European Securities and Markets Authority

Reply form for the Consultation Paper on MiFID II/ MiFIR review report on the transparency regime for equity and equity-like instruments, the DVC and the trading obligations for shares

4 February 2020

European Securities and Markets Authority

Date: 4 February 2020

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Consultation Paper on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligations for shares MiFID II/ MiFIR review report published on the ESMA website.

Instructions

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type <ESMA_QUESTION_CP_MIFID_EQT_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text "TYPE YOUR TEXT HERE" between the tags.

Responses 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.

Naming protocol

In order to facilitate the handling of stakeholders' responses please save your document using the following format:

ESMA_CP_MiFID_EQT_NAMEOFCOMPANY_NAMEOFDOCUMENT.

e.g. if the respondent were ESMA, the name of the reply form would be:

ESMA_CP_MiFID_EQT_ESMA_REPLYFORM or

ESMA_CP_MiFID_EQT_ANNEX1

Deadline

Responses must reach us by **17 March 2020.**

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 end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that 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 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 headings 'Legal notice' and 'Data protection'.

General information about respondent

Name of the company / organisation	AFME
Activity	Banking sector
Are you representing an association?	☒
Country/Region	Europe

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_CP_MIFID_EQT_1>
AFME[1] welcomes the opportunity to respond to ESMA's consultation on the transparency regime for equity and equity-like instruments, the double volume cap mechanism and the trading obligation for shares. We stand ready to assist ESMA to ensure future policy decisions are made on the basis of in-depth analysis.

Background

MiFID II represented a significant change to European financial market structure introducing, inter alia:

- a comprehensive cross-asset class transparency regime both pre- and post-trade;
- restrictions on dark trading in the form of the Double Volume Cap mechanism; and
- the Share Trading Obligation (STO)

Whilst MiFID I facilitated much needed enhanced competition in European financial markets with the introduction of multilateral trading facilities (MTFs) and best execution obligations, measures introduced under MiFID II have made European capital markets more transparent but also substantially more complex. Implementation has involved considerable investment from buy-side and sell-side firms as well as infrastructure providers in order to become compliant. At this point in time, just two years since MiFID II entered into force, European financial markets are still adjusting and evolving in response to these changes and guidance is still regularly issued either by ESMA or local national competent authorities (NCAs) to further improve and enhance market structure.

Price formation and the "health" of European equity markets

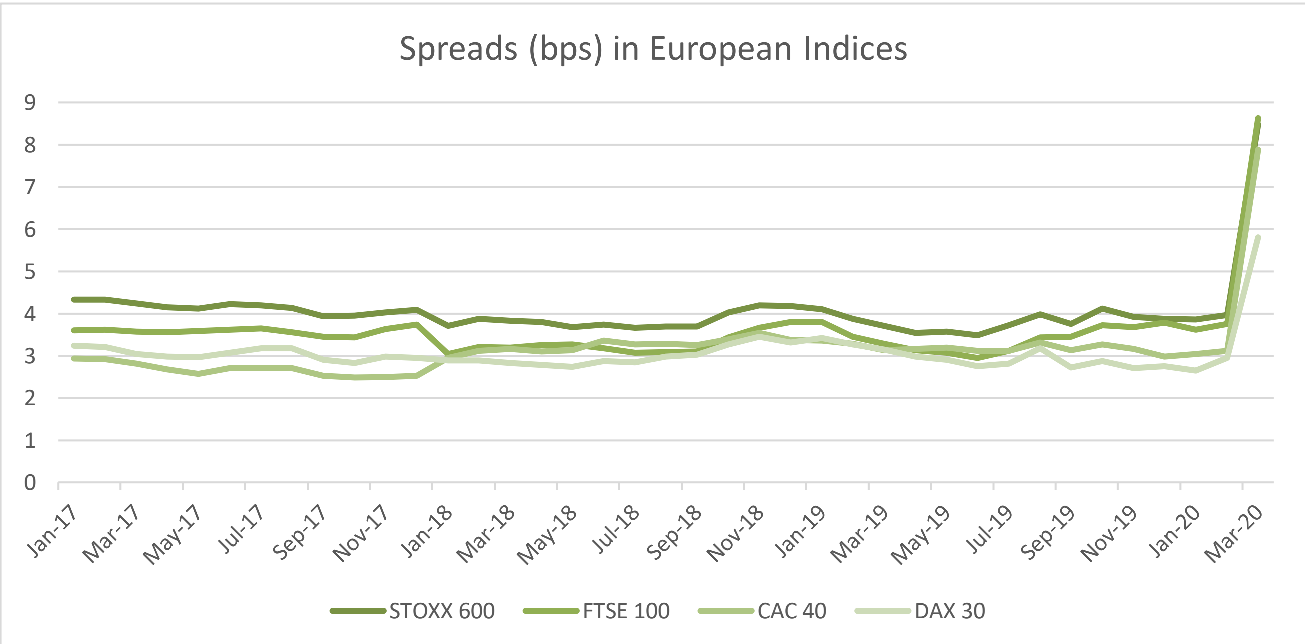
AFME does not believe enforcing increased lit market trading would necessarily improve price formation and, conversely, may impact the ability for firms to provide best execution for their underlying clients. Therefore, AFME supports the removal of the STO and the double volume cap mechanism. Neither of these policies advance positive outcomes for end-users, but further increase complexity in market structure.

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

ESMA's view, as set out in its Consultation Paper, is that there has been a decline in lit trading since MiFID II was implemented and that this raises a concern over transparency and price formation.

AFME members are doubtful there has been a significant change in the proportion of trading executed on venues and believe the current level of on venues trading versus OTC is instead due to a wider scope of application of post trade transparency requirements as well as implementation issues than to a change in trading practices or proof that MiFID II has failed to deliver its objectives. AFME members certainly do not believe that there has been a decline in the quality of the price formation process post MiFID II.

ESMA's analysis seems to suggest that pre trade transparency is the key, if not the only relevant metric, to assess price formation quality, ESMA offers no evidence in support of this suggestion. ESMA goes on to conclude that the current use of pre-trade transparency waivers could indicate an issue in the price formation mechanism in Europe. AFME members would contest that view and believe there are a number of factors contributing to price formation including pre-trade transparency but also post-trade transparency (which has improved in scope significantly under MiFID II), market sentiment, news, earnings and other issuer statistics disclosed under issuers' continuous disclosure obligations, to mention but a few. AFME members believe that price formation in Europe is healthy and does not require remedial attention, particularly in the form of more significant change to Europe's already complex market structure. This is evidenced by spreads on lit markets remaining stable or in some cases tightening post-MiFID II (e.g. STOXX 600 and DAX 30) up until recent reactions to the ongoing Coronavirus pandemic, as demonstrated by the chart below.



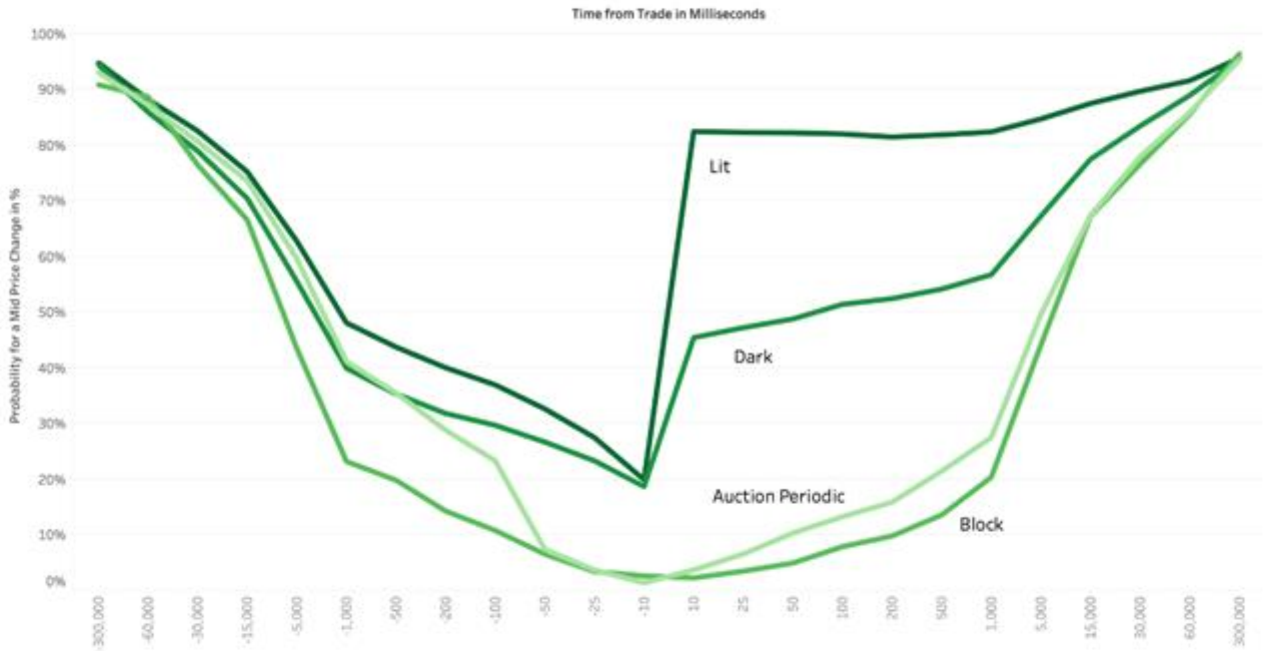
Source: Refinitiv 2020

Although we recognise the importance of lit order books in the price formation process, we would argue that incumbent stock exchanges maintain the appearance of providing a pivotal role in price formation because the existing market dynamics force over reliance on the data of such venues.

The status quo is maintained by a market failure: a venue with considerable market share in a security exerts high pricing power in the market data for that security. Participants must buy the data as a condition of access and to fulfil investor protection obligations (best execution). A venue in this position can then use high data revenues to cross subsidise *ad valorem* execution fees in that security (which are subject to competitive forces). This helps the venue to maintain its market share in the trading of the security and maintains its pricing power from a market data perspective.

The view that this is a healthy situation rests on a notion sometimes promoted by incumbent venues that price formation is inherently centralised. It is not; and whilst selective case studies have been used to show that markets stall when a primary market is unavailable, others show the opposite. AFME members would argue that what those case studies demonstrate is that the market often defers to the primary exchange until such time as it believes it is chronically unavailable at which point it will begin to form prices on the venues which remain available. The emphasis on an incumbent stock exchange as a central source of price formation is outdated and is a symptom of market failure rather than an argument for preservation of the status quo. Breaking this cycle would lead to more open, resilient and deeper capital markets in Europe.

Furthermore, MiFID II's best execution obligation requires firms to take sufficient steps to obtain the best possible result for a client when executing a client order. The factors an investment firm will consider in applying its best execution obligations will be driven by a client's objectives and strategy, which can differ significantly. The execution strategies, differing venues and liquidity providers used by investment firms today to facilitate best execution for clients reflects the wide range of needs and objectives of market participants in European markets. Importantly, firms will always consider market impact when seeking to achieve optimal execution outcomes for their clients. The chart below demonstrates how price impact varies across different types of execution venue ("Dark" includes trading venues operating under a reference price waiver (RPW)):



Reducing competition in European markets by restricting liquidity and requiring increased trading on lit markets significantly limits the optionality and flexibility investment firms require to facilitate the needs of clients. This will effectively result in a detrimental impact on execution quality, ultimately impacting end investors whose pensions and savings are dependent on investment managers' ability to execute transactions in a way that minimises overall impact and costs to the value of their portfolios.

Data Quality

One of the by-products of enhanced transparency facilitated by the MiFID II framework, is a proliferation of post-trade data, which may have also increased the proportion of off venue trading or trading under the systematic internaliser (SI) regime. There are a number of factors contributing to this:

- **There is a far broader range of financial instruments subject to post-trade transparency obligations under MiFID II than under MiFID I.** For example, MiFID I post-trade reporting obligations applied only to transactions in shares admitted to trading on regulated markets[2], whereas the MiFID II post-trade reporting obligations applies to all equity and equity-like instruments traded on an EEA trading venue (TOTV)[3]. Many of these instruments have a primary listing, and are issued by companies incorporated, outside of the European Union. This is the case for stocks such as Apple or Roche which are both amongst the 50 top traded stocks on SIs (according to Big XYT data, both stocks had a turnover of EUR 5 billion on SIs during February 2020).

