

VIRTU ITG EUROPE LIMITED (“VIEL”) RESPONSES TO ESMA CONSULTATION PAPER ESMA70-156-2188 OF 4 FEBRUARY 2020 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 SHARESⁱ

NOTE: Many trading firms across the industry will not have had time to respond fully to this consultation given the extraordinary market conditions in light of COVID-19. We therefore strongly suggest that ESMA extends the period for this consultation by 6 months.

Foreword: VIEL notes that the intention behind the introduction of MiFID I was so that there was “the degree of harmonisation needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community, being a Single Market”ⁱⁱ. The core principles were therefore (i) investor protection and (ii) moving away from fragmented, national markets towards the pan-European Single Market. VIEL would like to stress the importance of these two principles and ask ESMA to consider with each proposal to amend or alter the regime, whether the change pursues these principles or runs counter to these principles. Certain of the proposals contained in the consultation VIEL considers to go against the tenets of best execution and therefore against the principle of investor protection. In addition, the trend in the proposals to place more restrictions on the trading which can take place on FBAs and venues utilising pre-trade price transparency waivers is tantamount to a push for trading to go back to the primary exchanges, which moves away from the pan-European trading principle within the Single Market and back towards national trading on the primary exchanges, also known as the former Concentration Rule (itself further undermining the variety of choice inherent to best execution). VIEL has therefore answered the below questions with a focus on the original principles behind the MiFID regime.

PreTrade Transparency

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 RP and NT waivers, would you prefer to set a minimum threshold above which transactions under the RP and NT waivers would be allowed? If so, what should be the value of such threshold? What alternatives do you propose to simplify the MiFIR waivers regime while improving transparency available to market participants? Please explain.*

VIEL would rather there be no minimum size applied to RP/NT waivers. If there were to be a minimum size applied, it should be consistent with other size requirements – the most suitable being the SMS (although the SMS itself needs better calibration than the new values currently being proposed).

From VIEL’s analysis of dark trades, 25% of notional traded on dark venues is in sizes smaller than SMS today (10k EUR). On a trade count basis that figure is 80% of all dark trades under the current SMS value. If a minimum size requirement were to be introduced, the level of such requirement should reflect the level at which such a trade may have price impact if executed on the lit market. If set too high, resulting in sizeable trades not benefiting from the waiving of pre-trade price transparency requirements, investors would suffer detriment by way of their execution costs.

VIEL believes that the key facet of a minimum threshold is that it be very simply defined and consistently applied - unnecessary complexity should be avoided in order to support the smooth functioning of the markets. Currently, large-in-scale thresholds are too esoteric for end-investors to be able to determine on a stock by stock basis.

VIEL would also argue that the order management facility (OMF) waiver provides decreased transparency to the lit markets. Lit markets allowing fully or partially hidden orders (e.g. iceberg orders) means that the visible bid/offer prices and sizes are not actually representative of the real liquidity available. This seems counter-intuitive to the notion of transparent lit markets - the published data is not definitive and it is not guaranteed to accurately reflect the demand at each price level, even today. It is worth noting that icebergs



are already using SMS as the min order size requirements - again this is something that it would make sense to apply consistently: either by stipulating that a min size is not needed or by applying a min size to all forms of reduced pre-trade transparency. Although iceberg orders do require a portion to be visible, the size of that portion can be insignificant compared to the actual iceberg itself (e.g. just 1 share) and is not necessarily at the same price as the hidden portion.

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

If the intention is to apply this threshold to all ETFs, no. A distinction should be drawn between ETFs that are liquid and those which are illiquid (see VIEL's response to Question 8 below which addresses how the assessment of liquidity/illiquidity of ETFs should be approached).

EUR 5mn would be a significant trade size in illiquid ETFs. If this threshold were put in place in relation to illiquid ETFs, and transparency requirements were therefore placed on instruments which naturally trade below this threshold, VIEL anticipates it would likely see a negative impact on the quote spreads of illiquid ETFs. Such an effect on the quote spreads would be detrimental to end investors.

