

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



Responding to this paper

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

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

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

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

Instructions

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

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA_QUESTION_FOTF_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA_FOTF_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_FOTF_ABCD_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Consultation on the functioning of the Organised Trading Facility regime").

Publication of responses

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

Data protection

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

Who should read this paper

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

General information about respondent

Name of the company / organisation	OTCX Trading Limited, BidFX Systems Limited and FactSet Research Systems Inc.
Activity	Other Financial service providers
Are you representing an association?	☐
Country/Region	International

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_FOTF_1>

This consultation response has been prepared and submitted jointly by OTCX Trading Limited, BidFX Systems Limited and FactSet Research Systems Inc. (“**we**”/“**our**”). As technology solution providers to the financial markets, we welcome the opportunity to comment on ESMA’s consultation paper on the functioning of OTFs (the “**Consultation Paper**”).

After reviewing the Consultation Paper, in addition to the specific responses provided below, our overarching message is that, today, software vendors are critically important to integrating the EU’s disparate markets as well as to facilitating access from non-EU traders to EU liquidity providers, and vice versa. Billions of Euros have been spent by the industry in developing the services targeted by the proposals, with some software vendors having been supporting the EU markets for over 20 years. The signatories to this response alone cover, we estimate, over 1000 market participants and all would be dramatically impacted by the proposed changes, which have been levelled at the industry for a reason which is not supported by objective evidence.

The scale of the Consultation Paper’s proposed changes to the EU’s existing market structure in relation to multilateral systems would be profound, in particular where affected software vendors will need to reorganise their relationships with clients and liquidity providers or indeed where they choose to cease serving the EU market entirely. A fundamental rethink of these arrangements requires the informed contributions of, and adequate consideration by, various stakeholders other than those few incumbent trading venues who have complained of some unspecified “unlevel playing field”.

In particular, the Consultation Paper never identifies the exact problem ESMA is trying to solve nor does ESMA offer any details of the perceived benefits to market participants that would flow from implementing ESMA's proposals.

About Us

OTCX was founded in 2014 to automate the manually intensive bilateral relationship between the buy side and their liquidity providers in OTC derivatives, and provide improved operational efficiency and risk management. OTCX improves efficiency for bilateral negotiating and streamlining trading processes for OTC derivatives in over 30 currencies.

BidFX – a trusted, global FX e-trading technology solutions provider for the financial marketplace that enables improved trading and lowered operational costs through a customer-centric, agile and secure platform. BidFX offer cutting-edge FX trading solutions across OTC and listed markets, allowing connection to more sources of liquidity, a complete suite of negotiation protocols and a hub to the algo suites of all major banks featuring best-execution capabilities. BidFX transaction cost analysis (TCA) solution also features pre-trade predictive models, in-trade benchmarking and post-trade synopses. Founded in January 2017, BidFX currently has over 100 of the world's largest banks, hedge funds and asset managers connected to its platform.

FactSet creates flexible, open data and software solutions for tens of thousands of investment professionals around the world, providing instant anytime, anywhere access to financial data and analytics that investors use to make crucial decisions. |

<ESMA_COMMENT_FOTF_1>

Questions

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

<ESMA_QUESTION_FOTF_1>

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<ESMA_QUESTION_FOTF_1>

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

<ESMA_QUESTION_FOTF_2>

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<ESMA_QUESTION_FOTF_2>

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

<ESMA_QUESTION_FOTF_3>

|We do not agree with ESMA's clarifications regarding the application of Article 1(7) and Article 4(19) of MiFID II, due to the ongoing relevance of the execution of transactions.