- **There is also a much broader range of trading activity now subject to the post-trade reporting obligation including a significant proportion of OTC activity that was not previously reported.** For instance, transactions cleared via CBOE BATS ETR are for the most part non-price forming. They mainly represent an aggregate of activity that occurred and was already reported during the day on venue, which is then reported to ETR for the sole purpose of clearing and settlement. This set up is heavily used by SIs to ensure bilateral transactions entered into are cleared, which we believe is a welcome development in the context of G20 agreement and CSDR objectives. Consequently, with MiFID II and the development of SI activities, the proportion now reported through those mechanisms has grown significantly.

- The reporting obligations under MiFID II are unclear due to inconsistent interpretation of the rules and the lack of supporting data and infrastructure (e.g. the lack of a golden source for SI identification). This can lead to potential duplicate reporting or similar transactions being post-trade reported differently.

- Uncertainty over the reporting of certain technical trades (e.g. give-ups and give-ins, intra-group transactions for risk management purposes) means that a significant proportion of reported trades are not actually reflective of accessible liquidity and result in artificial inflation of the proportion of SI or OTC trades.

These data quality issues mean that the data supporting ESMA's analysis and assumptions may be flawed. For example, although ESMA poses the question of why the level of OTC trading in shares remains high post MiFID II, it has previously published Q&A advising market participants to report give up transactions as OTC due to their technical nature, which in turn inflates the number in question. Within the data presented in its consultation, ESMA does not differentiate between 'technical'

[2] See Article 27, Commission Regulation (EC) No 1287/2006

[3] See Articles 20 and 21, Commission Regulation (EU) No 600/2014

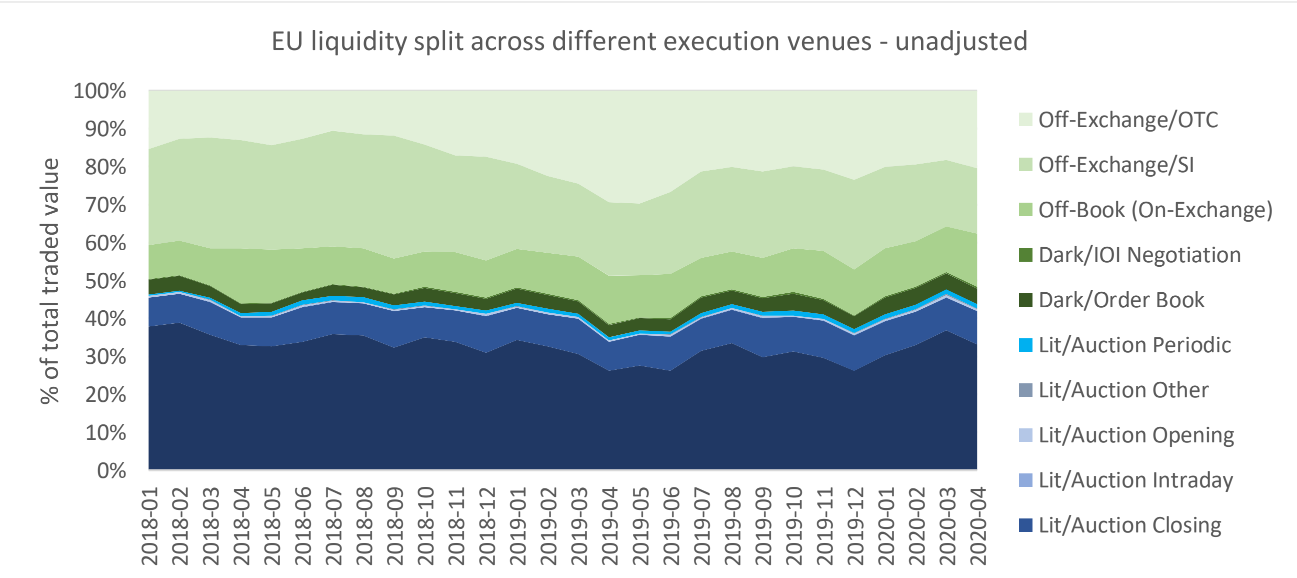
transactions and liquidity that market participants are able to access. Arguably, the current post-trade flagging options do not allow for such an analysis, however, some level of approximation may be achievable when looking beyond the 3 categories of trading venues, SI and OTC.

At present, a result of these factors is an inaccurate view of volumes being represented in current data. In the opinion of AFME members, it is not currently easy to form an accurate view of trading volumes, how those volumes are distributed across different execution venue types or how they have changed over time due to significant issues with data quality. Should ESMA and market stakeholders be able to sufficiently address data quality issues, AFME believes that a consolidated tape could go some way to improving knowledge on the size and distribution of executed volumes.

In addition, to understand if there are potential issues with the level of transparency and more generally price formation in Europe, the data needs to be analysed in more detail than in broad categories such as pre-trade transparent/under waiver or on-venue/SI/OTC transactions. As ESMA itself has concluded, the current level of data granularity available on the tape or otherwise (FITRS) presents major issues, whether in assessing the use of waivers or to qualify the contribution of SI liquidity or OTC trading to price formation.

Although data quality is an issue, some analyses run by independent stakeholders, such as data analytics firm Big XYT, give an approximation of what is likely to be the state of Equity instruments trading in Europe.

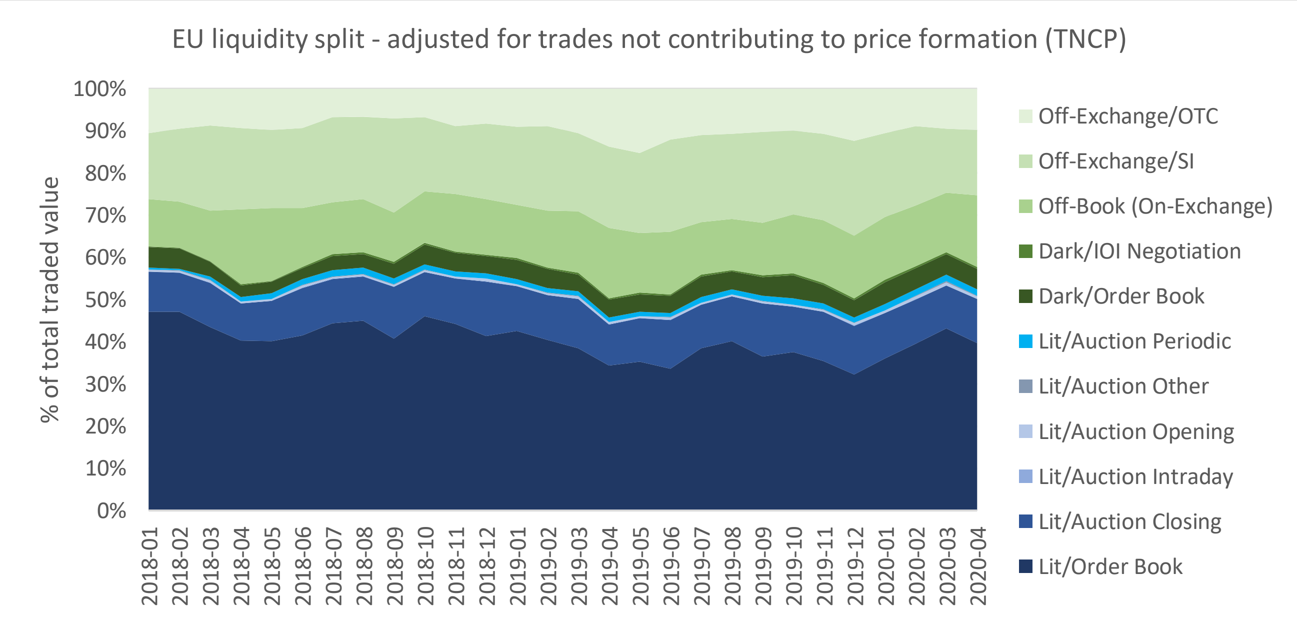
The chart below, provided by Big XYT, shows data reported up to early March 2020, without filtering, including all shares, ETFs, and other equity like instruments. It shows that the percentage of on-venue trading is roughly similar to the numbers provided in ESMA's Consultation Paper (looking at the second half of 2019): 45-50% is on a lit venue, 20-25% is SI and the rest is OTC or executed under a pre-trade transparency waiver.



Source: Big XYT, 2020

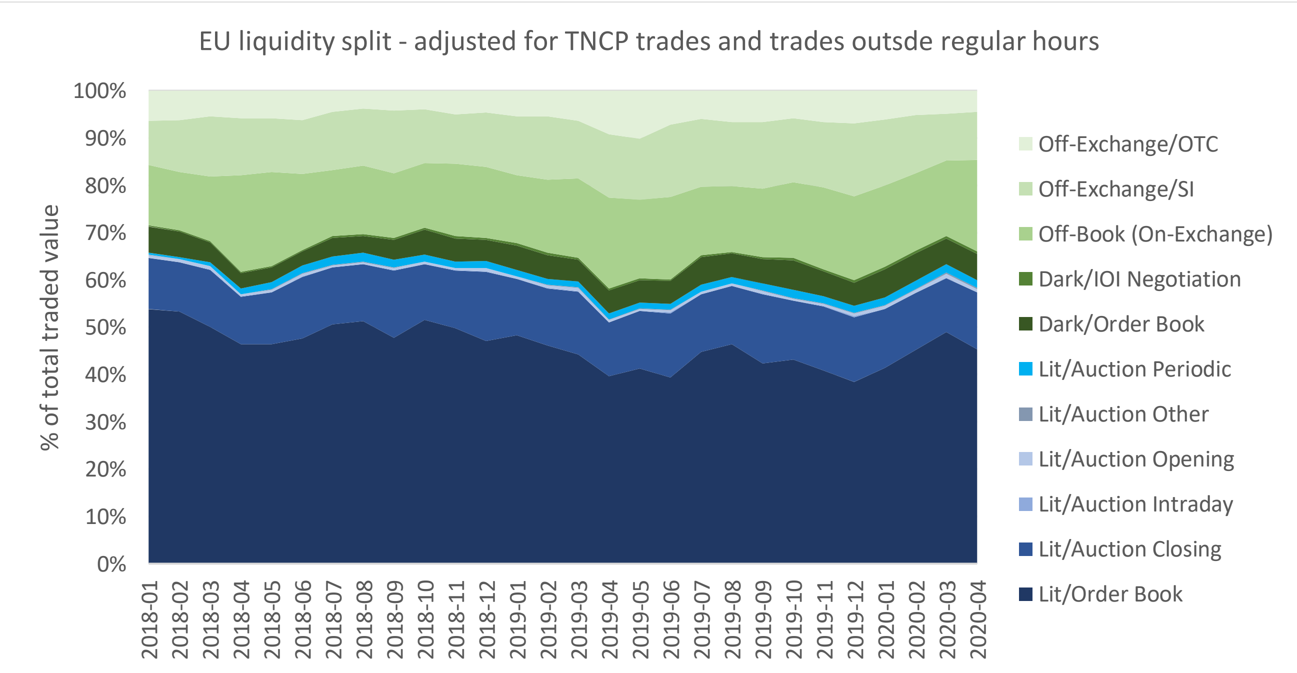
Big XYT then adjusts the value by categorising reports and removing certain reported OTC and SI transactions:

1. Those flagged as not contributing to price formation - on-venue trading then represents around 50-55% of the notional traded:



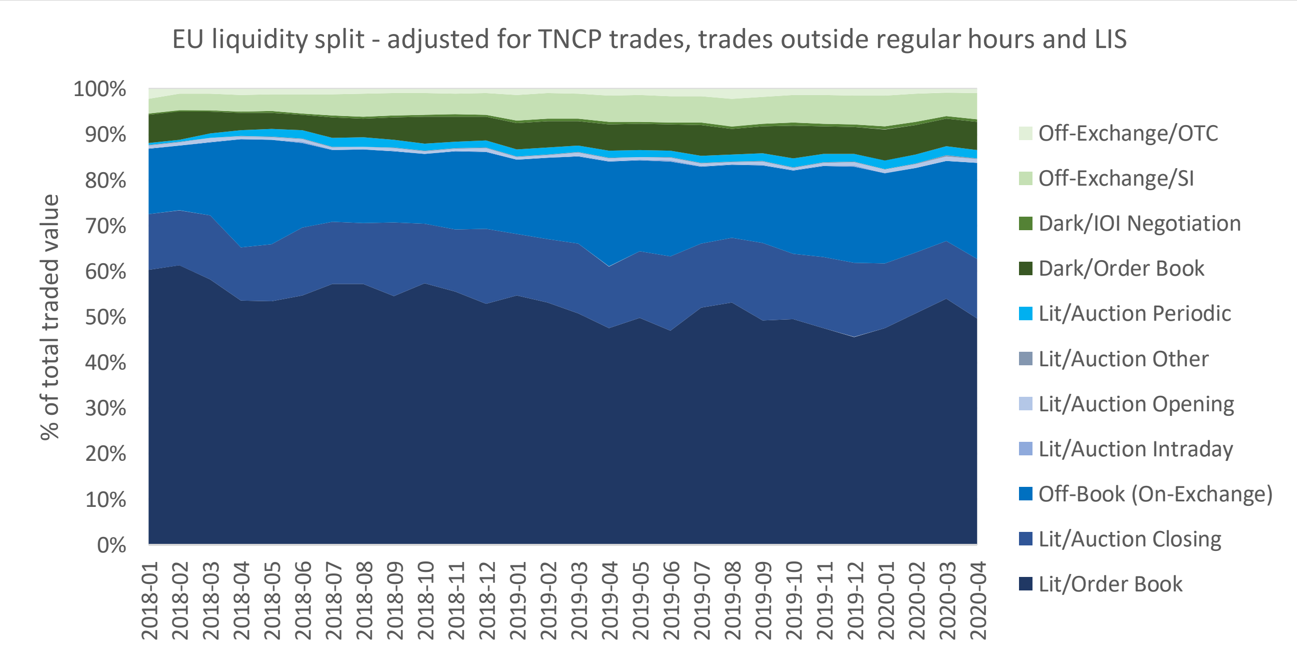
Source: Big XYT

2. Those happening outside of trading hours, which are likely to be technical transactions (give in/give ups, risk transfers between entities) - on-venue trading then represents around 65% of the notional traded:



Source: Big XYT

3. Big XYT removes SI and OTC trades above LIS (as they tend to be negotiated and unlikely to be fully addressable). We also assume that off-book trades reported on-trading venues are included in the "on-venue" category within Figure 6 of ESMA's Consultation Paper, therefore we have treated these types of trades in the same manner. The new picture is shown in the chart below, where on-venue trading is now almost at 90%. This contrasts with Figure 6 in ESMA's Consultation Paper which shows on-venue trading ranging between 50-60%:



Source: Big XYT, 2020

It is also worth noting that the recent volatility has favoured on-venue trading ahead of OTC /SI.

Although the above analysis may benefit from clarifications on post-trade flagging; it does give an insight into the difficult exercise of understanding the available data as it stands. Therefore, it is the view of AFME members that it might be premature to consider substantial changes to the EU transparency framework so soon after MiFID II implementation, especially when confronted with the difficulties in interpreting the data available.

AFME members are wholly supportive of making technical adjustments to the regime in order to improve the functioning of the MiFID II transparency regime. However, substantially reconfiguring the existing framework based on sub-standard data at a time when the industry is adjusting to poor volumes in 2019 and is now faced with an unknown legacy from the Coronavirus pandemic, is likely to result in poor quality policy outcomes at a significant cost to European investors which runs contrary to the EU better regulation principles. We are concerned that those costs would detract from the attractiveness of EU capital markets, weighing heavily on the returns of retail investors and detracting from the CMU objective of broadening participation and increasing the proportion of enterprise financing that is capital markets based.

We also note that this consultation coincides with the imminent departure of the United Kingdom from membership of the EU single market for financial services. Upon expiry of the Brexit transitional period the UK will cease contributing to the FITRS database. This may require firms based in both Europe and the UK to adjust to a different market access regime as determined by application of the

STO (both under EU regulation and UK regulation), in the event equivalence is not put in place. We anticipate this will have an impact on European volumes and venue/SI market share. The removal of UK data from FITRS will have a major impact on turnover figures used to calibrate the tick size regime and for liquidity calculations, amongst other things. Given this major change to European volumes and the data sets used to calculate them, AFME members believe this is another reason not to pursue significant policy changes based on current data.

Consistency with other European policy objectives

AFME members acknowledge that bringing greater transparency to European financial markets is a core policy objective of MiFID II. However, we stress that this objective should be balanced with other policy objectives of MiFID II and of the Single Financial Market more broadly.

In respect of MiFID II policy objectives, investor protection concerns are key to the MiFID II framework and are valued by AFME members. One of the key investor protection measures under MiFID II is best execution, which seeks to achieve optimal execution outcomes for investors. AFME members support this objective and see it as a valuable element of the European regulatory framework in achieving positive outcomes for investors. An important component of this is maintaining competition in financial markets so that execution options are not limited to primary exchanges alone, as was often the case pre-MiFID I. As MiFID investment firms, AFME members have an enforceable regulatory obligation to observe best execution when executing orders on behalf of clients.

Best execution requires firms to take into account a variety of execution venues and to assess those options against best execution factors. Orders should be executed in line with that assessment unless specific client instructions dictate otherwise. In many cases, that assessment and the post-trade analysis as to whether best execution was achieved (obligations in respect of which were enhanced under MiFID II regarding monitoring and evidencing) will involve an assessment of implicit execution cost which includes an analysis of market impact on a given trade.

To reduce implicit trading costs, brokers may seek to reduce market impact by executing a given order on venue under a pre-trade transparency waiver or as an SI or via a combination of venues and liquidity providers as these typically provide less market impact than a lit order book (please see chart above showing price impact variation across different types of execution venue). Restricting the alternative execution venues reduces ways in which brokers can manage market impact, which would result in higher costs of trading for end investors, higher volatility and, ultimately, reduced liquidity.

European investors, faced with increased costs and lower returns would be less inclined to invest in capital markets, and European firms, would in turn find it harder to finance themselves on capital markets. Therefore, AFME members consider that maintaining a variety of execution venues and trading modalities is supportive of the Capital Markets Union (CMU) and the attractiveness of Europe's capital markets, not only for European investors and issuers, but also vis-à-vis other major international marketplaces. We also note that tackling the "barriers to the flow of capital" is a priority in the Mission letter of the European Commission dated 10th September 2019. Ensuring free flow of capital both within, and into and out of, Europe is essential for effective and efficient European economies. Barriers to flow of capital will undermine this objective.

Diversity and non-substitutability in market structure

Diversity in trading choices supports positive outcomes for end-users and is a feature of a mature market structure. It is vital that ESMA acknowledges the important role played by SIs and market makers providing liquidity on risk. This risk intermediation is an absolutely essential part of a healthy investment ecosystem. SIs act as a 'shock absorber' for end-users by limiting price impacts of client positions. It is important to preserve such risk provision as part of the EU's market eco-system.

Bank SIs provide investors with a trading service similar to the one corporate banks provide to business: the bank uses its capital and balance sheet to facilitate cheaper, more efficient and better priced investment transactions to the buy-side, which in turn benefits end investors, such as pensioners and savers, who entrust their money to asset and portfolio managers. Likewise, market maker SIs play a role in providing liquidity and price improvement within this ecosystem. We believe it is important to preserve these models in the MIFID review.

There is no evidence to indicate that Bank SIs have had any negative impact on liquidity or price discovery. As sources of liquidity they add much needed diversity which only stands to benefit investors. Should SIs be removed from the STO or further restricted otherwise, the only beneficiaries would be primary exchanges which risks establishing oligopolies in European markets.

AFME members note that liquidity assessments, SMS thresholds and LIS thresholds should be carefully calibrated as to achieve a balance between transparency objectives and risk profile of the asset. In the case of ETFs, particular care needs to be taken with regards the nature of the ETF and its correlation with its underlying. An ETF on bonds should not be treated the same as an ETF on equities. As for illiquid symbols, it is important to be mindful in the calibration of the whole framework (waivers, liquidity assessment, SMS and LIS) not to impair the ability of a market participant to provide liquidity without undue risks.

We strongly support an in-depth review of the STO. Whilst AFME members believe the STO should be removed from MiFID II, if that is not considered feasible, AFME proposes a number of amendments to ensure its scope of application is limited to truly European shares. We also strongly oppose the suggestion to ban SIs as an execution venue for shares subject to the STO. Finally, we call for further work on post trade transparency, as it appears that although MiFID has brought progress on the matter it has also added complexity and confusion as to the nature and scale of OTC/SI transactions and level of pre trade transparency in Europe.

AFME members strongly believe a MIFID review can be instrumental in delivering the CMU objectives and help in making European markets attractive as a capital-raising destination as well as an internationally competitive investment location. However, we would caution against the introduction of sweeping and substantial changes to existing market structure as it could undermine these objectives. MiFID needs to be simplified but changes should only be introduced after careful evaluation of evidence, inter alia, a robust data gathering exercise, which may very well need to go beyond the data currently readily available to market stakeholders and regulators alike.

<ESMA_COMMENT_CP_MIFID_EQT_1>

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.

<ESMA_QUESTION_CP_MIFID_EQT_1>
AFME does not support the removal of the RP waiver and negotiated trade (NT) waiver[4] nor applying a minimum threshold for the use of these waivers.

Further constraining the available pre-trade transparency waivers would increase the trading costs of asset managers, eroding investor returns and potentially accelerating the ongoing trend of a move to passive investment strategies. This would be particularly damaging for those small retail investors who rely on collective investment schemes for their investments and for financing retirement.

In our view, the current pre-trade transparency waiver regime provides appropriate balance, allowing market solutions to meet a range of execution objectives, including more urgent trading which requires certainty of execution (via a lit market) and the execution of orders where managing market impact is a key objective (potentially at the expense of likelihood of execution). The current range of execution venues allow market participants to tailor their approach with venues benefitting from pre-trade transparency waivers providing an important function.

For example, the NT waiver is particularly useful for program trading, which is used by low cost index trackers and retail/pension funds. Removing the NT waiver would increase the cost of trading and therefore reduce returns for investors in those funds.

In addition, removing in all circumstances the possibility to execute trades under the reference price waiver would not be appropriate and would have negative impact for investors.

If ESMA were to recommend a size threshold for RP waiver orders, AFME members recommend that this be appropriately calibrated by liquidity on an instrument-by-instrument basis at a sufficiently granular level such that less liquid names (likely to be small-cap securities) are not unduly disadvantaged in a way that would make them more difficult and expensive to trade. Accordingly, we urge ESMA to ensure that any threshold is established by reference to empirical evidence based on a rigorous data driven approach.

The DVC mechanism has been and is still difficult to understand for the wider investor community, whether inside or outside of the EU due to the complexity it introduces to European market structure and interventionist nature of restricting certain modes of trading above arbitrary thresholds. Adding further conditions through imposition of minimum thresholds of size per order on the use of relevant waivers would only serve to make the framework even more complex.

[4] We understand ESMA proposal to remove the NT waiver as referring to the NT waiver for liquid instrument and not for removing the NT waiver for illiquid instruments, which is important for facilitating transaction in illiquid shares or the NT waiver used in the context of transactions not subjected to current market conditions, which is heavily used in the context of specific transaction such as buy backs or BATS ETR

We would also question the notion that usage of the waivers leads to price formation issues. As explained in our preamble and as stated by ESMA, the usage of waivers is not a data point easily accessible. It would be valuable to further analyse this point, possibly by requesting directly from Trading Venues, data on the waivers being flagged for order record keeping and transaction reporting purpose.