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

VIEL believes that DVC restrictions disproportionately impact mid- and small-cap equities in respect of which lit/displayed equity is thin. Restrictions on dark trading increase transaction costs significantly as a result of the market impact arising from certain transactions being undertaken on lit venues. The DVCs therefore act as a disincentive for funds to hold illiquid equity assets.

Therefore VIEL disagreed with extending the scope of the application of the DVC illiquid instruments. Reducing impact when trading illiquid instruments is a priority for the end investor and trading on dark venues reduces price impact and thus improves best execution and, as noted in the foreword, VIEL considers best execution to be a key priority.

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

Currently VIEL operates a combination of waivers in its trading venue, POSIT MTF. This process simplifies routing and networking costs for the end-investor. If there were a limitation on operating a combination of waivers in one venue, the venue operators would be likely to split the flow into additional venues, introducing more complexity and fragmentation.

In the event that venues were forced to run multiple order books with a single waiver each, practical work-arounds could be implemented, such as the recoding of algorithms / SORs taking that into account: e.g. an algorithm would place an order in the LIS system while it could, then, as it decreased in size, move the order across into the RPW book. If the algorithm was not finding liquidity in the LIS book it would break itself down into smaller pieces and place more in the RPW book instead.

Ultimately, such a process would yield more or less the same outcome as would be the case if the orders in a single book were allowed to interact, as they do now, but it would require the brokers to refine their algorithms to facilitate this outcome – i.e. you replace a simple process with a more complex process without practical differences being achieved.

There is therefore no perceivable benefit from taking the step to remove the combination of waivers. It is hard to determine how such restriction would improve market structure, as it would prevent buyers and sellers coming together without jumping through a series of additional hoops.



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.*

For shares and equity-like instruments, VIEL would suggest reducing the cost of trading during continuous trading (CT) on lit exchanges as well as ensuring that trading at auctions on lit exchanges does not cost more than during CT.

Also, focusing on OTC trading, which currently represents 19% of notional value traded, and encouraging the transition of this flow to lit and dark trading venues will increase price transparency and liquidity to more participants.

In respect of ETFs, VIEL considers that a “trade through” rule, similar to the approach taken in the USA, may be appropriate. ETF trades executed via principal RFQs should interact with the top of the lit order book if the top of the order book price is equal to, or better than, the principal RFQ price. The direct interaction with the lit order book would increase lit volumes but additionally offer a greater incentive for market participants to leave resting orders in the lit order book.

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.*

- Option 1: *assess the liquidity in accordance with the average daily number of transactions and the average daily turnover;*

- Option 2: *assess the liquidity in accordance with the market capitalisation, the average daily number of transactions and the average daily turnover.*

VIEL considers that assessing the liquidity by reference to the average daily number of transactions and the average daily turnover is most likely to be sufficient – and is highly correlated with the market capitalisation of a stock, and therefore VIEL does not have a particular preference between Options 1 and 2.

The two options are sufficient to assess the frequency of trading and therefore the appropriate thresholds for the percentage of days traded measurement is unnecessary in our view.

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

No, VIEL would suggest a different approach to identifying whether an ETF is liquid or illiquid. The liquidity of an ETF is not only defined by how frequently or how much it trades on a daily basis - an ETF is as liquid as the underlying basket or proxy assets to that basket. We would suggest a method which looks at the liquidity of the underlying basket or proxy assets to determine whether an ETF is liquid or not. For example, an S&P 500 ETF that trades frequently on exchange is likely to have similar liquidity to that of an S&P 500 ETF that trades infrequently, as the underlying basket via the creation/redemption process or proxy assets, such as futures, dictates the total liquidity.

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.*

During conventional periodic and frequent batch auctions (FBAs), the indicative Price and Volume are the most important values required for electronic interaction. This information becomes available only when there are both Buy and Sell orders present.

VIEL does not agree with the proposal to require the disclosure of orders submitted to FBAs, orders which are submitted and are only single sided will not trigger the publication of Indicative Volume and Price and could have adverse effect or larger trading impact.



