

## Securities and Markets Stakeholder Group

# Advice to ESMA

**SMSG advice to ESMA on its Third consultation Package (CP 3) on equity transparency (RTS 1 and CDR 2017/567), volume cap (RTS 3) circuit breakers (new RTS), SI (new ITS on SI notification), the equity CTP (new RTS on input / output data of the pre-trade and post-trade equity CTP) and the flags for non-equity transparency (RTS 2)**

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## 1 Executive Summary

The SMSG provides its views on specific questions raised by ESMA in the Third consultation package (CP 3) on equity transparency (RTS 1 and CDR 2017/567), volume cap (RTS 3) circuit breakers (new RTS), SI (new ITS on SI notification), the equity CTP (new RTS on input / output data of the pre-trade and post-trade equity CTP) and the flags for non-equity transparency (RTS 2).

This SMSG advice is limited to the following key areas of the consultation package:

1. Pre-trade transparency for systematic internalisers
2. New requirements on Circuit Breakers and amendments due to DORA framework

The amended MiFIR text mandates ESMA to redefine two thresholds to comply with pre-trade transparency obligations in Articles 14 to 17 of MiFIR:

- The quoting size subject to pre-trade transparency, and
- The minimum quoting size that SIs must comply with.

The SMSG is fully supportive of ESMA redefining the two thresholds taking into consideration the objectives to increase the pre-trade transparency of equity instrument for the benefit of end-investors, maintain a level playing field between trading venues and systematic internalisers, provide end investors with an adequate choice of trading options and ensure that the trading landscape in the Union remains attractive and competitive both domestically and internationally.

The SMSG agrees with the ESMA's approach for establishing circuit breaker principles, stating that regulated markets need flexibility to calibrate parameters for halting trading based on asset class liquidity, market model, and user types. However, we suggest clarifying conditions for using only static or dynamic circuit breakers to include market characteristics. We support increasing transparency in circuit breaker areas, including

changes to MiFID Article 48, which require exchanges to publish the methodology underpinning their circuit breakers and trigger conditions. However, we argue that ESMA's draft RTS 7 would prohibit the public disclosure of circuit breaker parameters, which is not in line with MiFID II level 1 legislation. We also argue that disclosure of circuit breaker parameters is a common industry practice for derivatives exchanges but maintains confidentiality around frequency exchange systems and controls trigger and alerts. If ESMA is nevertheless adamant on the disclosure of circuit breakers alert, we recommend limiting it to publication by competent authorities and under extraordinary circumstances.

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## **2 Pre-trade transparency for systematic internalisers**

- 1 Article 14 of MiFIR sets out that systematic internalisers are required to make public firm quotes in equity instruments where those systematic internalisers deal in sizes up to the standard market size (SMS). In addition, as per Article 15(4), where a systematic internaliser (SI) is quoting only one quote or whose highest quote is lower than SMS and that SI receives an order from a client of a size bigger than its quotation size, but lower than the SMS, it may decide to execute that part of the order which exceeds its quotation size, provided that it is executed at the quoted price.
- 2 Recital 13 of the amended MiFIR, states that, as SIs are free to decide at which sizes they quote provided they quote at a minimum size of 10% of SMS, this has led to very low levels of pre-trade transparency. The MSG agrees this has led to what can be described as low levels of transparency because SIs have opted to issue public quotes at the minimum quote size, noting that although this quote size is small, it is transparent, if we consider the regulatory requirements under the previous MiFIR.
- 3 Given the low level of current SI pre-trade transparency, and in an effort to maintain a level playing field between trading venues and systematic internalisers, ESMA has been mandated to redefine two thresholds. These being 1) the determination of the threshold up to which SIs are subject to the pre-trade transparency obligations in Articles 14 to 17 of MiFIR if they deal in sizes up to that threshold, and 2) the determination of the minimum quoting size that SIs must comply with.
- 4 The MSG is fully supportive of ESMA redefining the two thresholds taking into consideration the objectives to increase the pre-trade transparency of equity instrument for the benefit of end-investors, maintain a level playing field between trading venues and systematic internalisers, provide end investors with an adequate choice of trading options and ensure that the trading landscape in the Union remains attractive and competitive both domestically and internationally. However, given the specificity set out in Article 14(7) of the amended MiFIR, the MSG believes ESMA has been to a large

degree limited in how it can redefine the thresholds. Its task is also rendered challenging by the fact that it has these multiple objectives to balance.