<ESMA_QUESTION_CP_MIFID_EQT_1>

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

<ESMA_QUESTION_CP_MIFID_EQT_2>

AFME does not support increasing the pre-trade LIS threshold for ETFs to EUR 5,000,000 and cannot see that a substantive rationale has been put forward for the proposed change.

Although a EUR 5,000,000 trade in a liquid Developed Market Equity ETF will generally have a readily available hedging instrument, this will not be the case for a number of ETFs, especially where the underlying is a non-equity instrument such as a bond. This means that liquidity impacts may occur due to firms being unable to adequately manage their risk exposure. Given this risk AFME does not agree with ESMA's proposal.

<ESMA_QUESTION_CP_MIFID_EQT_2>

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

<ESMA_QUESTION_CP_MIFID_EQT_3>

AFME members support the removal of the DVC. The mechanism does not result in positive outcomes for end-users and unnecessarily increases the complexity of European market structure.

In the event that the DVC mechanism is retained, AFME would not support extending its scope to systems that formalise negotiated trades for illiquid instruments. The NT waiver is widely used for trading illiquid instruments, where liquidity is often thin in lit order books. As a result, investors tend to favour trading in primary exchange auctions (and more recently on Periodic auction books) or bilaterally with an SI willing to provide a risk price on the asset. Not all clients will be comfortable or permitted to trade under the latter arrangement. The negotiated trade waiver enables trades executed in this manner to be subject to the rules of and be processed by a trading venue.

Subjecting NTs for illiquid instruments to the DVC mechanism would remove the option of bilateral negotiation of trades being brought on venue.

Such a change would have a negative effect on already thin pools of liquidity, leading to sub-optimal outcomes for end investors. Given the difficulty in trading illiquid instruments, AFME members support retaining maximum flexibility regarding trading mechanisms.

<ESMA_QUESTION_CP_MIFID_EQT_3>

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.

<ESMA_QUESTION_CP_MIFID_EQT_4>

AFME members do not agree with ESMA's proposal to remove the ability for trading venues to apply for a combination of pre-trade transparency waivers. We note that no data is available regarding volumes executed using a combination of waivers and therefore would not recommend ESMA takes any policy decisions in absence of a full analysis of usage. We see no evidence to support the notion that ESMA's proposal would lead to greater pre-trade transparency.

We note that ESMA makes an observation in paragraph 54 that a combination of RP and LIS waivers allows for RP (i.e. sub-LIS) orders to be executed under the LIS waiver. It is our understanding that in this specific example, the RP order and the proportion of the LIS executed against that RP order would in fact be executed under the RP waiver rather than the LIS waiver as is implied by ESMA. We understand that it is typically the case that trading venues operating combination waiver order books operate in the way we have described rather than the way that is implied by ESMA.

Combination waivers are foremost designed to offer operational efficiencies for venue participants in order to simplify management of their orders and execution strategies.

We believe that efforts designed to reduce the availability of trading under pre-trade transparency waivers on alternative venues would increase the implicit and explicit costs of trading for investors. AFME does not support any proposals that bring increased complexity to EU markets and would note that the existence of pre-trade transparency waivers (in their current state) maintains relative consistency with non-EU markets regarding the availability of different trading mechanisms.

If ESMA's aim is to identify the volume of transactions taking place under the various waivers, AFME recommends that this should be achieved by introducing appropriate flags within the post-trade transparency regime. However, any decision to do so should undergo a full cost/benefit analysis.

<ESMA_QUESTION_CP_MIFID_EQT_4>

Q5. Do you agree with the proposal to report the volumes under the different waivers separately to FITRS? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_5>
If ESMA's aim is to identify the volume of transactions taking place under different types of waiver, AFME recommends that this should be achieved by introducing appropriate flags within the post-trade transparency regime. However, any decision to do so should undergo a full cost/benefit analysis.

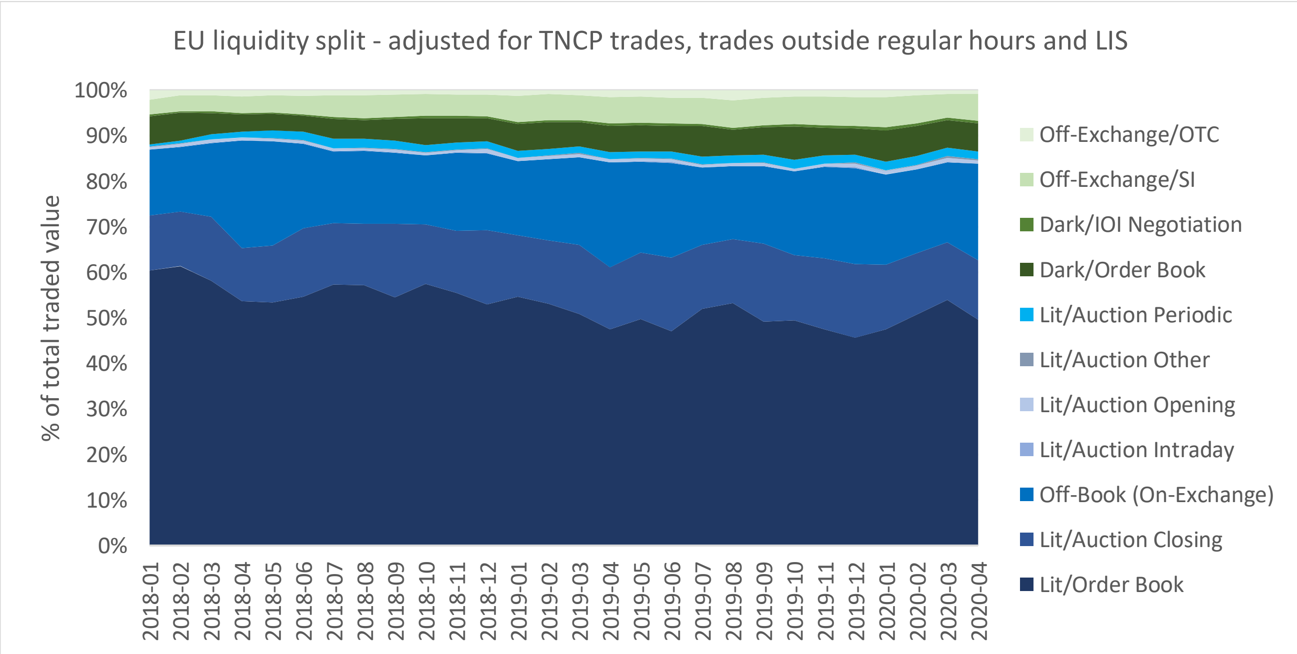
<ESMA_QUESTION_CP_MIFID_EQT_5>

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.

<ESMA_QUESTION_CP_MIFID_EQT_6>

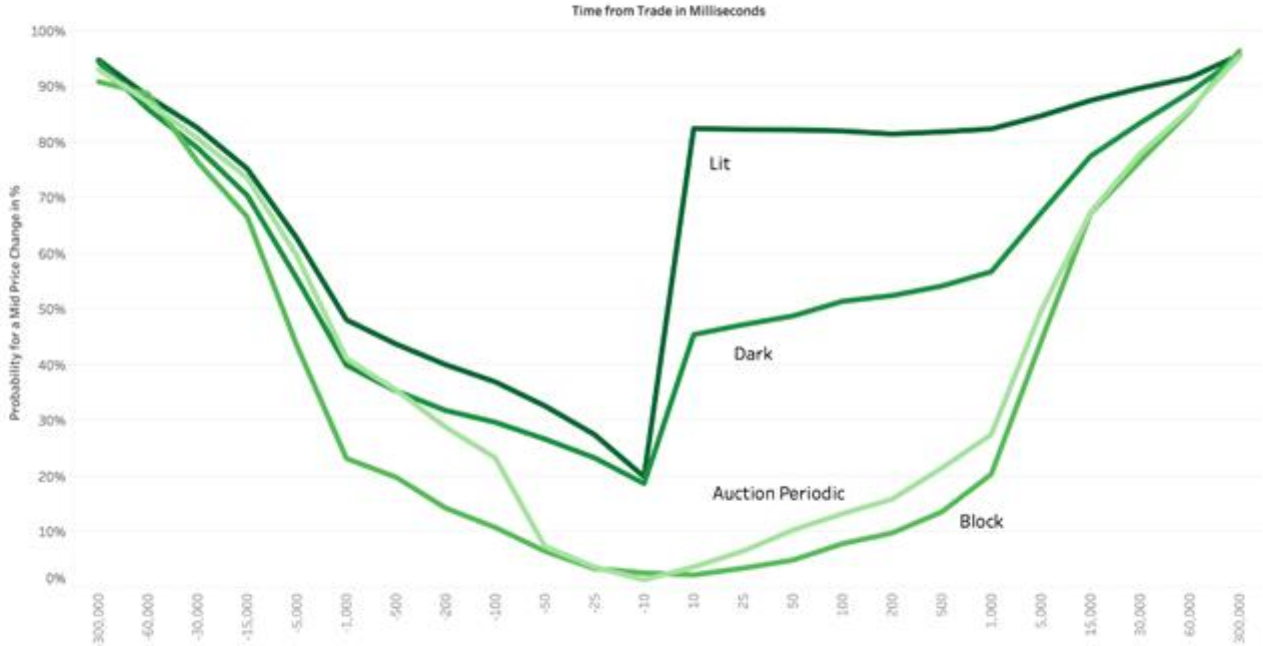
AFME members are supportive of data driven research for the purposes of enhancing market quality and believe that market innovation driven by commercial incentives isthe best way to encourage market evolution. We welcome ESMA's interest in exploring ways to improve lit market conditions.

Post 2017, primary exchanges have increased their market share in addressable liquidity (see chart below), however in AFME members' view the focus for policymakers should be on achieving good outcomes for market participants rather than on a single intermediate objective of increasing trading on lit markets. AFME is supportive of further data driven research on means of improving the quality of markets, including lit markets. Matters warranting investigation include reconsideration of market microstructure measures under MiFID II/MiFIR such as relaxing restrictions on commercial incentives for liquidity providers and market maker obligations under RTS 8. Such relaxation may allow operators of lit markets to pursue commercial means of encouraging liquidity providers to be more present.



Source: Big XYT, 2020

In AFME members' opinion, the current disadvantage presented in lit markets is a lack of available liquidity. In market conditions of low volumes and low volatility (as was the case in 2019), market participants are more likely to use execution venues that offer stable prices and reduce information leakage on orders (which information may be used by venue participants operating low latency strategies to move prices against investors). The chart below shows how price impact varies across different types of execution venue ("Dark" includes trading venues operating under a reference price waiver (RPW)):



AFME members see this as one reason for the increase in auction trading in recent times (as demonstrated by the chart above show the proportion of trading activity taking place across different execution venues). Reducing market hours, in lines with proposals put forward by AFME and the Investment Association[5] (representing buy-side firms) may be one means of concentrating liquidity on lit markets and providing more evenly distributed volumes throughout the day.

AFME notes that price formation is not inherent to the type of mechanism trading venues operate but a consequence of the interaction of investors in the market. AFME members strongly believe that enforcing a framework that allows for different execution models and a strong and calibrated transparency regime is the best way to incentivise robust and fair price formation. We do not believe that forcing lit trading is the universal answer to guaranteeing robust and reliable price formation and such a requirement would also risk detrimental impacts to end investors by limiting the optionality for firms to facilitate client trading objectives and strategies.

AFME members would contest the view that pre trade transparency is the only or even the most prominent factor to a robust price formation. We believe there are a number of factors contributing to price formation including pre-trade transparency but also post-trade transparency (which has improved significantly in scope under MiFID II), market sentiment, news, earnings and other issuer statistics disclosed under issuers' continuous disclosure obligations, to mention but a few.

