ESMA- *Consultation on MiFID II/ MiFIR review report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares*

I. General remarks

Spanish CNMV Advisory Committee (hereinafter “the Committee”) welcomes the public consultation on this ESMA- Consultation on MiFID II/ MiFIR review report on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares

We very much welcome that ESMA consults on the functioning of the transparency regime for equities. This consultation is very timely and should help to inform the debate of the MiFID II/MiFIR Review launched by the European Commission.

The objective of MiFID II/MiFIR was to significantly improve transparency for equity instruments by bringing more trading to lit multilateral trading venues, i.e. Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs) in an attempt to improve price formation and investor protection. However, more than two years after the implementation of MiFID II/MiFIR, the situation is at odds with the spirit of legislation.

The equity market share of continuous lit order books is decreasing, while the combined share of OTC and SI trading keeps growing. The aggregated levels of OTC and SI trading in terms of turnover represent 22% and 18% respectively for 2019 based on STOXX 600 data from Big xyt. This has led to increased complexity and opacity of equity markets with further fragmentation of liquidity, which is damaging the price formation process.

In light of this, we wish to underline that an adequate equity market structure is a prerequisite for a successful CMU, because:

a well-functioning market structure supports a robust price formation process, to the benefit of companies and investors; and

a well-functioning price formation process enables trading to take place and delivers more efficient and fairer markets (which benefits investors) and lowers the costs of capital for businesses.

Against this background, we propose a simplified market structure concept designed to strengthen lit markets by:

building market models that buttress price formation rather than fragment it,

making markets more inclusive, especially for local intermediaries.

offering investors (big or small) better ways of interacting with multilateral markets.

Hence, there would no longer be a need for a double volume cap (DVC) mechanism in such a scenario, since pre-trade transparency waivers would be limited to the LIS waiver which protects from market impact and the order management facility (OMF) waiver as orders in an OMF facility ultimately become pre-trade transparent and therefore contribute to the price formation process.

Lastly, in an attempt to improve data reporting standards and facilitate the ‘consolidatability’ of data, we suggest applying the industry-led initiative Market Model Typology (MMT) to all trading venues, execution venues as well as to OTC transactions, as well as bring MMT under the governance of ESMA. Investors should be able to analyse executions in a consistent manner with adequate flagging of executed trades using MMT, as already offered by Regulated Markets and MTFs.

We would also like to underline that a number of concerns remain regarding reporting of reference data such as consistency of CFI codes. There have also been concerns regarding exchange of information, specifically in outreach to competent authorities regarding clarifications of requirements.

Our proposal would greatly contribute to a simplification of rules in line with the EU’s better regulation principles as well as provide better opportunities for the MiFID II framework to deliver on its intentions since such simplifications would also make the framework more straightforward for NCAs to enforce.

<u>Assessment of the current level of pre-trade transparency</u>

Q1: What is your view on only allowing orders that are large in scale and orders in an order management facility to be waived from pre-trade transparency while removing the reference price and negotiated trade waivers? Instead of removing the reference price and negotiated trade waivers, would you prefer to set a minimum threshold above which transactions under the reference price and negotiated trade waivers would be allowed? If so, what should be the value of such a threshold? What alternatives do you propose to simplify the MiFIR waivers regime while improving transparency available to market participants? Please explain.

We support ESMA’s proposal to limit the available waivers under the transparency regime to the large in scale (LIS) and order management facility (OMF) waivers, removing the reference price (RP) and negotiated trade (NT) waivers in order to increase pre-trade transparency. In such a scenario, the double volume cap (DVC) mechanism would be rendered obsolete. Instead, we believe that the LIS threshold should be used as the main tool to delineate dark trading. The main purpose of the waiver regime is to protect market participants from adverse market movements following the execution of large orders and there seems to be little justification for trading small orders via the RP or NT waivers. Using the LIS threshold to delineate dark trading would be an efficient way to incentivise lit trading and address concerns about the impact of dark trading on financial markets and the price formation process all the while contributing to a much-needed simplification of the current framework. In addition, it makes sense to maintain the OMF waiver as an order in an OMF facility ultimately becomes pre-trade transparent and therefore contributes to the price formation process.

However, in such a scenario, it would still be important to allow for non-price forming technical trades to be reported off-book on exchange. We call for such a reporting tool to be defined at Level 1.

Overall, quality and consistency of reporting and flagging are necessary in order to improve transparency available to market participants. Against this background, we call for the Market Model Typology (MMT) to be extended and mandated to all execution venues and sees merit in looking at how the technical implementation of MMT could be done under the governance of ESMA.

Q2: Do you agree to increase the pre-trade LIS threshold for ETFs to EUR 5,000,000?

We prefer to adjust the pre-trade LIS threshold for ETFs to the share LIS table.

Q3: Do you agree with extending the scope of application of the DVC to systems that formalise NT for illiquid instruments?

We are in favour of only allowing orders that are large in scale and orders in an order management facility to be waived from pre-trade transparency, while removing the reference price and negotiated trade waivers (please see response to question 1). In such a scenario, this question is no longer relevant.

Q4: Would you agree to remove the possibility for trading venues to apply for a combination of waivers? Please justify your answer and provide any other feedback on the waiver regime you might have.

We agree that applying for a combination of different waivers should be avoided, in order to strengthen lit trading through an overall simplification of the market structure for equity instruments. As stated in the response to question 1, we call for an overall simplification of the waiver regime provided for under Article 4 MiFIR. Specifically, we believe that the reference price and negotiated trade waivers should be removed. In such a scenario, only orders that are large in scale and orders in an order management facility would be eligible to be waived from pre-trade transparency. Hence, this question is no longer relevant.