FBA's operate in a manner very similar to that of conventional periodic auctions on primary exchanges and we do not consider that they ought to be subject to a distinct regimes. Based on VIEL's internal research, execution in FBA's have a higher quality of executions in the form of adverse selection relative to lit executions on Primary and MTF's. FBA's help investors by reducing market impact – that benefit would be undermined by requiring the disclosure of all orders submitted to FBA's.

VIEL notes that it may be contradictory to enable hidden or partially hidden iceberg orders on certain markets, as referenced in response to Q1 above, but to require the disclosure of all orders submitted to FBA's.

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

VIEL refutes the insinuation that FBA's constitute "non-price forming systems". A distinction should be drawn between a venue on which the only uncrossing price available is necessarily fixed by reference to a price derived from elsewhere (which would be inherently non-price forming), and venues which facilitate the execution of orders which the client has instructed be pegged to the mid-point. VIEL could agree that those venues which do not facilitate price-formation by means of their execution logic should operate under a pre-trade transparency waiver - however one should not confuse such venues with those which are facilitative of price-formation but, due to the majority of investors electing to submit orders to that venue which are pegged to the mid, the price formation of the venue is less apparent. If a buyer and seller both decide to limit their orders to the mid-point, the price formation process on any venue would by definition produce a mid-point price as the only price at which they can and should match. That does not preclude the periodic auction from generating a different auction price in other scenarios based on the order prices entered e.g. a sell order with a fixed limit vs. a buy order with a price protection of peg ask could be anywhere within the limits of those 2 orders.

VIEL would argue investors should be allowed to use pegged instructions as price protections on their orders without penalty.

Dark Volume Caps

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

Option A: to keep the 4% TV level threshold and the 8% EU level threshold;

Option B: to eliminate the 4% TV level thresholds and keep the EU level threshold at 8%.

Option C: to eliminate the 4% TV level threshold and reduce the EU level threshold to 7%;

Option B: to eliminate the 4% TV level thresholds and keep the EU level threshold at 8%.

VIEL would advocate for removing these DVC levels and having much higher DVC levels than those currently specified – there does not appear to be any evidence that trading under the RPW/NT waivers at these levels is harmful to markets.

From the options above, however, VIEL would prefer Option B - to eliminate the 4% TV level thresholds and keep the EU level threshold at 8%.

The 4% cap adds unnecessary complexity and unfairly penalises venues. Further, each step which removes the ability to trade on a particular venue is a step away from offering investors the greatest variety of venues upon which to elect to execute their transactions.

The 4% cap in reality only impacts lower liquidity names as it is far more likely that a single venue will be able to reach 4% in a low liquidity stock, which may only be available on a narrow selection of venues, than a highly liquid stock which is available on a broad range of trading venues.



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

VIEL queries why there is a need to limit dark trading. The US markets function efficiently and have more dark trading than in Europe. The ability to trade on dark venues provides benefits to the end investor – it reduces market impact of orders which would otherwise raise execution costs for investors. This was recognised in the MiFID I regime through the introduction of pre-trade transparency waivers.

If necessary to limit in one respect or another, VIEL would be in favour of a minimum size requirement (although such minimum size requirement ought not to be set at too high a level), as very small trades would be unlikely to have market impact if traded on lit markets and therefore there would be less of a benefit in such orders being traded on dark venues.

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

In accordance with VIEL's response to Question 16 above, in which VIEL suggests the elimination of the 4% trading venue level threshold, VIEL agrees with the removal of the requirement in Article 5(7)(b) which obliges trading venues to ensure that they do not exceed the 4% threshold.

Q20: *Please provide your answer to the following survey on the impact of DVC on the cost of trading for eligible counterparties and professional clients.*

According to VIEL's internal research, across the last two years (2018 and 2019) there has been no material differences in transaction costs or reversion (pre- and post-trade) for trading activity conducted under the DVC vs. non-DVC trading activity. Aside from a shift in liquidity to certain types of venue, the market does not appear to see more favourable trading results in respect of DVC securities.