Lit trading plays a key role in price formation but is not always the most appropriate way of trading. Forming a price is a function of a number of factors, where available pre-trade information is equally important to printed prices. We believe it is more important to make sure that post trade data clearly represents the differences between types of transactions (addressable, price forming vs. technical in nature). It is paramount not only to actual price formation but also essential in running functions such as algorithm calibration, risk management and trade surveillance.

Market participants understand the importance of refining post-trade data and initiatives such as the one led by the FIX Protocol Consolidated Tape Working Group, is evidence of the fact that some industry consensus has already started to emerge.

[5] See AFME/IA response to the LSE Consultation Paper on market structure and trading hours – link here

AFME members stress the importance of ensuring that European markets continue to attract a wide range of market participants to support robust and reliable price formation across various trading mechanisms. Restrictions on mechanisms within which trades can be executed risks increasing the frictional costs of trading.

<ESMA_QUESTION_CP_MIFID_EQT_6>

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.

<ESMA_QUESTION_CP_MIFID_EQT_7>

AFME members believe that both, the free float and the frequency with which a share is traded are important indicators of an instrument's liquidity and should be considered in any liquidity assessment.

Option 1 excludes both dimensions, which could result in a number of false positives where otherwise illiquid shares become subject to disclosure requirements, further impacting already thin liquidity. For this reason, we do not believe that Option 1 is a suitable alternative to the existing definition.

Option 2 proposes to use market cap as an indicator of liquidity instead of free float. Our view is that market cap is not an indicator of liquidity, as it includes shares held by insiders which are never traded on the market. Free float, however, is a more accurate metric to provide an indication of liquidity. We therefore do not support this option.

AFME members consider that non-price forming activity should not be included in transparency calculations. More granular post-trade flagging standards would help to filter out these trades, as appropriate.

<ESMA_QUESTION_CP_MIFID_EQT_7>

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

<ESMA_QUESTION_CP_MIFID_EQT_8>

AFME does not agree with ESMA's proposals. Whilst ADV may be relevant for shares, ESMA's approach for equity-like instruments should also reflect the liquidity of the underlying instruments: thinly traded ETFs can be considered to be liquid by virtue of the fact that the investment exposures they represent are themselves liquid. An optimal mechanism for assessing liquidity of ETFs and DRs would therefore be one that allows a look through to the underlying assets and the availability of hedging instruments.

<ESMA_QUESTION_CP_MIFID_EQT_8>

Q9. Do you agree in removing the category of certificates from the equity-like transparency scope? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_9>

AFME agrees with ESMA that certificates are not a significant part of equity like instrument and we would support a removal from the transparency regime.

<ESMA_QUESTION_CP_MIFID_EQT_9>

Q10. Do you agree in deeming other equity financial instruments to be illiquid by default? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_10>
AFME members agree with ESMA's proposals. We note that this approach is consistent with the approach taken for non-equities instruments within RTS 2, MiFID II.

<ESMA_QUESTION_CP_MIFID_EQT_10>

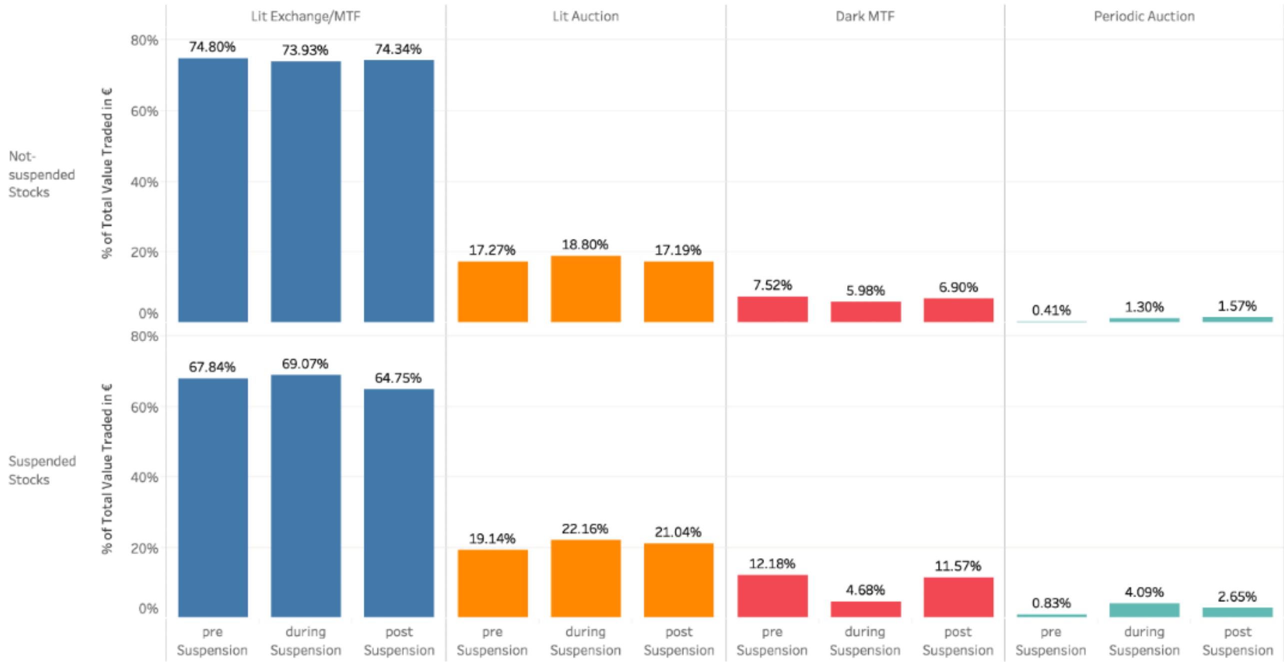
Q11. Do you agree in separating the definition of conventional periodic auctions and frequent batch auctions? Do you agree with ESMA's proposal to require the disclosure of all orders submitted to FBAs? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_11>

AFME does not support ESMA's proposal to separate the definition of conventional periodic auctions and frequent batch auctions (FBAs). We disagree with the proposition that the characteristics of FBAs undermine the price formation process and that all orders submitted to FBAs should be disclosed. FBAs are now an established and valued trading mechanism in uncapped stocks in their own right, as well as capped stocks, and with little or no correlation to other trading mechanisms.

Furthermore, we do not agree that FBAs are used to circumvent the DVC. The FBA market share for both suspended and unsuspended stocks post uncapping (see chart below) suggest that market participants view FBAs as legitimate market mechanisms offering differentiated liquidity.

Liquidity Trends for Capped/Non-Capped Stocks:



Source: Big XYT

The chart above based upon data from 2018 shows that FBAs had already established themselves as an independent source of liquidity utilised by end investors as part of their wider trading strategies. We also note that FBA volumes remain proportionately low when compared to other established execution venues. This perspective is consistent with the views presented by the FCA who's research into periodic auctions in June 2018 concluded that FBA activity "has grown from being tiny to being very small". The FCA also noted that "growth has been consistent across shares that are capped as well as those that are not".

Current FBA designs are pre-trade transparent, lit order books that have been approved as being compliant with the pre-trade transparency regime. Through publishing indicative price and indicative execution quantity prior to executing orders, periodic auctions ensure that they meet the requirements of Article 3, RTS 1.

Table 1 of Annex 1, RTS 1, provides that periodic auctions are deemed pre-trade transparent provided that the following information is made public:

"The price at which the auction trading system would best satisfy its trading algorithm in respect of shares, depositary receipts, ETFs, certificates and other similar financial instruments traded on the trading system and the volume that would potentially be executable at that price by participants in that system.

In our view, any adjustments to the level of pre-trade transparency should be left at the discretion of FBA operators with the goal of ensuring optimal execution outcomes and maximising liquidity. We note that in ESMA's Final Report following its Call for Evidence on Periodic Auctions, ESMA notes that,

"Overall, most respondents did not identify pre-trade transparency issues with both types of system".

We believe that this reflects the views of market participants and therefore AFME recommends that ESMA does not separate the definition of conventional periodic auctions and FBAs or stipulate that all orders submitted to FBAs should be disclosed. Execution needs are differentiated among different types of market participant which requires the existence of a variety of complementary liquidity pools and execution venue types. AFME members value the role of the lit order book and there is no desire to see non-exchange flow to represent the majority of execution within equities markets. However, we urge ESMA to recognise the benefits to end investors brought about through the existence of a variety of execution choices, including FBAs which as currently operated, provide a valuable and additive source of liquidity.

<ESMA_QUESTION_CP_MIFID_EQT_11>

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

<ESMA_QUESTION_CP_MIFID_EQT_12>

AFME does not agree with ESMA's proposal. Pre-trade transparency waivers and trading at mid-point is not the same as "non-price forming".

The ability to trade at mid-point does not mean a transaction has not contributed to price formation. Instead, the critical factor is how the uncross price is achieved. For example, an interest in trading at "mid-or–better" via a periodic auction is information that contributes to price formation. Furthermore, a participant trading at the mid-point can help stabilize the spread given that willingness to trade at mid-point demonstrates trust in the price formation process.

We provide below a worked example of price formation. The purpose of this worked example is to show how a typical FBA would establish an auction price and to highlight that peg orders are not guaranteed at a reference price.

<u>Auction Book Price Formation</u>

	Bid		Limit Price	Offer	
	Buy Ref	Volume		Sell Ref	Volume
			101.0	O2 (Limit)	15
Primary Best Offer					
			100.9		
			100.8		
			100.7		
			100.6		
			100.5		
	O1 (Peg Mid with Limit)	20	100.4		
			100.3		
			100.2	O3 (Limit)	50
			100.1		
Primary Best Bid					
			100.0		

In the above example, the order book is displayed vertically to illustrate crossed orders (hence prior to the uncross). The green lines represent the PBBO (100.0 – 101.0).

Both orders O1 and O3 are marketable. i.e. the buyer is willing to pay more than the seller is willing to sell at. O2 is not marketable against the buyer O1 and therefore excluded from the price formation process. The marketable orders are:

- O1 is a Buy Peg Mid Order with a Limit at 100.4 (Quantity 20)
- O3 is a Sell Limit order at 100.2 (Quantity 50)

The mid-price of the PBBO is 100.5 (highlighted green) and the example uses the tick band MiFID 4. For O1, the limit price of 100.4 is used as the price on the order since it is the lower value between the mid-price and the limit price.

As with all auctions, an FBA seeks to establish an equilibrium price. To establish an equilibrium price an FBA will;

- maximise executable quantity
- apply a tie breaker rule if necessary.

In this example, to maximise quantity, the price points of 100.2, 100.3 and 100.4 are available (highlighted grey above). Since there are multiple price points available to maximise quantity, the tie-breaker rule is applied by taking price at the centre of this range. In this case 100.3 is selected as the equilibrium price.

This example therefore makes it clear that an FBA will (i) establish a price based on orders present in the orderbook and (ii) shows that pegged orders are not guaranteed to execute at a reference price.

<ESMA_QUESTION_CP_MIFID_EQT_12>

Q13. What is your view on increasing the minimum quoting size for SIs? Which option do you prefer?

<ESMA_QUESTION_CP_MIFID_EQT_13>

On the basis that the SMS remains at current levels and subject to further in-depth analysis before being proposed, AFME members could be supportive of increasing the minimum quoting size to 100% of SMS for shares as this broadly represents the average trade size of business executed on trading venues, meaning SIs can control their risk and continue to use the top of book as the benchmark to quote and reflect prevailing market conditions. However, we would like to emphasise that such a decision should only be taken on the basis of in-depth, data driven analysis which fully considers impacts to European market structure.

AFME members stress that such a proposal can only be acceptable if the SMS continues to be a fair representation of the average traded value for the stocks.

We strongly oppose changing the definition of SMS and, in particular, to index it on the average daily turnover instead of the average traded size. Average daily volumes are vastly influenced by market conditions, both cyclical and seasonal and cannot form the basis on which firms trading on risk would be requested to quote at firm prices.