Q5: Do you agree with the proposal to report the volumes under the different waivers separately to FITRS? Please explain.

We agree with the proposal to report the volumes under the different waivers separately to FITRS.A more granular approach for reporting volumes under the waivers would be more appropriate. It is quite burdensome to report volumes “total excluding waiver a and b”. It would be clearer to report separately the total volume as well as the volume under each waiver.

Q6: What would be in your view an alternative way to incentivise lit trading and ensure the quality and robustness of the price determination mechanism for shares and equity-like instruments? Please explain.

This question needs to be placed in a broader context and recognise that market structure improvements are a prerequisite for a successful CMU. We believe equities market structure needs to become less complex and build on lessons learned from MiFID II to truly support lit trading. The objective of MiFID II/MiFIR was to bring broker crossing networks (BCNs) to lit multilateral trading venues (i.e. RM and MTFs) in order to increase transparency and improve price formation and investor protection. The current situation is however at odds with the spirit of MiFID II/MiFIR. The market share of continuous lit order books is decreasing while the combined share of OTC and SI trading keeps growing.

The MiFID II review must be placed in the context of industry developments.

First, policymakers should address the concentration of flows via large sell-side banks. Today, over 50% of flows on cash equity come to European Regulated Markets through the smart order routers operated by six non-EU investment banks. This concentration of flow is driven by increased risk taking by the large US banks, i.e. their ability to allocate capital to run what is, in effect, proprietary risk disguised in central risk books or Systematic Internalisers. Flows from Tier 2 and 3 European regional banks and brokers are channelled through the workflow and smart order routers of the Tier 1 banks and do not hit lit markets, contrary to the objectives of MiFID II. We believe policymakers and regulators should assess this issue as a point of priority as it is critical for the proper functioning of the lit market environment and, crucially, for them to protect the integrity and viability of European regional banks.

Second, the intermediation of orders by the largest investment banks today forms part of a complex workflow. This workflow is designed to maximise the execution of orders away from price-forming, lit markets. Today, large investment banks will seek to match off flows against each other as well as against their own house account under a variety of frameworks (Systematic Internalization, OTC and proprietary dark MTFs). This means that: (i) public markets only receive residual exhaust flow; and, (ii) investment banks can perpetuate the 'self-fulfilling' claim that public markets are toxic trading environments. This narrative is aggressively sold to asset managers and issuers.

Any review of MiFID II market structure should address the following:

- The concentration of bargaining power over market structure in the hands of a small number of non-EU investment banks;
- Within the workflow managed by the investment banks, the prioritization of internal vs public execution. Lit, price-forming markets currently come last in execution policies – they should be the first stop, not the last;
- A simplification of the fragmented execution landscape and a removal of blurred lines (removal of some waivers and removal/limitation of the SI regime). In particular, (i) far tighter regulation of what is an SI vs the central risk book and (ii) what is denoted as "client facilitation" vs prop trading vs market making. These lines are currently blurred at best and being abused at worst.

The overall ambition should be to work on a simplified market structure concept to strengthen lit trading by:

(i) building market models that buttress price formation rather than fragment it,
(ii) making markets more inclusive, especially for local intermediaries, and
(iii) offering investors (big or small) better ways of interacting with multilateral markets.

It can be observed that at this point in time, the aggregated levels of OTC and SI trading in terms of turnover represent 22% and 18% respectively for 2019 based on data from Big xyt. This has led to increased complexity of equity markets and further fragmentation of liquidity - in stark contrast with the spirit of the legislation.

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.

Market structure concept proposal

1. Systematic Internaliser Regime

We believe that restricting SI trading to above LIS only would be an efficient way to incentivise lit trading, ensure the quality and robustness of the price determination mechanism in line with the initial objective of MiFID II/MiFIR.

In such a scenario, the large in scale threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading should be confined to Regulated Markets and MTFs exclusively. We underline that rules applicable to MTFs should continue to apply, specifically operators of MTFs would be prohibited from engaging in proprietary trading, running bilateral systems and applying discretionary and discriminatory rules. These trading venues would in principle always be subject to real-time pre- and post- trade transparency requirements thus creating a lit space for trades below LIS. There would no longer be a need for a double volume cap mechanism since pre-trade transparency waivers would be limited to the LIS and OMF.

SIs activity would be restricted to above LIS only. Above LIS trading constitutes a legitimate dark space in which trades are not be subject to pre-trade transparency and would benefit from delayed post-trade transparency. This applies to both multilateral trading venues (MTFs) and bilateral execution venues (SI) and it would result in an appropriate limitation of dark activity and a welcome simplification of the fragmented execution landscape. Below LIS, trades should contribute to price formation since those trades do not have market impact. This type of execution should operate in a trading venue, under non-discretionary and non-discriminatory rules, and comply with the tick size and transparency requirements.

2. Dark and OTC trading

We suggest to limit dark trading by reducing the number of available waivers to mainly large in scale (LIS) - this includes the repeal of the double volume cap mechanism: The main purpose of the waiver regime is to protect market participants from adverse market movements following the execution of large orders, thus, there seems to be little market impact by trading small orders. Hence, all standard orders below LIS should be subject to full transparency requirements to contribute to price formation.

OTC would be restricted to trades in shares not subject to the STO. We would also suggest extending MMT to all execution venues as well as to OTC transactions under ESMA governance.

3. Request for Quote systems

MiFID II introduced increased transparency requirements applicable to ETFs however the fundamental concern is that the large majority of trading - approximately 90% - still takes place on alternative trading systems, as opposed to on-Exchange lit markets. Therefore, we suggest that ESMA investigates this liquidity shift from lit order book trading to RFQ trading and assesses its potential long-term impact on ETF market structure. Potential mitigating measures should be proposed by ESMA if this trend is perceived to be not compliant with ESMA's objective to ensure the quality and robustness of the ETF price determination mechanism for all types of investors.

