European Securities and Markets Authority

Reply form

For the Consultation Paper (CP) on ESMA's Opinion on the trading venue perimeter

28 January 2022 | ESMA70-156-5287

Responding to this paper

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

1. respond to the question stated;

2. indicate the specific question to which the comment relates;

3. contain a clear rationale; and

4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 April 2022**.

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

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 publicly 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

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Who should read this paper

This document will be of interest to all stakeholders involved in the securities markets. It is primarily of interest to competent authorities, investment firms and market operators that are subject to MiFID II and MiFIR. This paper is also important for trade associations and industry bodies, institutional and retail investors, their advisers, consumer groups, as well as any market participants because the MiFID II and MiFIR requirements concern the market structure of the EU and the perimeter of trading that should be considered as multilateral and regulated as such.

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

<ESMA_QUESTION_TVPM_1>

No, Boerse Stuttgart cats GmbH disagrees with the interpretation of the definition of multilateral systems. In general, we consider the interpretation as way too broad. While we appreciate ESMA's aim to create level-playing field between regulated and currently unregulated market players, we urge ESMA to maintain proportionality and to avoid regulatory overshooting.

The perimeter should not be excessively burdensome and should not cover practices that only facilitate the efficient communication between market participants. In addition, as national competent authorities will rely on the upcoming Opinion, ambiguities that could lead to extensions of the perimeter should be avoided. We believe that ESMA in some parts creates rather confusion than clarity. One example is the case when it comes to a clear delineation between what constitutes the financial service of reception and transmission of orders (RTO) and a multilateral system. ESMA only states that an RTO that carries characteristics of a multilateral system should be licensed as such. However, in order to identify whether a multilateral system is at hand, it would have been useful to get further guidance on when ESMA considers some RTO licensed entities as multilateral systems and when not. We will refer to further inconsistencies below.

Furthermore, we urge regulators to apply a case-by-case approach when considering whether specific market players would fall under the trading venue perimeter. The consideration of individual cases should necessarily take into account all the components of the definition of a multilateral system and not only selected parts of it.

In the following, we would like to **A) outline our concerns with ESMA's proposed interpretation of the definition of a multilateral system**. After that, we would like to **B) draw ESMA's attention to the impacts on the functioning of the market** – especially the bilateral trading – if ESMA follows the provided broad interpretation of the trading venue perimeter.

A) Concerns on ESMA's interpretation of the definition of a multilateral system

<u>System or facility</u>

In paragraph No. 19, ESMA states that even "contractual agreements or standard procedures" which "shape and facilitate interaction between participants' trading interests" fall under the term "system or facility". We believe that this interpretation of what constitutes a system or facility is too broad and leaves too much room for interpretation. Specifically, by including any set of contractual agreements or standard procedures, it risks to also include innovative mechanisms or processes that are neither intended to be considered nor de facto operate as multilateral systems within the perimeter.

In the German jurisdiction, the BaFin has provided a definition of what constitutes a "system" which we strongly support because it adequately reflects what is at the core of a (trading) system. According

to BaFin, a system is “an objective set of rules governing membership, the admission of financial instruments to trading, trading between members, notifications of completed transactions and transparency obligations” [1].

Moreover, we would like to draw ESMA's attention to inconsistencies in the consultation paper. While for instance on page 10f. it is still acknowledged that a system requires a rulebook, ESMA revises this on p. 12 (paragraph 28): there, ESMA states that the conclusion of a contract is not a prerequisite for the operation of a system. In our view, however, a rulebook can only be effective if it has been recognized by the trading participants at least in the form of general terms and conditions. Otherwise, there would be no legal basis under which a trade could be concluded.

Multiple third-party buying and selling trading interest

In paragraph No. 23 ESMA interprets the term “third-party” would relate to “persons other than the system operator, that are not directly connected and are brought together in a transaction.” The word “multiple” would refer “to the system allowing various trading interests to interact in the same system or facility.” And in paragraph No. 24 ESMA, states that “also systems where only two trading interests interact, provided such trading interests are brought together under the rules of a third-party operator.”