We will similarly raise concerns if firm quoting obligation were extended to illiquid instruments, as the change in risk profile of quoting at SMS would be even more prevalent.

<ESMA_QUESTION_CP_MIFID_EQT_13>

Q14. What is your view on extending the transparency obligations under the SI regime to illiquid instruments?

<ESMA_QUESTION_CP_MIFID_EQT_14>

AFME members do not believe that the SI transparency obligations should be extended to illiquid names. There are several complexities linked to trading illiquid names from determining the appropriate price for a stock that potentially rarely trades (thus not having a reliable continuous reference price) to ensuring that a firm can source sufficient stock to meet demand, particularly in light of developments around initiatives such as CSDR. Extending the quoting requirement to illiquid stocks may disincentivise facilitation activity in those names if the risk profiles are not sustainable, which would impact available liquidity on those stocks without necessarily bringing more flow on venue.

<ESMA_QUESTION_CP_MIFID_EQT_14>

Q15. With regard to the SMS determination, which option do you prefer? Would you have a different proposal? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_15>

AFME members do not believe calibrating SMS on the average daily turnover of stock instead of its average traded size is appropriate. Average daily volumes are vastly influenced by market conditions, both cyclical and seasonal and cannot form the basis on which firms trading on risk should be requested to quote at firm prices.

In the event that SIs have to offer considerable size, it is possible that even a portion of the size is not available at the current best bid and offer. If this were to be the case, SIs would need to price through several price levels which, given the restrictions imposed around pricing off tick, may not be permitted. In this instance, there would not be a level playing field between the models that operate on a lit order book that provide for pricing at multiple levels versus an SI that would have to tick round to produce a single price at SMS.

AFME believes it is important that ESMA recognises the fundamental difference between the SI framework and that of trading venues. An exchange does not facilitate trades using its balance sheet and instead brings together buyers and sellers by providing a matching mechanism. SIs, however, are offering access to their balance sheets which requires a different framework to ensure that this liquidity can continue to be offered to the European investor community within a structure that appropriately allows a firm to manage their risk. Furthermore, trading venues operating central limit order books do not tend to match in sizes above SMS. Whereas SIs have the ability to transact business in sizes above SMS whilst managing price impact, albeit in business that may be below LIS but still relatively large in size and in sizes not available on lit venues.

<ESMA_QUESTION_CP_MIFID_EQT_15>

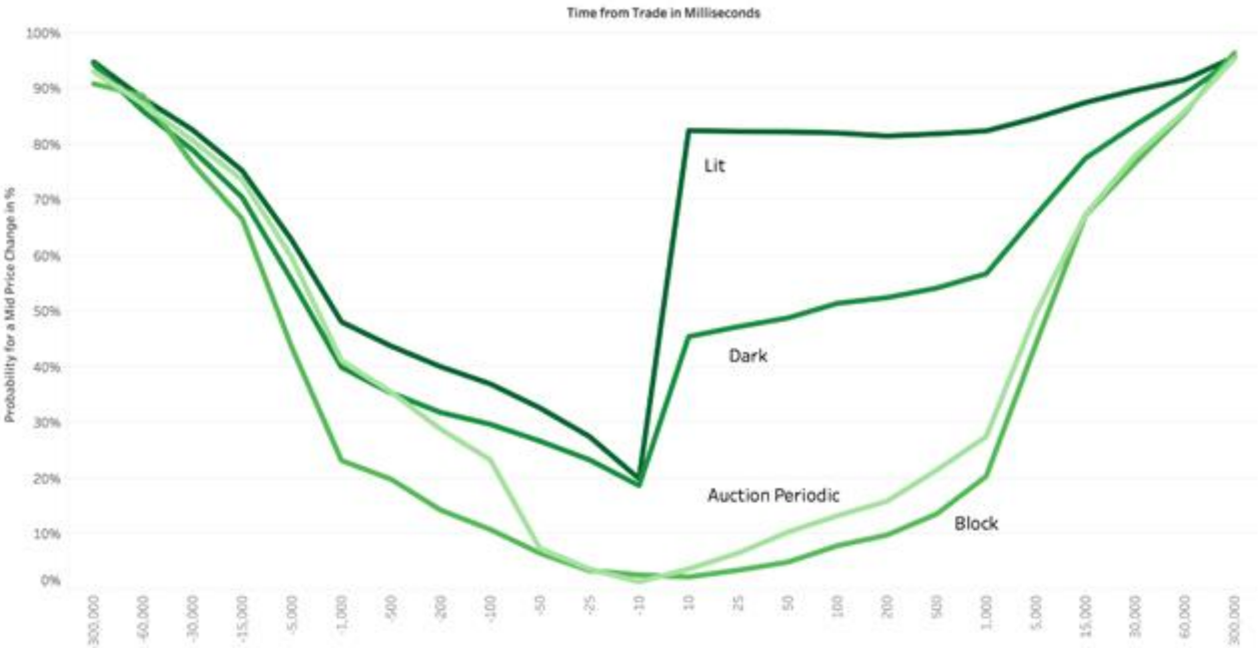
Q16. Which option do you prefer among Options A, B and C? Would you suggest a different alternative? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_16>

AFME members' support the removal of the double volume cap. It does not result in positive outcomes for end-users while increasing complexity in market structure.

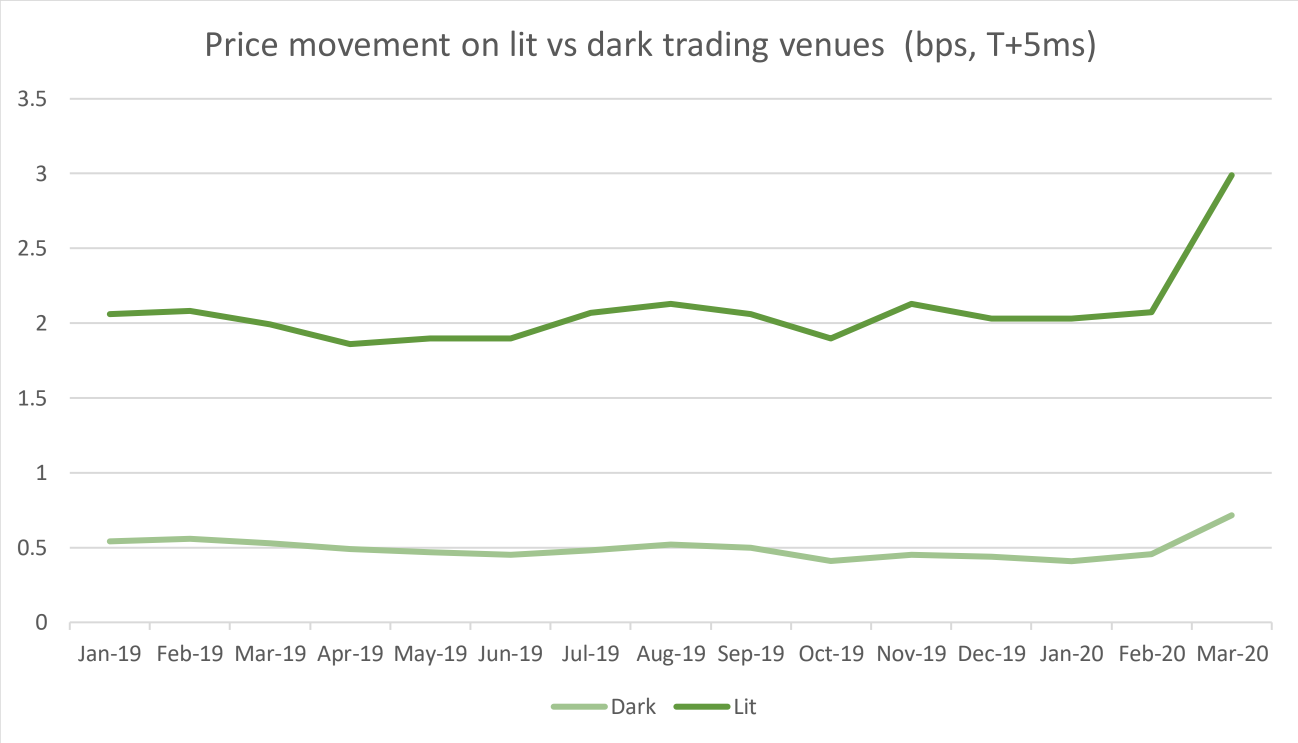
Should the DVC continue, AFME members consider that Option B represents the least damaging proposal.

Diversity of execution mechanisms is critical to facilitating diverse trading and investment objectives. In particular, active investment strategies often require execution of larger trade sizes and these should be achievable without paying a penalty owing simply to the fact that there is a large trade to execute. The chart below shows the choice facing an investor when attempting to execute a large trade whilst seeking to limit the risk of a price movement against them. The range in the probability of price movement during the lifecycle of a trade demonstrates the importance of a diverse choice in execution venues being made available to investors.



Source: Big XYT, December 2018

The chart below shows the difference in price movement in basis points when comparing execution across lit and dark trading venues. For 2019, average price movement after 5 milliseconds on non pre-trade transparent execution venues was 0.48 basis points whilst for lit trading venues this figure was 2.01 basis points.



Source: Big XYT, 2020

Asset managers when trading in size on behalf of their funds' investors, cannot complete their orders on central limit order books (as trades there are too small for institutional sized orders) and must be able to complete their trading without their trading intention being detected by market participants employing latency sensitive strategies triggering large price movements against them. Any constraint on firms' ability to access different types of execution venues would increase the trading costs of asset managers, eroding investor returns and potentially accelerating the ongoing trend of a move to passive investment strategies. This would be particularly damaging for those small retail investors who rely on collective investment schemes for their investments and for financing retirement.

The application of the double volume caps came without any assessment on what the appropriate levels of dark trading should be. AFME is unaware of any evidence that the caps have been effective in avoiding any damage to price formation.

AFME members value the price formation and price discovery provided by lit venues and do not wish to see that undermined. However, there is no evidence to demonstrate that these qualities are impacted by levels of dark trading corresponding to the limits currently set under the DVC. In this regard, we refer to the FCA Occasional Paper, "Aggregate Market Quality Implications of Dark Trading" which asserts that *"since the trades executed in the dark are based on reference prices determined on the lit exchanges, the overall market's price discovery process is more efficient for each stock traded simultaneously in the dark and lit venues"*. FCA concludes that trading quality is "*furthered by the existence of dark pools operating alongside lit exchanges. It is important that policy makers take care not to eliminate the market quality benefits of dark trading by arbitrarily imposing uniform dark trading restrictions for all stock sizes*".

ESMA refers to an AMAFI study[6] in its Consultation Paper and states in paragraph 177 that *"the paper confirms that the DVC tightened the bid-ask spread"*. Although we agree there are some differences in how the spread evolves for symbols subjected to the cap and those that never were, AMAFI's study also points out that the differences are marginal and may not be statistically valid. As per their executive summary: *"Our study tends to indicate that the DVC statistically has a positive but very limited impact on the lit market micro-structure for the targeted shares, through the decrease of the bid-offer spreads and the increase of size of the available interest at the best limit. This effect however is of a secondary order relative to the impact of the general level of volatility in the market during the observation period."*

EU markets are alone in having a volume-based constraint on dark trading making them a global outlier in attempting constrain trading activity that has the objective of achieving better execution performance for end investors by reducing market impact and, therefore, implicit trading costs. There is no evidence of similar concerns around levels of dark trading in other developed markets. This constraint serves to make European capital markets less competitive compared with other nations, including the US, Canada, Japan and Switzerland, and is also inconsistent with objectives under the Capital Markets Union.

Based upon the concerns outlined above, AFME members' preference is for the removal of the double volume cap or recalibration to a level corresponding to empirical evidence of damage to price formation. However, given the options presented by ESMA, AFME members consider that Option B represents the least damaging proposal.