Therefore, we would suggest that RFQ trading systems should only be made available for ETF transactions above the LIS thresholds so that the bulk of trading, i.e. smaller size trades, are executed on transparent trading platforms thereby contributing to the price formation process.

4. STO

We propose to modify the share trading obligation (STO) regarding its third country dimension, scope, exemptions and application to asset classes: i) To address the third country impact by the current scope, the STO should apply to those shares with an ISIN starting with a country code corresponding to an EU27 Member State plus those starting with a non-EU country code but where the issuer has its primary (fully-fledged) listing within the EU27 while allowing for best execution principle for dual listings; ii) Moreover, the potential of a risk-sensitive, case-by-case based recognition regime for third country trading venues should be considered as foreseen in the review clause of the recently amended ESMA Regulation taking into account their effect on liquidity as well as the development of the Capital Markets Union; iii) Exemptions should be removed where trades are "non-systematic, ad-hoc, irregular and infrequent", instead exemptions should only apply for those trades that do not contribute to price formation based on a clear and consistent list of qualifying non-price forming trades; and iv) The scope of the STO should be extended to ETFs in order to incentivise lit trading and investor protection in this growing asset class.

5. Midpoint trading

We would also take this opportunity to point out that while some would argue that mid-point is a valid execution price since it is predictable and based on tick sizes, any order pegged at midpoint means that some orders are entered in between tick sizes, which was not foreseen by MiFID II/MiFIR for trading venues' lit order books. It should also be noted that midpoint is a non-displayed order and therefore plays a role in reducing market transparency. Against this background, midpoint orders are executed at the expense of participants willing to set or display a price. Ultimately, the idea that a mid-point price is fairer is flawed as pegging can in some circumstances act similar to a reference price without being subject to a waiver. Any review of MiFID II/MiFIR should address these concerns. In consistence with other comments throughout this consultation response, we thus believe that for below LIS orders, midpoint pegging should not be allowed in central limit order books, but for above LIS orders midpoint pegging should be available.

This market structure proposal would enhance the ability of MIFID II/MiFIR provisions to increase investor protection and further the level playing field amidst concerns about the impact of dark trading on financial markets and the price formation process.

We are mindful of the links that exist between the complexity of legislation and the challenges in relation to enforcement and believes that this proposal would greatly contribute to a simplification of rules in line with the EU's better regulation principles. Better opportunities should be given for the MiFID framework to deliver on its intentions and these simplifications should be more straightforward to enforce by NCAs.

Definition of a liquid market

Q7: Which option do you prefer for the liquidity assessment of shares among Option 1 and 2? Do you have an alternative proposal? Do you think that the frequency of trading should be kept as a criterion to assess liquidity? If so, what is in your view the

appropriate thresholds for the percentage of days traded measured as the ratio between number of days traded and number of days available for trading (e.g. 95%, 90%, 85% etc.)? Please explain.

Our view is that using ADNT and ADT as parameters to assess liquidity would be an improvement in comparison to the four conditions currently used. We would caution against looking at market capitalisation as a parameter since this would introduce undue complexity. It should also be noted that free float data can in some cases be unreliable. If free float data would be reliable we support to maintain it as a liquidity parameter.

Q8: Do you agree in changing the approach for ETFs, DRs as proposed by ESMA? Do you have an alternative proposal? Please explain.

We agree with changing the approach for ETFs and DRs as proposed by ESMA.

Q9: Do you agree in removing the category of certificates from the equity-like transparency scope? Please explain.

We disagree with ESMA's proposal to remove certificates from the equity-like transparency scope. The intention of MiFID II was to extend the transparency regime to a wide set of asset classes, this also includes certificates. However, we believe that it is important to have a more precise definition and clarification on what exactly certificates constitute.

Q10: Do you agree in deeming other equity financial instruments to be illiquid by default? Please explain.

Before answering this question we would ask ESMA to clarify first, what exactly is meant by "other equity financial instruments".

Experience of new trading systems – Frequent Batch Auctions

Q11: Do you agree in separating the definition of conventional periodic auctions and frequent batch auctions? Do you agree with ESMA's proposal to require the disclosure of all orders submitted to FBAs? Please explain.

We in principle see merit in correctly distinguishing between various types of auctions. Trading venues operating auctions is nothing new, on the contrary, auctions are widely used to orderly open and close trading sessions and many venues also organise intra-day auctions. However, the Frequent Batch Auctions (FBAs) which grew in market share since beginning of 2018 differ significantly and one of the relevant distinctions could be whether the auction includes an element of price formation or not along with other features like the length of the call phase and the level of pre trade transparency.

The various auctions are modelled to serve the market participants' needs for efficient trading within the overall transparent and multilateral environment. Regarding the information to be made public, "ESMA suggests that all orders (volume and price) submit-ted to FBAs should be disclosed to meet the MiFIR pre-trade transparency requirements." we would need more information on the exact requirements suggested by ESMA as it is unclear whether ESMA would want to align the pre-trade transparency requirements for FBAs with those applying to "continuous auction order book trading system" or define new specific requirements. As such, we consider that any consideration of regulatory measures in this area should be based on a thorough analysis of the overall market structure paying special attention to the price formation nature of auctions.

Q12: Do you agree that all non-price forming systems should operate under a pre-trade transparency waiver? Please explain?