ESMA is proposing to materially depart from its long held view that execution is the central component of a multilateral system to expand the definition to include any system “that allows trading interests in financial instruments to interact, including information exchange, between parties on essential terms of a transaction (being price, quantity) with a view to dealing in those financial instruments”.¹

ESMA's longstanding position, clearly stated in its Q&A on market structures topics, is that “the fundamental characteristic of a trading venue is to execute transactions”.² ESMA has also recognised that “a transaction cannot be concluded on more than one venue”³ such that each transaction flow has one point of execution and therefore one possible trading venue. Other jurisdictions have reached the same conclusion. For example, in the United States, for a

¹ See Consultation Paper at ¶ 43

² See Question 7 of Section 5 (*Multilateral and bilateral systems*), Questions and Answers on MiFID II and MiFIR market structures topics, ESMA70-872942901-38 (29 May 2020) (“**Market Structures Q&A**”). See also Question 28 of the Market Structures Q&A (a multilateral system must, *inter alia*, facilitate “direct execution” of transactions).

³ See Market Structures Q&A at 44.

system to fall within the definition of “swap execution facility”, the system must, *inter alia*, facilitate “the execution of swaps” between counterparties.⁴

Treating execution as the *sine qua non* of a trading venue is deeply embedded in the history of trading. Prior to electronification, trading venues were open-outcry pits that provided a central, single location where orders were submitted and trades were agreed. Following electronification, the need for a physical location may have diminished but electronic trading still requires some central, if non-physical, location for orders to be submitted and for trades to be agreed. Such location is provided by the venue’s electronic order book or other automated system that provides for the collection and matching of orders, and the resulting execution of transactions.

Electronification did not, however, stop with electronic order books and other trading venue systems. New types of service providers – such as aggregators and other execution management systems – brought to market an innovative and efficient means by which orders and other forms of trading interest can be transmitted to a trading venue’s electronic systems. In other words, these service providers simply give their users an efficient means of communicating trading interest for execution rather than replacing the need for the trading venue to provide the necessary service of execution. In so doing, such service providers are merely providing a solution to a market communication issue that enables their users to have faster access to trading information, improving their trading decisions.

No amendment to the Level 1 text is required for the reasons discussed in this consultation response. Further, the requisite review and deliberations of any proposed changes to the Level 1 text can only be achieved through a formal legislative process involving the European Commission and Parliament. The effective date of any resulting legislation would also provide affected service providers, as well as those that depend on such services, to make an orderly transition to the new market structure required by ESMA. |

<ESMA_QUESTION_FOTF_3>

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

<ESMA_QUESTION_FOTF_4>

|For the reasons articulated in this consultation response, we believe that ESMA’s proposal in relation to redrawing the regulatory perimeter for multilateral systems is flawed and would subject a significant portion of the EU market’s service providers to obtrusive and unnecessary regulation as authorised trading venues, eliminating competition and harming end-clients.⁵ If, despite these concerns, ESMA determines to proceed with expanding the scope of trading venue authorisation requirements under MiFID II, in our view it should only do so through a formal legislative amendment procedure, such as the upcoming MiFID II review, rather than through issuing an ESMA opinion.

⁴ See Section 1a(50) of the CEA.

⁵ Please see our response to Question 10 for an explanation of the important and beneficial role that service providers targeted by the proposals play in EU markets.

ESMA opinions are not the appropriate mechanism to achieve a legal change of this magnitude. The Consultation Paper itself is an implicit admission that the current scope of the MiFID II authorisation framework for trading venues does not and was not designed to capture certain types of service providers, such as the bilateral systems and aggregators we address in this consultation response. It has been ESMA's firm policy in respect of other EU financial market legislation that it does not have the power to amend the scope of primary legislation.⁶ It would be a significant and unjustified departure from this longstanding policy to use an opinion in this instance, not least because no concrete evidence has been presented as to market harm.