<ESMA_QUESTION_CP_MIFID_EQT_16>

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

<ESMA_QUESTION_CP_MIFID_EQT_17>

AFME members support the removal of the DVC. It does not result in positive outcomes for end-users of the market yet results in complex market structure. Diversity in modes of execution is important to facilitating diverse trading and investment objectives. In particular, active investment strategies often require being able to achieve execution of larger trade sizes, without paying a penalty owing simply to the fact that they have a large trade to conduct. Such large trades cannot be achieved on a central limit order book (because trade sizes are far smaller on such venues) and there are market participants trading latency-sensitive strategies that may move the market against them. AFME members believe that the application of any arbitrary system to limit dark trading is unlikely to result in benefits to transparency, price formation or overall market quality in EU markets.

Should ESMA recommend the continued use of a mechanism to restrict trading under a pre-trade transparency waiver on the basis of concerns around price formation, AFME would strongly encourage ESMA to define the measures in which it will determine when price formation has been damaged.

We refer to the FCA Occasional Paper, "Aggregate Market Quality Implications of Dark Trading" which asserts that *"since the trades executed in the dark are based on reference prices determined on the lit exchanges, the overall market's price discovery process is more efficient for each stock traded simultaneously in the dark and lit venues*". We also note the Paper's conclusion that trading quality is "*furthered by the existence of dark pools operating alongside lit exchanges. It is important that policy makers*

[6] See AMAFI – Impact of the MiFIR volume cap mechanism on the microstructure of European equity markets – AMAFI / 19- 103

take care not to eliminate the market quality benefits of dark trading by arbitrarily imposing uniform dark trading restrictions for all stock sizes".

EU markets are alone in seeking a volume-based constraint on dark trading making them a global outlier. As highlighted in our response, investors utilising dark pools do so with the objective of reducing market impact and therefore implicit cost. This in turn contributes to achieving better execution performance for end investors. Therefore, we do not agree with proposals to constrain this type of activity in the absence of a robust analysis that truly evidences erosion in the price formation process. We would like to reiterate that there is no evidence of similar concerns in other developed markets. This constraint positions European capital markets as less competitive, when compared to other nations including the US, Canada, Japan and Switzerland, and is thus inconsistent with objectives under the Capital Markets Union.

<ESMA_QUESTION_CP_MIFID_EQT_17>

Q18. Do you agree in removing the need for NCAs to issue the suspension notice and require trading venues to suspend dark trading, if required, on the basis of ESMA's publication? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_18>

AFME does not agree with ESMA's proposal. Trading venues rely on the notices provided by the NCAs as an additional control to ensure that instruments are suspended/unsuspended in accordance with the ESMA publication.

<ESMA_QUESTION_CP_MIFID_EQT_18>

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

<ESMA_QUESTION_CP_MIFID_EQT_19>

AFME supports ESMA's approach on the basis that it provides a simplification of the existing process and that the requirements set out under Article 5(7)(b) are only technically possible at ESMA level.

<ESMA_QUESTION_CP_MIFID_EQT_19>

Q20. Please provide your answer to the following survey (<= click here to open the survey) on the impact of DVC on the cost of trading for eligible counterparties and professional clients.

<ESMA_QUESTION_CP_MIFID_EQT_20>
[CLICK ON THE WORD "SURVEY" IN THE QUESTION IN ORDER TO PROVIDE YOUR ANSWER]
<ESMA_QUESTION_CP_MIFID_EQT_20>

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

<ESMA_QUESTION_CP_MIFID_EQT_21>
In order to provide a full view of response to ESMA's proposal, AFME recommends that ESMA make clear which period of time would be considered as a replacement to the existing 12-month timeframe.

<ESMA_QUESTION_CP_MIFID_EQT_21>

Q22. Do you agree foresee any issue if the publication occurs after 7 working days instead of 5? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_22>
AFME members have not identified any issues that would arise if the publication of DVC results occurs after 7 working days instead of 5 provided that trading venues and investment firms have the same amount of time, as they do today, to act on the publication.

<ESMA_QUESTION_CP_MIFID_EQT_22>

Q23. Do you agree that the mid-month reports should not be published? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_23>
AFME believes that the mid-moth reports are of limited value. We agree with ESMA's conclusions and the proposal that these reports should not be published.

<ESMA_QUESTION_CP_MIFID_EQT_23>

Q24. Do you agree with ESMA's proposal to include in Article 70 of MiFID II the infringements of the DVC suspensions? Please explain.

<ESMA_QUESTION_CP_MIFID_EQT_24>
AFME agrees that if the DVC continues to exist, it is important that it is applied across all jurisdictions and trading venues. However, it should be noted that the infringements that ESMA refer to were due to technical issues and not with the intention of not complying, This should be taken into account in any supervisory actions and may not require specific provisions to be included in the Level 1 text.

<ESMA_QUESTION_CP_MIFID_EQT_24>

Q25. Do you agree with ESMA's assessment that the conditions for deferred publication for shares and depositary receipts should not be subject to amendments? If not, please explain.

<ESMA_QUESTION_CP_MIFID_EQT_25>
The deferral regime appears appropriate, however, AFME members would like to take the opportunity to suggest that ESMA review the deferrals regime for illiquid instruments. An extension of the deferral period from end of day to the end of the next trading day would allow market participants additional time to unwind positions, thus reducing the cost of trading.

<ESMA_QUESTION_CP_MIFID_EQT_25>

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.

<ESMA_QUESTION_CP_MIFID_EQT_26>

AFME does not agree with increasing the qualifying size to €20M from €10M. As it stands, for ETFs with less liquid underlyings, 60 minutes is insufficient time to fully hedge the resultant risk. Should the qualifying size be increased, it is likely that market makers may step back from pricing larger blocks, or otherwise widen spreads to account for increased risk from the market trading ahead, thereby reducing liquidity. Such an increase to introduce transparency, at the expense of liquidity is not desirable because it would most likely increase costs to end investors and increase the risk of front running on illiquid underlyings. Especially when the underlying is under a different transparency regime than ETFs, for example as it is for bonds.

<ESMA_QUESTION_CP_MIFID_EQT_26>

Q27. Do you agree with ESMA assessment of the level of post trade transparency for OTC transactions?

<ESMA_QUESTION_CP_MIFID_EQT_27>

We consider it reasonable for deferral thresholds for OTC trading (including SI) to be in line with those for venues. We would further note that in terms of the data assessed for this question, the reason that "the turnover of deferred transactions is significantly higher on the OTC segment compared to the on-venue segment" is that trading in larger sizes is an inherent feature of trading OTC (i.e. on risk) as compared to trading on-venue, and importantly addresses different client needs. In this sense, OTC trading should be seen as complementary to, rather than a substitute for, on-venue trading.

AFME also notes that data relating to OTC activity is likely to be inflated by the reporting of certain technical trades (e.g. give-ups and give-ins, intra-group transactions for risk management purposes). AFME stands ready to work with ESMA, regulators and other market stakeholders (for example with the FIX Protocol Consolidated Tape Working Group) in order to address this issue.

<ESMA_QUESTION_CP_MIFID_EQT_27>

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.

<ESMA_QUESTION_CP_MIFID_EQT_28>

AFME agrees with the proposal to report and flag transactions which are not subject to the STO but subject to post-trade transparency. We think it would lead to overall improved data quality and accordingly more refined transparency calculations. However, we think the flags should be granular enough to allow market participants to distinguish addressable versus non-addressable liquidity. AFME members believe that non-price forming activity (e.g. give-up/give-in trades) should not be included in transparency calculations (e.g. liquid market, SMS).

AFME notes that market stakeholders have been addressing these issues in industry working groups such as FIX Protocol.

<ESMA_QUESTION_CP_MIFID_EQT_28>

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.

<ESMA_QUESTION_CP_MIFID_EQT_29>

AFME members consider that for systematic trading (such as electronic execution) publication standards should be the same for OTC trading (including SIs) as they are for trading venues and thus an immediate publication requirement is reasonable. However, for manual trading (such as voice-brokerage) it is reasonable to incorporate provision for a slight delay given the challenges with capturing trade information in a timely fashion in this context. In this regard, we consider it appropriate to calibrate timing with the standards set out in RTS 2. We agree that there should not be scope in the regulation to allow market participants to incorporate a deliberate delay and so some reference to the means of trading might be appropriate when setting an appropriate timeframe.

<ESMA_QUESTION_CP_MIFID_EQT_29>

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.

<ESMA_QUESTION_CP_MIFID_EQT_30>

We agree in principle with the position set out in the ESMA Opinion and so would support ESMA continuing to adopt this approach. However, for legal certainty and consistency we would like to see the position taken in the Opinion reflected in amendments to the Level 1 text.

<ESMA_QUESTION_CP_MIFID_EQT_30>

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?

<ESMA_QUESTION_CP_MIFID_EQT_31>

AFME members believe the STO should be removed. It does not result in positive outcomes for end-users and increases complexity in market structure. We echo the concerns about the STO recently stated by the German Ministry of Finance in their MIFID II review position paper[7]. Further, the STO can impact the confidence that (particularly international) clients have in the ability of EU firms to

[7] Position papers on MiFID II / MiFIR forwarded to the European Commission – link here

provide best execution on their behalf, and consequently the international competitiveness of these firms. This undesirable outcome is not consistent with the stated objectives of the CMU.

Should the STO continue to exist, we strongly agree that the scope of the STO should be adjusted to ensure that third country shares are excluded from its scope. It should be noted that for even this EU-only STO, there will exist a fundamental contradiction with best execution requirements. This tension will continue to result in sub-optimal outcomes for end investors.

The current STO has created unintended outcomes with negative consequences for investment firms and investors in European equities. We believe its current form goes beyond its intended purpose which we understand was to ensure trading in European shares occurs within the European jurisdiction or under an equivalent regulatory regime. We do not believe the intention was to prevent EU investment firms from trading shares such as Facebook or Mitsubishi on their home markets. Neither do we think the desired outcome was to put EU Investment Firms at a disadvantage by restricting access to the venues to which non-EU firms would have access.

Mitigating some of its potential unforeseen negative consequences has taken significant effort from EC officials, regulators and practitioners across the industry, for little benefit. The legislation has not cast the EU in a favourable light as a place in which to invest or raise capital. We believe this is because MiFID already ensures that multilateral trading cannot take place outside of a regulated market or a multilateral trading facilities. In addition, the SI regime and its qualifying thresholds ensure adequate supervision of firms that effect price forming transactions outside of trading venues. Further, EU brokers trading EU shares will be driven by MiFID II best execution obligations to access the largest pools of liquidity. For European shares this will typically be on European venues. Additionally, the needs of firms to benchmark prices to the primary market for a given share drives trading to European venues including the primary listing venue. Finally, the overall transparency regime for Equities ensures visibility of both pre and post trade information.

With the current regulatory framework, it is therefore unlikely that removing the STO would materially change the manner in which firms undertake transactions in shares in Europe.

AFME members' preference would be to remove the STO: trading in European shares was already taking place in Europe before the introduction of the rule and we believe it will continue to so without it. If removal of the STO is not considered appropriate, AFME proposes a number of amendments to make it more functional and ensure its scope of application is limited to truly European shares rather than any shares which may be capable of being traded in Europe (i.e. any shares traded on a trading venue).

In order to achieve this, an option would be to limit the STO to shares with an exchange listing in the EEA, rather than to all shares that are available for trading on EU venues. The rule should also recognise that where European-listed issuers have chosen to raise capital and list on a third country regulated market, as such trading in that listing should remain accessible to EU investment firms and EU investors. When referring to third country listings we mean shares in respect of an exchange listing has been pursued *at the initiative of the issuer* both on a regulated market in the EU and a third country equivalent. Such listings perform a valuable and legitimate role for companies' capital raising (both for EU firms raising capital abroad and non-EU firms raising capital in the EU).

Third Country Listing Exemption

An exemption for third country listings is necessary to avoid detrimental impacts for investors. Clients may be required to trade this line of the share (e.g. because their client mandate may include the currency of permitted investments), or they may need to otherwise access the closing price on that third country market (for example, where the non-EU line of the share is the one represented on an index they are tracking or are benchmarked to).