We believe that trading models allowing for non-price forming transactions combined with insufficient level of pre trade transparency should operate under a pre-trade transparency waiver, provided that this does not prejudice the possibility of reporting non-price forming technical trades as off-book on exchange. Such a reporting tool should be formulated at Level 1. As per article 4 MiFIR, systems that formalise selected negotiated transactions and systems matching orders based on a reference price can be waived from pre trade transparency requirements. Avoiding pre trade transparency requirements can be seen as a benefit or a consequence of concluding transactions which are not price forming (like price referencing to the midpoint of the primary market). With trading models like FBAs operating under different and rather limited levels of transparency; combined with the lack of price formation from most, we agree with ESMA that trading models allowing for non-price forming transactions and limited pre trade transparency should operate under a pre trade transparency waiver.

Consistently with supporting repealing the negotiated trade waiver and the reference price waiver (see our answer to question 1), those trading models would either operate under one of the remaining pre trade transparency waivers under MiFID II, namely LIS and OFM waivers or not be allowed anymore.

In addition, we would caution against distinguishing between price-forming and non-price forming systems. Rather, and in the interest of consistency and simplicity, we support working off the current Level 2 framework on non-price forming transactions (RTS 1 Article 2 and Article 13 provide a list of such transactions) which would also prove more effective than a definition of non-price forming/price forming models as it would avoid potential loopholes. We would also suggest extending MMT to all execution venues under ESMA governance in order to reinforce this framework with proper flagging.

Part 2 (The SI Regime)

Q13: What is your view on increasing the minimum quoting size for SIs? Which option do you prefer?

We acknowledge that the current minimum quoting size of 10% of the SMS is incredibly low and leads to very limited mandatory pre-trade transparency for SIs as outlined by ESMA in the consultation paper. A minimum quoting size of 100% of the SMS would be more appropriate than what is currently in place.

That being said, we believe that any review of MiFID II market structure should focus on designing a simplified market structure concept to strengthen lit trading. In order to achieve this, we propose (as outlined in response to question 6) to confine SI activity to above LIS only. In such a scenario, the question of the minimum quoting size for SIs becomes irrelevant. This illustrates, once more, that the use of the large in scale threshold as the main tool to delineate lit and dark trading would greatly contribute to a much-needed simplification of the current framework.

Q14: What is your view on extending the transparency obligations under the SI regime to illiquid instruments?

We think that extending the transparency obligations under the SI regime to illiquid instruments would be an improvement compared to what is in place under the current framework.

Although it has not been mentioned in the Consultation Paper, we would like to draw ESMA's attention to additional aspects:

1) Importance of flagging SI trades at an EU level: The current flagging is very unclear and inconsistent. A broader implementation of the Market Model Typology (MMT) which currently ensures consistency of exchange data would be a solution. We are convinced that the extension of the MMT would enhance data consistency and contribute to the increase of regulatory oversight of SI activity.

2) Operation of SIs: ESMA should review how SIs operate by looking more deeply into the transactions they conclude and report. One question is about riskless trading. We believe that connectivity hubs that have the potential to link up SIs and counterparties should be monitored to guarantee that they always work on a bilateral basis, and in case they do not but operate an internal matching system they must operate an MTF. Such activities must be monitored as there is the risk that trading takes place on a multilateral rather than bilateral basis.

3) Registration process of an SI: There does not seem to be any specific details of the operation of the business model required unlike what RMs and MTFs have to provide. Hence, a description of the business model and how regulatory compliance is maintained should be provided by SIs to maintain a level-playing field with RMs and MTFs.

That being said, we reiterates that any review of MiFID II market structure should focus on designing a simplified market structure concept to strengthen lit trading. For this, we propose to restrict SI activity to above LIS only (as outlined in response to question 6). In such a scenario the large in scale threshold would be used as the main tool to delineate lit and dark trading. There seems to be little justification for trading small orders via SIs when these could occur on Regulated Markets or MTFs and contribute to increasing transparency in the market. For this reason, below LIS trading should be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre and post trade transparency requirements thus creating a lit space for below LIS. Above LIS trading constitutes a legitimate dark space, such trades would not be subject to pre-trade transparency and benefit from delayed post-trade transparency. Below LIS, trades should contribute to price formation since those trading do not have market impact. This type of execution should operate in a trading venue, under non-discretionary and non-discriminatory rules, and comply with the tick size and transparency regimes. In such a scenario, the question of extending the transparency obligation under the SI regime to illiquid instruments is not as relevant.

Q15: With regard to the SMS determination which option do you prefer? Would you have a different proposal? Please explain.

We support ESMA's proposal to have different tables for liquid and illiquid instruments for shares, DRs, certificates and other financial instruments in order to have calibrated SMS for different ADT classes for each asset class (option 1). However, for ETFs, we prefer table 2 (the SMS for liquid instruments) also to illiquid instruments. The liquidity of an ETF is primarily determined by the liquidity of the underlying market rather than the ADT of an ETF. Correspondingly, ETFs tracking similar underlying markets typically demonstrate similar liquidity profiles in terms of average spreads. Hence, both liquid and illiquid ETFs should be subject to the same SMS. As a result, the table needs to be populated accordingly with appropriate SMS figures for the ADT classes below 500 000 EUR.

That being said, any review of MiFID II market structure should concentrate on putting in place a simplified market structure concept to strengthen lit trading. In order to achieve this, we propose to restrict SI activity to above LIS only (as outlined in response to question 6). In such a scenario the large in scale threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading should be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre and post trade transparency requirements thus creating a lit space for below LIS. Above LIS trading constitutes a legitimate dark space, such trades would not be subject to pre-trade transparency and benefit from delayed post-trade transparency. In such a scenario, the question of amending the methodology by which SMS is determined is not as relevant.

Part 3 (Double Volume Cap)

Analysis of the impact of the DVC on cost of trading and market structure

Q16: Which option do you prefer among Options A, B and C? Would you suggest a different alternative? Please explain.