Paragraph 27 of the Consultation Paper gives the impression that ESMA does not recognize that investment firms use systems/software developed by third parties but are operated by the investment firm. We would like to point out that in that case the control of the software is in the responsibility of the investment firm, not the software provider. Hence, it is not accurate to consider the software provider as a separate entity, i.e. as system operator. In the end, it must be possible to differentiate between a mere software and an entire marketplace. Thus, we believe it is inappropriate to consider this as “multilateral”.

Closely related, we would like to discuss the term “trading interest”. We find it difficult to imagine a system operator that follows an interest in buying or selling securities for its own account. According to regulations of the operation of multilateral systems, this possibility is even explicitly excluded. In our view, ‘multilaterality’ should not stem from the mere fact that three different parties are involved in a transaction. This would de facto affect all firms providing the financial services of “reception and transmission of orders (RTO). We do not believe that it is the aim of the regulator to ban RTO services. As RTO is listed as financial service in MiFID II and therefore in Level I text, it must be subject to changes on Level I amendments.

With regard to paragraph 24, we have considerable doubts as to whether the application of the court ruling C-658/15 to the cases covered by the ESMA opinion is appropriate. In our opinion, the facts underlying the judgment are different. The Robeco vs. AFM case was about "multiple brokers and funds are affiliated to 'EFS' Euronext." There, a large number of interests were represented – or at least possible – on both sides (buy- and sell-side), which is why a multilateral system could indeed be assumed. The cases described by ESMA in the consultation paper, however, disregard the very aspect

that multiple third parties must at least be possible on both sides. Therefore, an application is only meaningful to a limited extent.

Interaction between trading interests

It would have been useful if ESMA had provided more considerations on the negative scope of the "able to interact" criterion, such that market participants have more clarity on what is excluded from the perimeter. In particular, the terms "arranging and/or the negotiations of trading interests" should be clarified. The broad interpretation of these terms is likely to have the undesirable consequence of including facilities in which there is no genuine trade execution or arranging taking place.

In addition, we would like to draw ESMA's attention to a passage in the consultation paper that we consider to be a non-legally compliant interpretation. In paragraph 28, ESMA states that interests must be able to interact **in the system**. In contrast, ESMA says in paragraph 14 "systems broadcasting trading interests to multiple clients with those clients being able to interact, within the system **or through the software**, with those trading interests, are likely to constitute a multilateral system in the MiFID II sense." We consider this extension of interaction within a system to include also "software" to be unlawful and not justified. We think it must still be possible to distinguish between a system with a clear set of rules and a mere software.

Another point where we see confusion and inconsistency in paragraph 28 is the following sentence: "The definition of multilateral systems does not require the conclusion of a contract as a condition, but simply that trading interests can interact within the system. Hence, the conclusion of a contract is not a prerequisite for a firm to be required to request authorisation as a trading venue for the system or facility it operates." This is fundamentally in conflict with ESMA's statement in its Q&A "on MIFID II and MiFIR market structures topics", where it says in Answer 7 on page 41 that "the fundamental characteristics of a trading venue is to execute transactions". The latter statement is also what we highly recommend to apply here. When execution does not take place in a system, it cannot be considered as a trading venue.

B) Impact on the market / bilateral trading

At this point, we believe it is incredibly important to inform ESMA of the consequences that an expansion of the trading venue perimeter would have, particularly for technology providers operating under an RTO license.

Stricter regulation of technology providers conducting RTO would have significant implications for users of these services. Central users of these services are retail brokers and market makers operating as Systematic Internalizer (SI). With the elimination of RTO and technology providers, any SI using the software of providers such as Boerse Stuttgart cats to efficiently connect to multiple counterparties would have to implement its own technology and develop its own software to connect to each(!) individual counterparty in bilateral trading. This would involve significant costs and would make bilateral trading much more inefficient and expensive for end investors. It would not be unlikely that

such costs could be borne exclusively by large market participants which have the material resources to develop their own IT infrastructure and services. The market access of smaller or new market participants would be further restricted as a result. This would be detrimental to a level-playing field and a fair competition in the market.

