be limited in the same way as ESMA proposes in the draft opinion. Based on the above, the SSMA therefore recommends that ESMA will postpone this issue until after the MiFIR Review.

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

No, the SSMA does not agree. In the opinion of SSMA the definition of multilateral system has in fact become more unclear following this consultation.

The criteria/characteristics of multilateral system that follow from the level 1 definition must be respected and it is important to avoid a too extensive interpretation on level 3.

Under level 1, all four criteria of the framework need to apply in order for an entity, whether automated or non-automated, to qualify as multilateral.

1. It is a system or facility; AND
2. there are multiple third party buying and selling interests; AND
3. those trading interests need to be able to interact; AND,
4. trading interests need to be in financial instruments.

Brokerage services which a firm provides under a license to execute client orders should not, for technical reasons, be classified as multilateral system.

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

No, the SSMA does not agree. In the opinion of SSMA the definition of multilateral system has in fact become more unclear following this consultation.

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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.

No.

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.

No, EMS or SOR should not be considered as a trading venue since they do not organise interaction between multiple trading interests and there is no client matching in the EMS. The routing that takes place is bilateral.

We agree that the system in figure 1 is not quality as multilateral trading, i.e. should not require license as a trading venue.

As regards figure 2 we have difficulties in understanding how the definition of multilateral trading is fulfilled. For each transaction there can be only one execution venue. No execution takes place in the EMS.

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?

Yes.

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.

The SSMA does not agree.

First of all, we do not understand what kind of system ESMA has in mind in figure 5.

Moreover, the interpretation disregard recital 20 MiFIR and article 18.7 MiFID 2.

In a single dealer system, there is no interaction between third parties. Each transaction takes place against a single counterparty. This cannot be considered as multilateral trading.

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?

Yes we agree that pre-arranging transactions, i.e. what is referred to as "manual trades" or "processed trades" should not require authorisation as trading venue.

Q8: Are there any other conditions that should apply to these pre-arranged systems?
No

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.

In our response to ESMA's consultation on OTFs, the SSMA was critical towards the proposal to consider that the conclusion of the agreement is "outsourced" and we therefore appreciates that ESMA has amended its proposal in this regard.

However, we also question the new proposal requiring signing of contractual agreements which we do not believe to be a workable solution in practice and considers that it adds unwanted complexity.

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