We support ESMA's proposal to limit the available waivers under the transparency regime to the LIS and OMF thus rendering the DVC mechanism obsolete (Section 3.1.2.1 – B. Conclusions and Proposals).

We therefore consider that the 3 options for maintaining or adjusting the current DVC system should be discarded. We consider deletion of Article 5 MiFIR to be the best option and favours doing away with the complexity introduced by the DVC system rather than maintaining or increasing it. Maintaining or increasing the complexity introduced by the DVC is not desirable and goes against effective enforcement of the regulation which would benefit from a simplification of rules.

In any case if we have to choose between options A,B or C, we prefer C

Q17: Would you envisage a different system than the DVC to limit dark trading? Please explain.

The double volume cap has been designed to limit the trading taking place under the RP waiver, provided in Article 4(1)(a) of MiFIR, and the NT waiver for liquid instruments, set out in Article 4(1)(b)(i)) of MiFIR. We are calling to limit the available waivers under the transparency regime to the LIS and OMF waivers. In this case, the DVC mechanism would disappear.

We does not believe that the RP and NT waivers should remain in place nor that the double volume cap should be maintained or adjusted. We instead suggest a different approach to limit dark trading:

We believe that restricting SI trading to above LIS only would be an efficient way to incentivise lit trading and ensure the quality and robustness of the price determination mechanism for shares and equity-like instruments.

In such a scenario the large in scale threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading would be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre- and post-trade transparency requirements thus creating a lit space for below LIS. The available waivers under the pre-trade transparency regime (Article 4 MiFIR) would be limited to the LIS and OMF waivers and the double volume cap mechanism would disappear.

SI activity would be restricted to above LIS only. Above LIS trading would constitute a dark space in which trades would not be subject to pre-trade transparency and would benefit from delayed post-trade transparency. This would result in an appropriate limitation of SI activity and a welcome simplification of the fragmented execution landscape.

OTC would be reserved to non-price forming trades in such a scenario. For this, we support working off the current Level 2 framework on non-price forming trades and would all suggest extending MMT to all execution venues under ESMA's governance.

Such an approach would enhance the ability of MIFID II/MiFIR provisions to increase investor protection and further the level playing field amidst concerns about the impact of dark trading on financial markets and the price formation process. We are also mindful of the links that exist between the complexity of legislation and the challenges in relation to enforcement and believes that its proposal would greatly contribute to a simplification of rules in line with the EU's better regulation principles.

Q18: Do you agree in removing the need for NCAs to issue the suspension notice and require trading venues to suspend dark trading, if required, on the basis of ESMA's publication? Please explain.

We are calling for a removal of the double volume cap mechanism. In such a scenario, this question is no longer relevant.

In the current system, we see value in the NCAs' suspension notices.

Q19: Do you agree in removing the requirements under Article 5(7)(b)? Please explain?

We are calling for a removal of the double volume cap mechanism. In such a scenario, this question is no longer relevant.

<u>Application of the DVC to instruments without 12 months of data</u>

Q21: Do you agree in applying the DVC also to instruments for which there are not 12 months of available data yet? Please explain

We are calling for a removal of the double volume cap mechanism. In such a scenario, this question is no longer relevant.

Publication within 5 working days

Q22: Do you foresee any issue if the publication occurs after 7 working days instead of 5? Please explain.

We are calling for a removal of the double volume cap mechanism. In such a scenario this question is no longer relevant.

Mid-month reports

Q23: Do you agree that the mid-month reports should not be published? Please explain.

We are calling for a removal of the double volume cap mechanism. In such a scenario this question is no longer relevant.

Sanctions for infringements

Q24: Do you agree with ESMA's proposal to include in Article 70 of MiFID II the infringements of the DVC suspensions? Please explain.

We are calling for a removal of the double volume cap mechanism. In such a scenario this question is no longer relevant.

Part 4 (Post-trade transparency)

Assessment of the post-trade transparency framework for trading venues

Q25: Do you agree with ESMA's assessment that the conditions for deferred publication for shares and depositary receipts should not be subject to amendments? If not, please explain.

We would agree. As only a small portion of large trades benefit from deferred publication it appears that, in general, the MIFIR deferral regime has delivered on its objectives, i.e. to protect large trades while maintaining a high level of real-time transparency.

Q26: Do you agree with ESMA's proposal to increase the applicable threshold for ETFs and request for real-time publication for transactions that are below 20,000,000 EUR? If not, please explain.

We agree with ESMA's proposal to increase the applicable deferred publication threshold for ETFs and request for real-time publication for transactions that are below 20,000,000 EUR.

Q27: Do you agree with ESMA assessment of the level of post trade transparency for OTC transactions?

Yes, we agree with the ESMA assessment of the level of post-trade transparency for OTC transactions and considers that there is no need to apply different thresholds for OTC and on-venue transactions. Rather, we think that trading OTC does not mean that post-trade transparency shall be minimal. In general, we are of the opinion that OTC transactions, hence in the case of shares, exemptions to the share trading obligation, shall reach the same level of quality in post-trade reporting; this appears as well necessary to monitor the correct application of Article 23 MiFIR and its exemptions.
We would also like to take this opportunity to reiterate that the availability, quality and consistency of OTC post-trade data is a major issue. As ESMA underlined in the MiFIR II/MiFIR Review Report No. 1, there are significant shortcomings on data quality in particular for OTC trades and work needs to be done in this area. Today it can be observed that SI and OTC data quality, reliability and consistency is not fit for that purpose. Most sources of reliable data, such as exchange data, are consolidated by market data vendors and made available to users. However, there is a lack of non-trading venue quality data. This is because low levels of off-venue post-trade data quality, reliability and consistency of SI and OTC transactions hampers accessibility and readability and consolidation of such data. This concerns both the timeliness and content of the data, as well as the inconsistent approaches in respect of flagging trades.