ESMA opinions would also be unsuitable due to their limited legal authority. Opinions published pursuant to Article 16 of Regulation (EU) No 1095/2010 ("**ESMA Regulation**") are "soft law" which, while influential, nevertheless do not carry the same force as Level 1 or Level 2 legislation.⁷ Moreover, the opinion envisaged by ESMA would be addressed to the various national competent authorities ("**NCAs**"), which then raises further complications. For example, each NCA is subject to its own domestic rules in respect of investigations and enforcement mechanics, including in terms of timing, and given the complexity of this area of law it is highly unlikely that all NCAs would reach identical conclusions as to which service providers are newly subject to trading venue authorisation requirements.⁸ ESMA may then be faced with an uncoordinated patchwork of compliance, where different NCAs take different approaches, which would sow further confusion and could even lead to forum shopping within the EU itself as providers move to the most welcoming, or slowest-moving, jurisdiction.

<ESMA_QUESTION_FOTF_4>

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

<ESMA_QUESTION_FOTF_5>

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<ESMA_QUESTION_FOTF_5>

⁶ See, e.g., Final Report: Draft regulatory technical standards on indirect clearing arrangements under EMIR and MiFIR, ESMA/2016/725 (26 May 2016) at ¶ 26 (noting that the scope of indirect clearing requirements "are related to level 1 considerations...which are not in the hands of ESMA"). See also *id.* at ¶ 7 (noting that, as territorial scope of indirect clearing requirements is "defined in level 1 legislation, ESMA does not have the mandate to redefine" such scope).

⁷ ESMA's own Securities and Markets Stakeholders Group has stated that measures published by ESMA under Article 16(1) of the ESMA Regulation "aim to achieve a 'common, uniform and consistent' application of [EU] law" however "they are not legally binding". See Securities and Markets Stakeholders Group, Advice to the European Commission: Response to the Public Consultation on the Operations of the European Supervisory Authorities, ESMA22-106-210 (10 May 2017) at ¶ 9.

⁸ For example, the German federal financial supervisory authority, BaFin, has stated that "only when BaFin adopts" an ESMA measure does it have any effect on firms subject to its supervision. See BaFin, Guidelines and Q&As issued by the European Supervisory Authorities. BaFin goes on to note that such adoption could require a legislative act to German regulations and that, in certain cases, BaFin refused such adoption where it identified a conflict with features of German supervisory law.

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

<ESMA_QUESTION_FOTF_6>

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<ESMA_QUESTION_FOTF_6>

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

<ESMA_QUESTION_FOTF_7>

|Having had the benefit of reviewing the response form prepared by Symphony in relation to this question, we wholeheartedly endorse their reply. |

<ESMA_QUESTION_FOTF_7>

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

<ESMA_QUESTION_FOTF_8>

|Please see our response to Question 10 below. |

<ESMA_QUESTION_FOTF_8>

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

<ESMA_QUESTION_FOTF_9>

|Please see our response to Question 10 below. |

<ESMA_QUESTION_FOTF_9>

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

<ESMA_QUESTION_FOTF_10>

We describe below the key features of the business models of software providers as well as the numerous beneficial effects that such software providers have on EU markets and market participants. In our view, none of these business models constitute a multilateral system and therefore none of them should be authorised as such. No revisions to the categorisation of bilateral systems and software providers is required.

ESMA's Mischaracterisation of Software Provider Business Model(s)

A central theme of the Consultation Paper is ESMA's view that certain types of unregulated service providers are operating *de facto* multilateral systems and must therefore be authorised as trading venue operators to do so. ESMA identifies two such types of providers – “networks of SIs” and “software vendors” – and proposes to bring them within the scope of trading venue authorisation requirements.

However, ESMA has not properly ascertained how these two services work; instead, the relevant sections of the Consultation Paper simply resort to making vague and conclusory statements, which serve to mischaracterise many bilateral systems and aggregators whose services are, in our view, clearly distinguishable from those of a trading venue. We have set out several material distinctions below in respect of what we term “bilateral systems” as well as aggregators.⁹ We would note in particular that bilateral systems are essential to support access by buy-side firms and end-clients to trading in new and/or bespoke OTC derivatives; for instance, novel OTC instruments, including derivatives as well as digital assets, are created frequently and traditional trading venues are slow to innovate and create marketplaces for such instruments. As a result, trading initially takes place on a bilateral basis or needs to be aggregated across many liquidity sources; trading which existing or new software vendors can support. ESMA should therefore proceed carefully to ensure that the providers of such essential services do not withdraw from the EU entirely.