Ultimately, there would even be a risk that bilateral trading would be deprived of its technical basis and would simply no longer be able to occur, or would only be able to be conducted between a few large market participants. The selective choice of counterparties or customers by an SI - a key feature of bilateral trading - would no longer be possible if technology providers through which SIs communicate with counterparties require a license as an MTF. This customer selection would be eliminated because MTFs have non-discretion in admitting trading participants. By removing the technical support of external technology providers, the existing market structures for SIs are thus likely to be subject to severe restrictions - and, due to a growing range of simple individual solutions, market integrity as a whole. Similarly, this would run fundamentally counter to the goal of European financial market regulation and the Capital Markets Union, which is to promote competition between different trading and execution venues.

In addition, existing multilateral systems would also lose their unique character to some degree if nearly every provider (whether operating as an RTO or as an unregulated technology provider) that provides trading participant communication software ends up being classified as a multilateral system. This is detrimental to the diversity of business models and ultimately to the many different customer interests that consciously choose to trade multilaterally or bilaterally via execution venue of an SI or OTC, bilaterally, or over-the-counter. The diversity of the trading landscape in the EU corresponds to this choice of trading and execution venues that investors need and should therefore be preserved. Furthermore, clients and end-investors would lose important financial services that stem from customization. Tailoring the offering and service to the needs of clients while fulfilling all regulatory requirements of execution venues is the nature of a Systematic Internalizer, not of a multilateral trading facility. Regulator should appreciate that every trading and execution venues fulfills a dedicated demand from market participants. Under the new conditions, it would be impossible to imagine how bilateral trading or SI business could continue to be provided (efficiently) with external technology providers.

[1] own translation, for the original text, please see
https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_091208_tatbestand_multilaterales_handelssystem.html

<ESMA_QUESTION_TVPM_1>

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

<ESMA_QUESTION_TVPM_2>

In our understanding and in accordance with the legal definition, the core criteria of a multilateral system are:

a) Whether multiple trading interests are able to interact and not limited to a one-to-one arrangement in each single security transaction;
b) That interaction and matching of orders follows an objective set of rules, outlined in a rulebook to all trading participants;
c) And that the execution takes place within the system (and not within the realm of a software provider).

In addition, to understand better what other relevant characteristics to a multilateral system are, we would like to highlight the following:

d) The existence of mandatory standards and workflows for the complete trading cycle, e.g. quoting obligations, standard product & service offerings as well as standard execution workflows including standard settlement procedures for all trading participants;
e) The non-existence of any ability to customize features, service and products on an individual client-targeted basis

We believe it is important to distinguish between (i) systems that allow multiple third parties to interact in a system, and (ii) systems that allow for multiple bilateral interactions with existing relationships (where each bilateral interaction cannot interact with each other). The former are true multilateral systems while the latter are a collection of bilateral relationships with no multilateral aspects.

In addition, any facility where there is no genuine trade execution taking place in the system (see MiFIR Recital 8) and which does not have any involvement on how and where the trade might take place, should not be forced to become a trading venue. As ESMA stated in its Q&A on market structure topics (Answer Question 7), “the fundamental characteristic of a trading venue is to execute transactions”. Hence, software provides where there is no genuine trade execution taking place in the system and which do not have any involvement on how and where the trade might take place, should not be required to become a trading venue.

Furthermore, we want to point out that in bilateral SI-trading the financial service (selling and buying of financial instruments) is provided for by the bank. This is the service to be regulated, not the setting up and maintenance of an IT-platform. If the IT-service provider would in the future qualify as MTF, this would lead to higher costs for the customers without a clear benefit for market participants and end-users. Or the IT-service providers might give-up their services altogether – forcing banks, investments funds, etc. to insource IT-infrastructure. We do not believe that such change in business models is intended by the MiFIR provisions on trading venues.

<ESMA_QUESTION_TVPM_2>

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.