Q28: Do you agree with the proposal to report and flag transactions which are not subject to the share trading obligations but subject to post-trade transparency to FITRS? Please explain.

Yes, we agree and welcome more transparency in this area. It is important that exemptions to the share trading obligation are clearly identified and flagged. All transactions identified as not contributing to the price discovery or non-price forming should benefit from an individual flag in FITRS. Again, this would ensure proper application of the exemption possibilities to the share trading obligation.

Q29: What is your experience related to the publication of post-trade transparency information within 1 minute from the execution of the transaction? Do you think that the definition of "real-time" as maximum 1 minute from the time of the execution of the transaction is appropriate/too stringent/ too lenient? Please explain.

For electronic order book systems, we consider that 1 minute would be too long and that the timeframe could be much shorter. Allowing up to 1 minute to report opens up for potential misuse. We would like to stress that exchanges strive to publish the information as fast as possible, based on the type of trade executed; 1 minute is anyway too generous for such systems. We would also like to state that the maximum delay should be equal for all execution venues including SIs.

When it comes to technical, non-price forming trades, we would consider that a 1-minute timeframe is appropriate.

Transparency requirements applicable to third country transactions

Q30: Do you agree with ESMA's approach to third-country trading venues for the purpose of transparency requirements under MiFID II? If no, please explain.

We agree with the approach taken for third-country trading venues regarding transparency requirements, level playing field and ensuring adequate supervision.

Part 5 (Share trading obligation)

Q31: Do you agree that the scope of the share trading obligation in Article 23 of MiFIR should be reduced to exclude third-country shares? If yes, what is the best way to identify such shares, keeping in mind that ESMA does not have data on the relative liquidity of shares in the EU versus in third countries? More generally, would you include any additional criteria to define the scope of the share trading obligation and, if yes, which ones?

We agree with ESMA's proposal to limit the trading obligation to EU shares.

The share trading obligation (STO) remains necessary and is an important cornerstone of the overall aim of MiFID II/MiFIR to enhance the efficiency, resilience and integrity of financial markets in the EU. For the STO to be fully functional, further work on clearly determining which shares should be considered EU shares is necessary. The approach should avoid undue complexity and be based on predictable and meaningful criteria.

According to the current STO definition, EU investment firms can only undertake trades in shares admitted to trading in the EU on EU trading venues or equivalent third country trading venues and SIs. Ahead of MIFID II/MiFIR application, the STO provision was therefore highlighted by FESE and others to policy makers as one which would likely generate unintended consequences due to its extraterritorial reach. This assessment was made since, if equivalence is not granted, shares traded on third country non-equivalent venues also admitted to trading in the EU would have to be traded in the EU by EU investment firms. These provisions would apply regardless of the liquidity of non-EU shares on EU markets, meaning that shares that are highly liquid on third country venues but for which liquidity on EU markets is low would also have to be traded in the EU.

To date, only a handful equivalence decisions have been adopted, while the Commission and ESMA have de facto limited application of the STO by interpreting the scope in a narrow way. Both Commission and ESMA have indicated that equivalence decisions will only be adopted for countries where the EU trading in the shares is of a certain magnitude and that the absence of an equivalence decision therefore does not prevent EU investment firms from trading shares admitted to trading in the EU on non-EU venues.

While the extraterritoriality has been de facto limited this way, the approach does not provide certainty to the industry as the regulation's requirement exempting 'non-systematic, ad hoc, irregular and infrequent' trading has not been clarified in a conclusive way.

We propose to modify the share trading obligation (STO) regarding its third country dimension, scope, exemptions and application to asset classes: i) To address the third country impact by the current scope, the STO should apply to those shares with an ISIN starting with a country code corresponding to an EU27 Member State plus those starting with a non-EU country code but where the issuer has its primary (fully-fledged) listing within the EU27 while allowing for best execution principle for dual listings; ii) Moreover, the potential of a risk-sensitive, case-by-case based recognition regime for third country trading venues should be considered as foreseen in the review clause of the recently amended ESMA Regulation taking into account their effect on liquidity as well as the development of the Capital Markets Union; iii) Exemptions should be removed where trades are "non-systematic, ad-hoc, irregular and infrequent", instead exemptions should only apply for those trades that do not contribute to price formation based on a clear and consistent list of qualifying non-price forming trades; and iv) The scope of the STO should be extended to ETFs in order to incentivise lit trading and investor protection in this growing asset class.

Q32: Would you support removing SIs as eligible execution places for the purposes of the share trading obligation? If yes, do you think SIs should only be removed as eligible execution places with respect to liquid shares? Please provide arguments (including numerical evidence) supporting your views.

We consider that SI activity should be limited to trades above LIS. Below LIS, this type of execution venue should operate as a trading venue, under non-discretionary and non-discriminatory rules, and comply with the tick size and transparency regimes. We would recommend retaining SIs as eligible execution places for the purposes of the share trading obligation but limiting the activity to trades above LIS.

In such a scenario the large in scale threshold would be used as the main tool to delineate lit and dark trading. Below LIS trading would be confined to Regulated Markets and MTFs exclusively. These trading venues would in principle always be subject to real-time pre and post trade transparency requirements thus creating a lit space for below LIS. The available waivers under the pre-trade transparency regime (Article 4 MiFIR) would be limited to the LIS and OMF waivers and the double volume cap mechanism would disappear.

SI activity would be restricted to above LIS only. Above LIS trading would constitute a dark space in which trades would not be subject to pre-trade transparency and would benefit from delayed post-trade transparency. This would result in an appropriate limitation of SI activity and a welcome simplification of the fragmented execution landscape. Please also see our response to question 6.