As described below, we believe that both services represent *bona fide* businesses that do not constitute the operation of multilateral systems. As such, these services do not present the same regulatory concerns as those motivating ESMA to seek market comment whether to expand the scope of the term “multilateral system” and should be expressly carved out of any future decision to include currently unregulated service providers within trading venue authorisation requirements.

Software Providers Support Bilateral Systems

In the Consultation Paper, ESMA expresses concerns about what it terms “networks of SIs”.¹⁰ These networks, in ESMA's view, “blur” the distinction between bilateral and multilateral systems.¹¹ ESMA goes on to restate its guidance in the Market Structures Q&A that a system that “provides quote streaming and order execution services” (emphasis added) for multiple SIs should be considered a multilateral system.

While we cannot exclude the fact that such systems may exist, we believe that many if not most bilateral systems instead provide a solution that does not involve the interaction of multiple trading interests. Instead, these vendors provide a “point-to-point” bilateral

⁹ The features are not meant to be mutually exclusive. For example, many bilateral systems bring together liquidity seekers and liquidity providers that already have trading relationships.

¹⁰ See Consultation Paper at ¶¶ 55-60.

¹¹ ESMA also expresses concerns about impermissible matched principal trading by SIs, which is not a business model that we address in our consultation response, as well as the fact that liquidity has not moved more completely onto lit trading venues, which is in our view irrelevant to the proper definition of “multilateral system”.

connectivity between pairs of liquidity seekers and liquidity providers. In such a “point-to-point” system, a liquidity seeker may only review the requests it has sent to each liquidity provider and may not see any requests sent by any other liquidity provider; similarly, each liquidity provider will only be aware of the requests it has received and will have no knowledge of any other quotes or messages by any other liquidity provider to any other liquidity seeker.

In other words, no liquidity seeker can interact on a price provided by a liquidity provider to another liquidity seeker, no liquidity seeker can interact with another liquidity seeker, and no liquidity provider can interact with another liquidity provider. These bilateral systems therefore do not meet the basic functionality of a multilateral system, i.e. that “multiple third party buying and selling trading interests are able to interact”.¹²

Aggregators

In the Consultation Paper, ESMA describes aggregators as “so-called software or middleware providers” that provide “enhanced access to various sources of trading interest”.¹³ Without any further analysis or description, ESMA then states that “those firms are *de facto* operating multilateral systems” and must be authorised as trading venues. ESMA’s position appears to rely entirely on the view expressed by “stakeholders” – persons not otherwise identified by ESMA – that aggregators use certain ambiguous terms in their marketing materials.¹⁴ Reliance on such unsubstantiated assertions is not a reasonable or adequate basis to conclude that all aggregators operate multilateral systems and must be authorised as trading venues.

In fact, a common feature of most aggregators is that the relevant software vendor does not create trading relationships where none existed before. That is, the vendor does not bring parties together for the purpose of trading; liquidity seekers and liquidity providers have already done so and have entered into the necessary trading documentation. The vendor’s role is to serve as a tool that helps its users customise the vendor’s software to connect to and communicate with that user’s pre-existing list of counterparties and/or trading venues. The user remains responsible for determining, inputting, and monitoring trade and risk controls and to remedy any alerts that may be raised. Orders communicated through the aggregator software are received by the liquidity provider – either a dealer counterparty or trading venue – where the transaction is executed.¹⁵

In this way, aggregators are not properly characterised as *de facto* trading venues but instead act as a form of third-party front-end system to allow users – primarily buy-side firms – to connect to the systems of their pre-existing liquidity providers. A buy-side firm without access to such software would still be able to execute transactions with each of its existing sources of liquidity, but doing so would be more costly and more cumbersome due to the need to maintain multiple screens and numerous data feeds and possibly be limited to trading over the telephone, being exposed to market movements when polling liquidity providers for the best

¹² We would also note that Article 18(7) of MiFID II requires that MTF and OTF operators have “at least three” materially active members which have the opportunity to interact with each other in a way that contributes to price formation. The “point-to-point” connectivity of the bilateral systems presented above does not contribute to price formation which provides further support that such services do not properly fall within the scope of “multilateral system”.