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

No. All rules should be consistently applied so there is no ambiguity or confusion – applying the DVC to a stock in respect of which there is not 12 months of data could create discrepancies in the treatment of instruments and unnecessarily hamper new listings.

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.*

No. The majority of ETF liquidity provision comes from market maker liquidity. The immediate publication of trades as large as EUR 20mn would have a negative impact on quoted risk spreads in particular for less liquid ETFs (see response to Question 8 above in respect of the approach to liquid/illiquid ETFs). A reasonable delay should be allowed for the hedging of risk associated with principal liquidity provision. Without a delay end-investors would be negatively impacted by wider spreads.

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.*

VIEL believe that the current regime for reporting the transactions subject to the share trading obligation is sufficient. Ultimately, changing the LIS levels to move more trading to lit venues will result in more trades having market impact which leads to increased costs for end-investors.

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.*

Too lenient. 1 minute, in electronic trading terms, is an extremely long time and would not be considered by those in the industry as amounting to "real time". Allowing certain participants to have knowledge of trades which have taken place for the duration of a minute whilst the rest of the market does not have such information seems inappropriate and susceptible to potential abuse. VIEL recognises that there will always be informational



asymmetries given different processing times of information by participants in the market place, however we would argue that 1 minute is significantly longer than necessary and that it would not be considered by the industry to be “real time” if a technology platform took close to 1 minute to process or disseminate information.

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.*

VIEL agrees that the Opinion published in December 2017 is sufficient in providing guidance as to which third-country venues do not necessitate republication of post-trade transparency requirements in the EU and that there is no further need for Level 1 legislation.

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?*

VIEL considers that achieving best execution for investors is a key principle which legislation should aim to protect and uphold. Third-country shares may be traded on a trading venue within the EU but, as ESMA identifies within its consultation, the main pool of liquidity for such shares can often be located outside the EU. Restricting EU investment firms from executing in the principal place of liquidity makes it less likely that best execution in the global context can be achieved for investors.

VIEL would support an ISIN-based approach, with those shares having third-country ISINs falling outside the scope of Article 23 of MiFIR. In line with ESMA’s comments in paragraph 277, a possible exemption from that general position would be to include within the scope of the share trading obligation those third-country ISIN shares where the issuer has taken steps to admit the shares on a trading venue in the EU, for example a third-country ISIN share with a dual primary-listing on an EU regulated market. A list of such shares should be published in order to ensure clarity and consistent application of this revised share trading obligation scope. VIEL considers that this approach would support and protect best execution principles whilst preserving liquidity of EU ISIN shares within the EU and having a clear approach which could be consistently applied.

Q33: *Would you support deleting the first exemption provided for under Article 23 of MiFIR (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.*

As noted in our response to Question 31, VIEL believes that best execution principles for investors should be integral to financial services regulation. The first exemption in Article 23 of MiFIR is designed to support best execution as it ensures investment firms in the EU are not compelled to execute on markets where there is insufficient liquidity. Removing the exemption would introduce such a compulsion, which could undermine best execution for EU investors.

VIEL would support further guidance on the definition of what constitutes “non-systematic, ad hoc, irregular and infrequent”, however. ESMA has previously stated (on 13th November 2017) that the absence of an equivalence decision indicates that “the Commission has currently no evidence that the EU trading in shares admitted to trading in that third country’s regulated markets can be considered as systematic, regular and frequent” but there is no further guidance as to what does constitute ad hoc, irregular and infrequent.

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?*

Given the significance of the closing auction as the single biggest liquidity event daily, and its significance as a reference price, ESMA should closely monitor the pricing practices of the primary exchanges which have a monopoly on this event and whether it can be justified to charge at a different rate for trading in that period given investors are increasingly forced to do so. There is nothing about matching during an auction that costs an exchange more to



implement that during continuous trading. If anything, it is likely cheaper for an exchange to run an auction than a continuous matching process from a technological point of view.

ⁱ <https://www.esma.europa.eu/press-news/consultations/consultation-mifid-ii-mifir-review-report-transparency-regime-equity-and>

ⁱⁱ Recital 2 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (MiFID I)