<ESMA_QUESTION_TVPM_3>

No, but we would like to point out here that ESMA, when looking at individual cases, should be careful to consider all the elements of the definition of a multilateral system and not just selected parts of it. Furthermore, with the ESMA opinion at hand, there is still no clarification provided that clearly delineates the provision of information from the allowance of trading to take place.

As stated in our answer to Q2, we believe that it is important to distinguish between systems that are matching multiple buy- and sell-side interests under a clear set of rules and those systems that facilitate the communication between two counterparties in bilateral trading on a customized offering and individual rules. Mixing these two systems in no way takes into account the key differences between software/technology providers and trading venues.

Once again, we would like to point out that compelling software/communication tool providers to become authorized as trading venues and subjecting them to complex and costly regulatory requirements will prevent these platforms from continuing to exist in their current form, limit their ability to continue to grow and develop, and ultimately reverse and stifle healthy competition and diversity within the marketplace. Such a stringent measure, as proposed by ESMA, will therefore limit competition in the market and reduce market efficiency with the costs being borne by the end-user.

<ESMA_QUESTION_TVPM_3>

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.

<ESMA_QUESTION_TVPM_4>

No. We do not find the illustration in Figure 2, which is supposed to depict an Execution Management System as a multilateral system, accurate. An EMS is used by investment firms to find the execution venue (trading venue, SI, etc.) that provides best execution for the clients. If such an EMS had to license itself as a multilateral system, the system would lose its functionality. The reason for this is that two execution venues would then be involved for the execution of an order, which is not possible from a regulatory and functional point of view. The nature of software providers and EMS is that they facilitate the technical access of clients to different venues where their client orders can finally be executed.

This nature would be lost if those actors had to license themselves as multilateral systems. Thus, end-users would be deprived of technologically efficient and cost saving services. We do not believe that this was the intention of the legislators.

<ESMA_QUESTION_TVPM_4>

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?

<ESMA_QUESTION_TVPM_5>

We agree that the arrangement shown in Figure 4 is a bilateral system that should not require authorization as a trading venue. In our opinion, this is mainly due to the fact that in each transaction Bank A is the counterparty and that no transaction could be concluded in this arrangement without Bank A. This is independent from whether the Bank operates the "system" by itself. The nature of "bilaterality" does not change at all if the provider of the system is a separated entity. The trading between two counterparties remains the same. Neither could customer A conclude a transaction with customer B in this arrangement, nor could customer C or customer N conclude a transaction with a bank B. Therefore, it is a bilateral system. Of course, it is market practice that Bank A does not necessarily use its own IT infrastructure. Often it is an external software provider that sets up and maintains the IT used to communicate with other market participants. We believe that RTO licenses are an adequate regulatory framework for such external software providers.

<ESMA_QUESTION_TVPM_5>

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.

<ESMA_QUESTION_TVPM_6>

As Figures 4-5 show, a critical factor is what role the system has in the two/three-party arrangement. We believe it is crucial to distinguish a technology provider from a multilateral system, i.e. a multilateral trading facility (MTF). As cited in our response to Q1, we think that BaFin has provided a definition of what constitutes a "system" we strongly support because it adequately reflects what is at the core of a (trading) system. According to BaFin, a system is "an objective set of rules governing membership, the admission of financial instruments to trading, trading between members, notifications of completed transactions and transparency obligations" [2]. Hence, the mere existence of an external third party, i.e. a provider of communication tools for counterparties engaged in bilateral

arrangements, does not suffice to be required as a multilateral system. In the end there must remain a regulatory differentiation between software and a marketplace.

[2] please see footnote 1

<ESMA_QUESTION_TVPM_6>

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?

<ESMA_QUESTION_TVPM_7>

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<ESMA_QUESTION_TVPM_7>

Q8 Are there any other conditions that should apply to these pre-arranged systems?

<ESMA_QUESTION_TVPM_8>

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<ESMA_QUESTION_TVPM_8>

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

<ESMA_QUESTION_TVPM_9>

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<ESMA_QUESTION_TVPM_9>