¹³ See Consultation Paper at ¶ 61.

¹⁴ *Id.* at ¶ 63 (stating that aggregators “use a terminology that is very close to the business of a trading venue and which is deemed to give an indication about their real business”).

¹⁵ Execution occurs subject to the rules of the trading venue or pursuant to the trading documentation in place with the dealer, who often has a “last look”.

price. The value proposition of these vendors is that their software can “talk” to multiple other systems at the same time and present a consolidated view of available liquidity in a cost-efficient manner.

Software Vendors Offer Substantial Benefits to Market Participants

The Consultation Paper proceeds on the basis of a claim by incumbent regulated trading venues that they face an “unlevel playing field” with respect to unregulated bilateral systems and aggregators. However, no evidence is provided to substantiate this claim nor has any harm to end-clients been identified. In fact, we would claim that very much the opposite is true: bilateral systems and aggregators that are the subject of this consultation response ensure greater choice for market participants, lower costs, enhance transparency and facilitate compliance with regulatory requirements. Indeed, many market participants feel that their needs are not being serviced by traditional venues, which are slow-moving (as well as requiring extensive onboarding to become a member or trade through a member) and focus on only the most standardised, high-volume financial instruments. Forcing bilateral systems and aggregators to change their business model to fall within the definition of a trading venue, MTF or OTF would lead many if not all to withdraw from the marketplace significantly curtailing market participants’ ability to transact on a bilateral basis which is essential for transacting non-standard financial products.

Software Vendors have Developed due to Client Demand

The emergence of software vendors and their innovative market solutions is a function of client demand due to technological change. In the late 1990s, the first vendors helped buy-side firms respond to the initial wave of electronification of the trading markets by offering systems to facilitate rapid and seamless access to multiple sources of electronic liquidity. The process of technological change has continued: in the last few years, the implementation of MiFID II has caused a shift away from voice trading in the OTC derivatives markets towards greater use of electronic trading.

In fact, MiFID II has increased the need for vendor solutions. GreySpark Partners identified that, in 2018, bonds and OTC derivatives liquidity was fragmented across more than 140 sources of liquidity, which led to corresponding challenges in the price discovery process for buy-side firms due to the variety of trading protocols and other differences across liquidity sources.¹⁶ This shift also represented a “make or break” moment for buy-side firms to adapt to electronic liquidity in light of their compliance obligations under MiFID II (discussed below). In the face of such complexity, buy-side firms have long sought solutions to help facilitate access to their existing sources of liquidity, which is the core service that vendors provide rather than replicating the services provided by authorised trading venues. ESMA’s proposal would stifle innovation and hinder the ability of buy-side and sell-side firms to build and commission technology designed to deal with the mounting complexity they face.

Software Vendors Offer Lower Costs and Lower Complexity

The use of bilateral systems and software vendors has been shown to lower transaction costs and to reduce operational complexity for buy-side firms. For example, it has recently been estimated that having access to multiple sources of liquidity, including dealers through the use

¹⁶ See “The Evolution of the Buy-Side Fixed Income Execution Management System” (1 November 2018), available at: <https://greyspark.com/the-evolution-of-the-buyside-fixed-income-execution-management-system/>.

of bilateral systems, can lead to reductions in trading costs of 70%-80% for buy-side firms.¹⁷ These savings were identified in respect of the spot FX market, however the overall conclusion – that using vendors helps to reduce transaction costs – holds across different asset classes.