Q33: Would you support deleting the first exemption provided for under Article 23 of MiFID (i.e. for shares that are traded on a "non-systematic, ad-hoc, irregular and infrequent") basis? If not, would you support the introduction in MiFIR of a mandate requiring ESMA to specify the scope of the exemption? Please provide arguments supporting your views.

We support deleting the first exemption under the STO as we consider that it has not been clarified in a conclusive manner. It has been subject to discretionary interpretation and therefore not worked in practice.

Q34: Would you support simplifying the second exemption of Article 23 of MiFIR and not limiting it to transactions "carried out between eligible and/or professional counterparties"? Please provide arguments supporting your views.

We support retaining this exemption and strictly limiting its use to transactions not contributing to the price discovery process. In practice, this would mean that the OTC space is limited to technical trades. In order to allow for clear and efficient rules, we support reviewing the current Level 2 list of eligible transactions under this exemption and tying its enforcement to an appropriate flagging of trades via MMT under the governance of ESMA.

However, the list should be clear and exhaustive in order to ensure that the STO will be applied in the same way by all market participants. For proper reporting of these trades, we suggest extending the MMT to all execution venues as well as to OTC transactions.

Part 6 (Closing auctions)

Q35: What is your view on the increase of volumes executed through closing auctions? Do you think ESMA should take actions to influence this market trend and if yes which one?

No, we does not believe at this stage that ESMA should take any regulatory action on the end of day trading mechanisms. Closing auctions are a crucial aspect of modern market structure and the value they provide should not be overlooked. They benefit the market by concentrating liquidity, reducing cost and safeguarding the price formation process. The popularity of closing auctions shows that there is a significant demand from investors for this highly transparent and non-discriminatory mechanism which is in the best interest of investors, public companies and the market as a whole.

We agree that the volume executed through closing auctions has increased in the past years. A major reason for the increase can be associated with MiFID II itself. Relevant factors in this context relate to the increased fragmentation since the introduction of the framework harming liquidity sourcing and transparent price formation with the emergence of systematic internalisers and alternative trading systems like periodic auctions and the increase in the number of venues under pre trade transparency waivers. As noted by ESMA in the consultation paper on page 28, ESMA received 330 equity waiver notifications from 29 EEA countries. In that sense we hope that the current consultation paper from ESMA will – if adequate measures follow in relation to the waiver regime – allow for a level playing field in the equity landscape and limit if not reduce the market's need for participation into closing auctions.

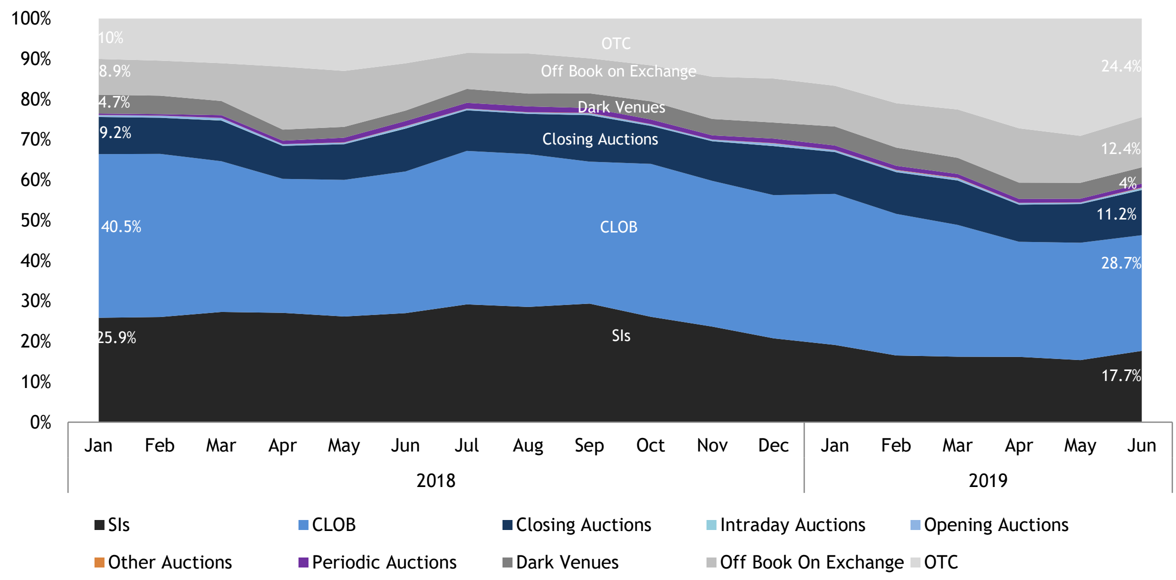
Closing auctions, as their name indicates, determine the closing price that is in line with the stock's intra-day performance, in the best interest of public companies and investors. They are relevant to set the reference price for a high number of financial instruments (ETFs, traditional funds etc.) and allow market participants to replicate exactly the price at which index rebalances are done. In addition, it is the official closing price that is used for calculations for corporate actions and other transactions, and indeed is the generally accepted reference price for many other purposes, such as tax matters or for the determination of settlement prices by CCPs.

Closing auctions aim at determining a unique and representative closing price specifically because they concentrate liquidity over a limited period of time (few minutes only). The more participants in closing auctions, the higher the liquidity, the more efficient the price and the lower the risk of manipulation. Closing auctions have become focal coordination venues for liquidity seekers (Admati and Pfleiderer (1988), Spiegel and Subrahmaniam (1995)), they also lower execution cost and sharpen price determination (see Pagano and Schwartz (2003) on the then-Paris Bourse and Comerton-Forde et al. (2007) on the Singapore Stock Exchange). Studies also find that the introduction of call auctions significantly reduced day-end returns' skewness, suggesting less manipulation.

