

# Systematic Internalisers - Response to ESMA Consultation on Amendments to Commission Delegated Regulation (EU) 2017/587 (RTS 1)

## **The aim of MiFID and the trading obligation under MiFIDii**

ABN AMRO Clearing Bank N.V. (AACB) has taken note of the ESMA Consultation on Systematic Internalisers (SI) Quote Rules under MiFIDii. (ESMA70-156-275)

The introduction of MiFIDii is intended to sustain and increase transparency by introducing a trading obligation for shares on regulated markets (RM), MTFs and SIs, as well as introduce a range of pre- and post-trade transparency measures. By reducing the possibilities for off-exchange trading in darkpools and via broker-crossing networks (BCN), there was a clear aim to improve the quality of public markets by increasing transparency on pricing, depth of the market and liquidity. AACB believes this development would promote efficient price discovery and creates a transparent level playing field between the various means of trading in Europe.

AACB is a firm believer in open, transparent and safe financial markets cleared by central counterparties (CCP). Since the introduction of MiFIDi and EMIR, increased transparency of the equity and derivative markets combined with (mandatory) clearing has led to lower spreads, better prices for end-users, greater market liquidity, reduced volatility, more transparency and – most of all - better distribution of systemic risks.

AACB understands that there are certain legitimate benefits of preserving the possibility of OTC trading and reduced transparency in specific circumstances. This includes, but is not limited to, the possibilities to trade via an SI or use the various transparency waivers that MiFID offers for large in scale orders, reference prices and negotiated prices. In AACB's view, the new MiFID requirements contain sufficient possibilities to facilitate this in order to ensure that large orders have no adverse market impact or create price movements that can cause market distortion.

In addition, AACB appreciates the upsides for various market participants to execute certain large orders on an SI or OTC rather than on an exchange or MTF. Particularly for buy-side and institutional players that still heavily depend on banks and brokers for execution, using SIs could provide them with price advantages, operational efficiencies, lower transaction costs and a reduced market impact for larger orders. At the same time, the new MiFID market infrastructure transparency and trading opportunities (also combined with unbundling) provide the buy-side with unprecedented new opportunities to use the markets in their own capacity rather than through traditional broker and banking relationships

AACB shares ESMA's concerns that SIs, by not being part of the harmonised tick size regime, could impact the level playing field on the European equity and ETF markets, particularly around transparency, price discovery and best execution.

## **Our concerns on the SI regime**

Effectively, within the current legislative setup of the MiFID framework, we believe an SIs is able to operate in the same way as an MTF or regulated market, albeit on a principal-to-principal basis while being able to offer a range of advantages compared to public trading venues. Overall, the SI would have many of the same characteristics as a trading venue, but without being subject to the more stringent requirements on transparency, non-discriminatory access, best execution, clearing and settlement. AACB believes that, unless proper guidelines ensuring a level playing field with on-exchange trades are in place, this development could lead to the detriment of transparently traded and cleared public markets. This is based on the following considerations:

- As a result of the internalisation of order flow and execution, the SI is not necessarily required to clear its transactions on a CCP. While the possibility of using ETRs or hedging SI exposures on trading venues exists, AACB believes that – given the potential size of the SI flows – an undesirable level of (intraday) systemic risk can be built up in the SI without being reported and cleared.

- The relief for pre-trade transparency requirements for orders above Standard Market Size (SMS), as well as fact that SIs are allowed to defer publication of large transactions, could have material implications for the price-discovery process, particularly if more volume would shift to SIs rather than to trading venues. This could potentially impact the quality of the public markets. It could also lead to front-running on trading venues by SI owners as a result of the increased latencies in their reporting and publication process of SI flows (i.e. they can turn around to trading venues with SI flow).
- Despite being subject to best execution, SIs are inherently better equipped to provide best execution compared to trading venues as a result of their ability to improve pricing, even for smaller orders in "justified" circumstances. Since they are not part of the harmonized tick size regime, SI providers could potentially use the information from trading venues to offer small improvement in their pricing and would therefore be able to offer best execution at all times where others cannot.
- The main feature of the SI is that it deals on own account (on a principal-to-principal basis), contrary to trading venues. Combined with their ability to hand-pick their clients (and subsequent order flow) the SI would potentially create market asymmetries between the various types of participants, most notably between sophisticated and less sophisticated (end)-users.
- The discussions on various definitions in the SI regime, most notably on clients and counterparties of investment firms operating as SIs, could lead to a risk of regulatory arbitrage between various European national regulatory regimes.
- Within the context of equivalence determinations under MiFIR, caution is also warranted to ensure that darkpools or alternative trading systems in third countries should comply with the European standards.

**Q1: Do you agree with ESMA's proposal to clarify that SIs' quotes would only reflect prevailing market conditions where the price levels could be traded on a trading venue at the time of publication?**

AACB welcomes this consultation and the recent amendments by the European Commission to ensure that matched principal trading by a network of SIs is not allowed and that the key characteristic of an SI's activity should be to provide liquidity bilaterally to clients by trading at for its own risk. AACB also agrees that SIs which are functionally similar to a trading venue would need to seek authorisation as such. AACB believes the EC amendments, ESMA guidance and this consultation already limit some of the potential consequences of the SI regime. At the same time, it still leaves a number of open issues with regard to the retention of a level playing field.

Although the SI is required to meet the best execution requirements of MiFID, based on the current provisions of MiFID and RTS has a range of opportunities to improve its pricing as it is not part of the harmonised tick size regime. It is therefore in an inherently better position to offer best execution compared to other forms of execution, particularly for orders below SMS. AACB supports ESMA's effort to bring the price improvement options for SIs in line with the harmonised tick size regime that applies to trading venues. This would enhance the price discovery process and make SIs a valuable and a truly competitive element in the trading infrastructure.

AACB would therefore strongly support ESMA's proposal to amend Article 10 of RTS 1 to clarify that, for equity instruments subject to the minimum tick size regime under MiFID II RTS 11, SI quotes would only be considered to reflect the prevailing market conditions where those quotes reflect the price increments applicable to EU trading venues trading the same instruments.

We believe that if there is no alignment between the regulatory framework between SIs, RMs and MTFs on quotes it would be to the detriment of a level playing field on transparency, price discovery and non-discriminatory access to markets. It could also lead to an increase in systemic risks and fragmentation of the European equity markets. As a result, it would achieve the exact opposite of the intended goals of MiFID, such as better prices for end-users, greater visible market liquidity, efficient price discovery and a transparent level playing field between the various means of trading in Europe.

**Q2: Do you agree with the drafting amendment described above?**

AACB agrees with the drafting amendments proposed by ESMA.