The use of vendor systems provides cost savings in additional ways. A recent analysis by TradingScreen found that the use of manual trading systems by fund managers causes delays in sending orders to the market. These delays average approximately 2.5 hours per day, which on average leads to a loss of \$8 million per year in terms of assets under management (“AuM”) for a mid-sized long/short equity hedge fund with \$5 billion AuM.¹⁸ Moreover, TP ICAP recently announced that it was able to retire 85 separate legacy trading systems and replace them with a single order management system from Trading Technologies.¹⁹ Having a single solution reduces complexity and duplication as well as minimises operational risk for TP ICAP’s interdealer business.

Software Vendors Enhance Transparency

Another significant benefit of using vendor solutions is the enhanced transparency for buy-side firms, who are able to easily and quickly compare live prices across various sources of available liquidity.²⁰ Having access to multiple liquidity sources can offer buy-side firms with better execution opportunities. For example, in the FX markets, smaller-scale orders can be filled competitively on trading venues, however as trade size increases it is often easier for buy-side firms to trade bilaterally with a dealer. The ability to survey market liquidity therefore increases the likelihood that buy-side firms can obtain lower spreads and minimise market impacts.

Software Vendors Support Regulatory Compliance

Finally, we would note that a significant benefit of software solutions is that they promote, rather than inhibit, compliance with new MiFID II regulatory requirements. For example, buy-side firms are now subject to heightened best execution obligations, including regular reports of their chosen execution venues across asset classes and contract types. Many buy-side firms would struggle to comply with these requirements in a cost-effective manner, whereas the data stored in a vendor’s software can help to generate such reports and to provide evidence that best execution has been obtained for a buy-side firm’s client.. Vendors may also supply reporting tools as well as other features that facilitate pre- and post-trade transparency. In all cases, however, the goal is the same: to help ensure efficient and effective compliance with MiFID II requirements.

As the foregoing discussion amply demonstrates, bilateral systems and aggregators serve a far different purpose than trading venues and bring a wide variety of costs savings and other benefits to the market that have not been taken into account in the Consultation Paper. It is unfortunate that the Consultation Paper does not include any facts or figures presented to substantiate the inchoate claims by incumbent trading venues of an unspecified “uneven playing field” or discuss what specific harm has resulted. Subjecting vendors to trading venue

¹⁷ See “Bilateral Streams slash FX trading costs by 80%, dealers claim”, *Risk.net* (13 November 2020).

¹⁸ See “Hedge Funds Losing Millions Annually as Manual Processes and Old Technology Takes its Toll on Trading” (16 September 2020), available at: <https://tradingScreen.com/news/post/hedge-funds-losing-millions-annually-as-manual-processes-and-old-technology-takes-its-toll-on-trading>.

¹⁹ See “TP ICAP installs OMS from Trading Technologies in multi-year deal”, *The Trade News* (7 July 2020), available at: <https://www.thetradenews.com/tp-icap-installs-oms-from-trading-technologies-in-multi-year-deal/>.

²⁰ Buy-side firms are only able to access liquidity where they already have trading privileges.

authorisation requirements without adequate justification will increase the costs of entry to new service providers – or cause current providers to exit the EU market – which will reduce innovation in emerging financial technologies and hamper the development of a seamless EU-wide market for trading in financial instruments.

The burden must therefore be on ESMA and the incumbent trading venues to precisely quantify the alleged costs and harm to the market of bilateral systems and aggregators, and that such costs and harm meaningfully outweigh the benefits such service providers bring to market participants. This cost-benefit analysis must, in our view, also account for the increases in costs for buy-side firms and end-clients that would result from bilateral systems and aggregators restructuring their operations to be that of a trading venue and the resulting on-going authorisation obligations, including the removal of the benefits to market participants identified above in terms of lower spreads, operational savings, greater transparency and cost-effective regulatory compliance.

<ESMA_QUESTION_FOTF_10>

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

<ESMA_QUESTION_FOTF_11>

We strongly disagree with the approach suggested by ESMA regarding software providers that pre-arrange transactions formalised on other authorised trading venues.