Closing auctions contribute to make companies listed in the EU visible and tradeable at large quantities with a certain degree of execution probability and reliable price (as EU closing auctions take place when US markets are open). The global reference for each relevant stock is guaranteed by the robust price formation process carried out by primary exchanges, based on high quality matching algorithms that determine the closing price that maximizes the turnover. These auctions have a fixed schedule defined by trading venues and processes are transparent as the theoretical auction price is continuously published. They do not substitute continuous trading which facilitates all orders as rapidly as possible during regular trading hours so that the trades are executed on a continuous basis at the prevailing market price but instead serve different purposes. They are also attractive as High Frequency Traders would not participate – time lapse is too long and does not fit their activities.

We observe that historically, closing auctions have always concentrated a significant share of the turn-over on trading venues in Europe. Since January 2018, the market share of closing auctions when compared to all other execution venue types grew from 9.7% to 11.7% in June 2019.

Figure 1: Market share per venue type for STOXX 600 instruments on European markets



Source: Big xyt data, FESE calculations

As mentioned above the growing importance of closing auctions can be seen as a result of the increase in SIs and OTC and venues under pre trade transparency waivers trading since the introduction of MiFID II. Indeed, the increase in off-exchange trading has the potential to negatively affect market quality and the price formation process. In such an environment, investors actively seek out the closing auction which is the only time in the day when investors they truly receive the benefit of centralised liquidity in today's highly fragmented markets. In short, the closing auction is critical to price discovery and the stability and transparency of Europe's capital markets. Closing auctions, given the efficient formation process they of-fer contribute to a competitive environment largely driven by process and execution costs rather than an anti-competitive domain of incumbent exchanges. Furthermore, as recently noted by the AMF, the growing importance of this end-of-trading phase can also be explained by the expansion of passive management, whose mechanism for creating and cancelling units usually uses the net asset value at the end of day and which requires trading at the closing price for exact replication (Autorité des Marchés Financiers, Growing importance of the closing auction in share trading volumes, October 2019, Risk & Trend Mapping).

The increased market share of closing auctions has sparked allegations that their centralised nature gives primary exchanges too much power. However, it is important to recall that there are currently approximately 300 execution venues in Europe, which shows evidence of a highly competitive market. Currently the European market structure includes dark and quasi-dark trading in SIs, OTC and dark pools alongside lit venues, and the popularity of closing auctions shows that there is a significant demand from investors for this highly transparent and non-discriminatory mechanism which is in the best interest of investors, public companies and the market as a whole. The benefits provided by closing auctions reflect the economic value participants gain from contributing to and participating in closing auctions.

We would like to underline that competitive alternatives to closing auctions on primary markets already exist, both from a business perspective and from a price formation perspective. On the former, closing mechanisms and internalisation practices by SIs and brokers using the closing price set on primary markets as a reference price risk undermining the price formation process within closing auctions. While price formation occurs across a range of venues, such alternative venues do not make investments in the full range of activities necessary to contribute to the core price formation process, but rather use the data provided by exchanges to run their own commercial business models. As evidence, when system outages occur on primary exchanges in Europe – be it for central limit order books, opening or closing auctions – MTFs (both lit and dark), SIs and OTC markets usually halt their trading. The same outcome is observed during volatility interruptions on primary venues. On the latter, alternative venues would actually increase fragmentation of the current trading landscape and trading venues replicating exchange closing auctions still present a risk that could ultimately result in the existence of several closing prices.

Further, some market participants have voiced concerns that as a centralised system, any breakdown could destabilise the markets. This concern appears however unfounded since exchange systems are reliable, monitored in real-time, dimensioned and scalable to the order flow's needs. In addition, Regulated Markets are also required as per MiFID II Article 48 to have in place effective systems, procedures and arrangements to ensure their systems are resilient and are able to ensure orderly trading under conditions of severe market stress. Regulated Markets must also have arrangements in place for in the case of any failure of their trading systems. Centralisation in itself does not create uncovered stability risks and with appropriate safeguards in place, primary exchanges have proven their value by creating trust in their rules and procedures. This trust from market participants is reflected by closing auctions' success and growth. Stability of the system would not be guaranteed with a less centralised distribution of liquidity; stability is guaranteed by the underpinning confidence that liquidity aggregation is framed by sound and safe practices. The centralisation of liquidity in the closing auctions guarantees that the price formed is dependable since it is protected by the rules established by exchanges.

We would like to recall that competition cannot be an objective per se but rather a tool to achieve higher-ranking policy objectives. In a fragmented market structure, some of the buy side have previously warned that it is becoming increasingly burdensome to source liquidity and identify who they trade with; this is at odds with the overall MiFID II goals to 'democratise' the investment process. Investors themselves have indicated that alternatives might fragment the current system and agree that having a single closing price is preferable. Dispersing trading across a large variety of venues and execution modes will come at the cost of deterioration of price formation. The proliferation of order flow across execution venues raises concerns around liquidity aggregation and the quality, reliability and efficiency of price determination. In this context we believe it is important that regulators and policymakers consider the range of price formation delivered by trading venues and acknowledge the core value of price formation on exchanges. The development of alternatives to closing auctions on primary markets would not constitute a form of mitigation to a central mechanism for closing auctions unless they were to invest in the full range of activities necessary to contribute to the core price formation process or alternative to a central mechanism for closing auctions, since the very purpose of auctions is to successfully concentrate high levels of liquidity. Hence we believe that ESMA shall not take any action be it by limiting the participation into closing auction or by intervening in the existing competitive landscape.