## **Shares**

- 5 The MSG agrees that, given that a significant percentage of turnover, transactions and ISINs falls within an AVT level that is below 10,000 for shares, it is appropriate to revise the AVT buckets to a more granular level in order to set a more appropriate lower threshold for these shares. This will lead to a significantly higher level of pre-trade transparency than is provided today, (although it is difficult to opine on the exact impacts without an individual per instrument level analysis). Separately, ESMA could also consider the potential to define SMS using ADT.
- 6 As required by level 1, the MSG is, also, pleased to note that ESMA has taken into account the evolution of other jurisdictions' practices in determining its approach, and notes that the UK has not proposed to move quoting thresholds, remaining below the levels proposed for minimum quoting sizes in the EU. However, we wish to note that market structures vary across jurisdictions and therefore, ESMA must first take into account the European market structure as a whole.

## **ETFs**

- 7 The MSG notes that the breakdown of the percentage of turnover, transactions and ISINs was more evenly split across the existing AVT buckets for ETFs and therefore questions the benefit from revising these to more granular buckets but as a general principal agrees that a more granular approach seems sensible.
- 8 In the context of ETFs, the MSG would also like to highlight that the level of liquidity provided on regulated markets is limited with the majority of trading occurring on MTFs, SI and OTC as detailed in Figure 11. That said, although ESMA deemed it unnecessary to amend Article 10, there is the potential there may not be quotes up to the equivalent size (SMS) on the most relevant market at a particular point in time. The MSG would, therefore, recommend that ESMA re-visit this article with respect to ETFs.

## **3 New requirements on Circuit Breakers**

### **3.1 Definition of algorithmic trade**

- 9 The proposed definition of algorithmic trading systems (Article 1) is overly broad and might require exchange staff to know all about all the users' algorithmic trading systems, which could be difficult to implement or give rise to enforcement risks for

matters outside of the exchange's control. Other areas of MiFID II cover market participant systems used for algorithmic trading, whilst draft RTS 7 intends to focus specifically on the trading venue systems. We suggest clarifying the scope of Article 1 (1)(a) by introducing the following changes (in bold and italic): "*(a) 'Algorithmic trading systems' means any trading systems **of the trading venue** that allow or enable algorithmic trading of the trading venues' participants.*"

### 3.2 Establishment of Circuit Breakers (Article 17)

- 10 We generally agree with ESMA's suggested approach for establishing circuit breaker principles. Regulated markets need sufficient flexibility to ensure that the parameters for halting trading are appropriately calibrated in a way which takes into account the liquidity of different asset classes and sub-classes, the nature of the market model and types of users and is sufficient to avoid significant disruptions to the orderliness of trading.
- 11 We do suggest clarifying the conditions for using only static or dynamic circuit breakers to include market characteristics. This could be best achieved by clarifying the conditions mentioned in Article 17(2) by introducing the following changes (in bold and italic): "2. Trading venues shall design the circuit breakers deployed for the instruments traded on the basis of a static and a dynamic reference price, unless the trading venue demonstrates to its national competent authority that due to market-specific **characteristics and** circumstances volatility is adequately managed deploying only a static or a dynamic reference price."

### 3.3 Methodology for the calibration of Circuit Breakers (Article 18)

- 12 We agree with the suggested general principles in the establishment of the methodology for the calibration of circuit breakers.

### 3.4 Disclosure requirement regarding circuit breakers (Article 19)

- 13 We support increasing transparency in the area of circuit breakers, including the changes to MiFID Article 48 on circuit breakers which require regulated markets to publicly disclose information about the circumstances leading to the halting or constraining of trading and on the principles for establishing the main technical parameters used to do so. However, Recital 19 of ESMA's draft RTS 7 aims to prohibit the public disclosure of circuit breaker parameters by regulated markets. The proposed recital of the draft RTS is thereby not in line with MiFID II level 1 legislation, which is mandating the disclosure of the principles for establishing circuit breakers parameters but does not prohibit further disclosure at the discretion of regulated markets. The

SMSG, therefore, proposes to clarify this aspect in Recital 19 of the ESMA draft RTS 7.

### **3.5 Disclosure of information on the triggering of circuit breakers (Article 19(1)(f))**

- 14 Whilst it is beneficial for the wider market stakeholders that regulated markets disclose information about the circumstances leading to the halting of trading and on the related principles applied, there are compelling reasons to maintain confidentiality around the frequency exchange systems and controls trigger and the alerts these systems produce. Disclosure of exchange alerts risks eroding market confidence due to the difficulties for the wider public to interpret their meaning, fuelling unnuanced sentiment on such number being too high or too low. In response, exchanges would have to consider the perception of the frequency alerts trigger by the wider public when calibrating its systems and controls, distracting from their principal responsibility to provide fair and orderly markets.
- 15 If ESMA is nevertheless adamant on the disclosure of circuit breaker alerts, we strongly advise to limit such disclosure to publication by competent authorities and under extraordinary circumstances. The disclosure of the frequency alerts trigger should be accompanied by the necessary context that would allow the public to understand their meaning.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

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[signed]

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