As also discussed in our response to Question 3, above, it is a time-honoured and uncontroversial understanding that trading venues provide for execution. ESMA's proposals in the Consultation Paper would divorce the term "multilateral system" – and hence that of "trading venue" – from the act of execution. This position appears based solely on the possibility that certain service providers provide for off-venue negotiation of transactions that are then formalised by execution on an authorised trading venue.²¹ In addition, the fact that the marketing materials for certain of these service providers may reference the term "execution" should not and must not affect the proper legal characterisation that service providers that *guide trading interest* to trading venues for execution are not themselves trading venues in their own right.

Were ESMA's proposed approach followed, market participants would immediately face substantial confusion in distinguishing between *bona fide* trading venues and other service providers. For example, based on ESMA's conclusory language in the Consultation Paper, any one of the following service providers may need to be authorised as a trading venue if ESMA's proposals take effect:

- enhanced chat communication systems;
- execution management systems unless exclusively providing routing; and
- software/middleware vendors.

²¹ See Consultation Paper at ¶71.

To take a simple example: consider where a middleware vendor permits a buy-side firm to see various prices across a number of execution venues (regulated markets, MTFs, OTFs, SIs) where it has trading privileges. The buy-side firm chooses to execute on an available MTF and then uses the vendor's software to transmit an order into the MTF's trading system, where the trade is executed.

Regulating middleware vendors as MTFs under these circumstances raises significant legal, regulatory and operational challenges. How does ESMA propose to provide for orderly trading conditions where a trade flow involves two sequential MTFs? It is not clear, for example, which MTF (the vendor or the "true" MTF) would have responsibility for pre- or post-trade transparency requirements, transaction reporting for non-investment firms or for ensuring adequate settlement arrangements. Nor is it clear which MTF bears liability to its users under which circumstances or the extent to which a multi-MTF trade flow would require coordination of the rulebooks and operating procedures of both MTFs.

ESMA suggests that the software vendor is the "true" trading venue that has outsourced execution to another trading venue which is now characterised as a third-party service provider.²² This approach conflicts with existing ESMA guidance, which states that "a trading venue should not be allowed to arrange transactions without formalising the execution of those transactions under its rules and systems" and that "a transaction cannot be concluded on more than one trading venue at the same time".²³

Moreover, treating the software vendor as the "true" trading venue would reverse the universally-recognised market expectation that the execution provider is the real trading venue, adding to the confusion of market participants. In addition, the regulatory relationship between the software vendor and the trading venue would be reversed due to MiFID requirements applicable to outsourcing arrangements. Specifically, Article 16 of MiFID II and Article 31 of Delegated Regulation (EU) 2017/565 provide for extensive supervision and oversight rights by an outsourcing form over the outsourced service provider, including rights to access data and to business premises. It is unclear whether incumbent trading venues would accept being relegated to the status of outsourced service providers, especially in light of the supervision, oversight and access rights that would need to be granted to the outsourcing software vendors.

<ESMA_QUESTION_FOTF_11>

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

<ESMA_QUESTION_FOTF_12>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_12>

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

²² See Consultation Paper at ¶ 74.

²³ See Market Structures Q&A at 41.

<ESMA_QUESTION_FOTF_13>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_13>

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

<ESMA_QUESTION_FOTF_14>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_14>

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

<ESMA_QUESTION_FOTF_15>

[TYPE YOUR TEXT HERE]

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

<ESMA_QUESTION_FOTF_16>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_16>

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

<ESMA_QUESTION_FOTF_17>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_17>

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

<ESMA_QUESTION_FOTF_18>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_18>

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

<ESMA_QUESTION_FOTF_19>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_19>

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

<ESMA_QUESTION_FOTF_20>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_20>

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

<ESMA_QUESTION_FOTF_21>

[TYPE YOUR TEXT HERE]

<ESMA_QUESTION_FOTF_21>