Where equivalence decisions have not yet been taken, permitting trading outside the EU in a share where there is a third country listing would also make it easier for EU companies to access additional pools of capital abroad as well as to encourage foreign issuers to list on European regulated markets. Finally, it would ensure that EU investment firms are not at a competitive disadvantage to non-EU firms when accessing liquidity. We do not share ESMA's concerns, identified at paragraph 277, that issuers would seek third country listings so as to become exempt from the STO. Seeking an additional listing is associated with stringent initial admission obligations, as well as ongoing disclosure obligations in the third country (and potentially other obligations under listing rules regarding governance etc). As a matter that would require substantial management time, expense and ongoing operational support (including complying with two different sets of rules), this means it would not be undertaken unless it is required by an issuer's capital raising strategy.

Implementation of a solution for identifying third country listings should be rather straight forward as primary issuance is a very tightly regulated and organised process in Europe. All regulated markets have knowledge of their issuers and hold this static data for the purpose of listing, trading and corporate actions management. In addition, the departure of the UK from Europe, the transposition of the EU rules into the UK rule book, the loss of the Swiss Equivalence and finally the ESMA guidelines vis a vis EU STO in the context of Brexit have already created the need to identify STO eligibility at a stock level, away from the TOTV concept. Such an effort should therefore be manageable, and the exemption rule would remove a number of uncertainties the market currently has to deal with as well as make EU capital markets competitive.

<u>AFME's view on ESMA's alternative suggestions</u>

<u>Alternative 1 – ISIN only</u>

We believe that, as far as the scope of the STO is concerned, the listing option is a superior solution to an ISIN only approach which first was considered after the removal of the Swiss Equivalence as well as to mitigate the potential issues of a no deal Brexit on STO. In that regard, we agree with ESMA's analysis at paragraph 273 that it would not solve the issues currently being experienced with the STO.

<u>Alternative 2 – ISIN plus currency</u>

We do not think that by adding a currency criterion to an ISIN approach (which would apply the STO to shares with an EEA ISIN but only if they trade in one of the EEA currencies) would serve to effectively mitigate the problems with the current scope of the STO or solve the issues identified by ESMA in paragraph 273 of its consultation. For example, EU firms would still be unable to trade shares such as Ryanair, Kingspan, Bank of Ireland and AIB on the London Stock Exchange (where significant liquidity pools exist for these shares).

<u>Summary</u>

We do not think that the STO serves a meaningful purpose in the EU market structure and have set out our reasoning as to why it is unnecessary above. If it is retained, we believe that casting the STO's scope as applying to shares that are admitted to trading on a regulated market in the EU, coupled with an exemption for third country listings, is the best, and most straight forward way, to mitigate the issues that have arisen since its introduction.

<ESMA_QUESTION_CP_MIFID_EQT_31>

Q32. Would you support removing SIs as eligible execution places for the purposes of the share trading obligation? If yes, do you think SIs should only be removed as eligible execution places with respect to liquid shares? Please provide arguments (including numerical evidence) supporting your views.

<ESMA_QUESTION_CP_MIFID_EQT_32>

AFME strongly opposes the removal of SIs as a legitimate execution venue for shares as part of the STO. SIs cover a range of activities which are complementary to liquidity available on Regulated Markets and MTFs as well as providing unique benefit to their clients.

AFME members as market intermediaries look to offer clients, including institutional asset managers a range of liquidity solutions to help meet their investment objectives. These include the execution of orders on execution venues, but also the ability for clients to gain the benefit of AFME members higher risk tolerance or balance sheet. An example of this is where an asset manager is looking to execute in large size with urgency. This liquidity may not be immediately available on trading venues. AFME members may take the risk from these clients providing certainty of execution to them and managing the subsequent market risk themselves.

In managing the market risk over an appropriate time horizon, AFME members will typically feed the risk into the market via multi-lateral trading venues. . In this way, they bridge the the asset manager's requirement to trade in large size and immediately, with the generally available supply of liquidity . As such SIs play an important role in bringing liquidity to the market.

Many AFME members operate SIs and strongly believe that there is considerable value offered by these structures to end investors. These "Bank SIs" provide unique liquidity that is distinct from that offered by other providers, such as exchange venues or Electronic Liquidity Provider SIs (ELP SIs). AFME believes that all of these sources of liquidity are important and that a diverse range of execution mechanisms should be offered to end investors to aid their performance and to encourage more investment from the firms outside of Europe, where alternative execution mechanisms co-exist successfully with the stock exchanges (e.g. in the US, Canada or Switzerland).

Depending on the size of an order, the liquidity of the stock and the trading objectives of an investment firm, dealing on behalf of corporate and/or retail clients, our members' expertise is critical to know how to execute the order to maximise performance and minimise impact. Sometimes, an open multilateral platform like an exchange is the best option and at other times, a Bank SI may offer the best execution outcome. A variety of execution services within banks currently operate under the SI regime: high touch trading and program trading for instance are activities where clients would often require the bank to transact in size, sometimes based on a commonly agreed benchmark such as volume-weighted average price (VWAP). As an SI, the bank will trade on risk and act as a facilitator for its client, unwinding the positions taken on its books over a period of time, most of the time on the Regulated Market. The service rendered to the client is twofold: they benefit from the bank's capacity to trade on risk, thus almost "lending" its capital, and they also benefit from the smooth execution of a trade that they would have otherwise found difficult on an order driven market. In some ways, the service provided by the Bank SI is akin to a bank lending money to a corporate, it acts as a shock absorber when clients want to trade large positions that would otherwise potentially create price deviation from the fair price of an issuer.

In their current form, European equities markets offer a diverse range of execution mechanisms to the benefit of market participants and end investors. Post MiFID II, there is now more focus on meeting best execution requirements than has been seen before, and AFME members think that a diversity of execution options, as well as competition between execution venues, results in beneficial outcomes for investors.

Throughout the MiFID II legislative process, there was a recognition that the continued provision of principal capital is important across asset classes and as such, the SI regime was reinvigorated. Banks and brokers have for years traded on principal with their clients and sought to continue to offer this important service by supporting the new SI structures created by the legislator for the purpose. AFME sees no evidence of a material increase in the amount of volume traded principally by banks over the last several years.

What was perhaps less expected was the emergence of ELP SIs, made up of proprietary market makers that had previously only operated anonymously on the lit and dark order books. It is important to note many ELPs represent some of the Regulated Markets and MTFs largest participants, often ranking in market share ahead of large sell side institutions. ELP SI volumes have grown since the introduction of MIFID II but remain low (2.4% of the overall market share based on Tabb's data from October 2019[8]).

It is important to understand the dynamics of bank SIs and to highlight some fundamental points:

- Bank SIs are distinct from BCNs as they only facilitate business that is deemed principal in nature (i.e. where a bank is offering its capital to a client to facilitate a trade). BCNs on the other hand, allowed bank clients to interact with other counterparties directly, without full transparency over who that other counterparty was.

- SIs do not provide the same service as an exchange. Bank SIs are putting up their principal capital to trade with clients, often in sizes considerably larger than that available on exchange lit books. Investors therefore have the option to trade with Bank SIs in cases it is deemed preferable according to the size and nature of their order. Removing this option would unduly restrict investors' choice in modes of execution and ultimately execution outcomes.

- Prior to recent market volatility, Europe has been operating in a liquidity constrained environment which has been well documented in the press. This was due to several factors including the macro environment, Brexit and the growth of the closing auction among other things. As such, over the period covered by ESMA's data, getting a trade executed throughout the day was harder meaning that the provision of capital via Bank SIs became an important and valued feature for investors. Our preliminary analysis of data since the Coronavirus pandemic (see charts in the pre-amble and in our response to Question 4 which shows data up to March 2020) shows a slight decrease in the proportion of OTC/SI and closing auction trading compared to the levels of continuous lit trading. This supports AFME's belief that levels of SI trading may have shown a slight upward trend during the period covered by ESMA's data (i.e. up to August 2019) as a result of macro factors and not as a result of market structure regulation.

In conclusion, Bank SIs provide investors with a trading service similar to the one corporate banks provides to business: the bank uses its capital and balance sheet to facilitate cheaper, more efficient and better priced investment transaction to the buy-side, which in turn benefits end investors, such as pensioners and savers, who entrust their money to asset and portfolio managers to obtain the best possible results for them.

<ESMA_QUESTION_CP_MIFID_EQT_32>

[8] https://tabbforum.com/opinions/mifid-ii-the-blocks-are-back/

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.

<ESMA_QUESTION_CP_MIFID_EQT_33>

Although it may be possible to argue that the exemption may not be necessary if the STO rule becomes limited to shares with a primary listing in Europe, it may still be important to keep such an exemption in place at Level 1 to allow ESMA flexibility in their regulatory guidance. Article 23(1) has been a cornerstone of the successive guidelines issued by ESMA and its relevance is directly linked to the hedge cases created by the rule. For instance, if the STO was limited to EU ISINs, some of the FTSE 100 names would not be tradeable on their home market, the London Stock Exchange, once the Brexit transition period has expired. If Hong Kong were to lose their equivalence, Prada would no longer be tradable for any EU investment firm. Thus, EU investors would be disadvantaged by compared to non-EU investors in their access to meaningful liquidity in certain stocks.

Finally, since Switzerland has lost its equivalence, Article 23(1) and ESMA guidance are also paramount in guaranteeing EU investment firms access to the Swiss issued listing of some European ISINs. In response to Question 31, we have set out our recommendations for how to adopt the scope of the STO and to introduce a third country listing exemption. We do not think other changes to the exemptions framework are required.

<ESMA_QUESTION_CP_MIFID_EQT_33>

Q34. Would you support simplifying the second exemption of Article 23 of MiFIR and not limiting it to transactions "carried out between eligible and/or professional counterparties"? Please provide arguments supporting your views.

<ESMA_QUESTION_CP_MIFID_EQT_34>

AFME members do not believe that removing the reference to eligible and professional counterparty would likely impact the usage of the exemption and would welcome a simplification to the rule. We think it is unlikely to have a significant impact considering the type of technical transactions benefiting from the extension are not retail in nature.

Regarding technical trades, we propose that industry participants and ESMA review ESMA's set of post trade transparency flags to identify possible improvements to post trade transparency. MiFID II has improved understanding of post trade data and in particular, off exchange trading. However, AFME believes further work could benefit the market as a whole. A recent example is the effort of the industry with regards the reporting of technical trades such as give ups. Further initiatives could be fostered to add flags to identify further technical trades and types of liquidity. We believe such an approach would be beneficial to the industry as a whole while not compromising the anonymous nature of post-trade transparency.

<ESMA_QUESTION_CP_MIFID_EQT_34>

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?

<ESMA_QUESTION_CP_MIFID_EQT_35>

The growth of volumes executed during the closing auction is a global trend which has not been developing/triggered in response to specific changes in regulation and there is little evidence to suggest that MiFID II has impacted this trend in Europe. AFME and the Investment Association[9] (representing buy-side firms) have set out arguments as to why shortening trading hours may be one means of providing more evenly distributed volumes throughout the day.

The structure of European closing auctions in contrast with the United States has resulted in the share of European closing auctions being perceived as some of the highest globally. However, this is largely attributable to the fact that auctions in Europe take place following the end of the continuous session, whilst in the U.S. central limit order book (CLOB) trading and the closing auction run in parallel.

We believe that closing auctions provide participants with access to a deep pool of liquidity that offers both certainty and speed of execution. However, closing auctions have until very recently remained a preserve of primary exchanges, and there has historically been no competition, which has led to higher participation fees, relative to CLOB trading, and little innovation. Given that primary venues exercise significant market power in relation to trading at the close, AFME recommends that ESMA and regulatory authorities promote competition and innovation in closing auctions.

It remains unclear as to whether the growth in auctions will continue or if initiatives such as the potential shortening of the trading will boost intraday activity. For this reason, we would like to recommend that ESMA continues to monitor the development of closing auctions over the next 12-18 months, and then determine whether any action is required. This would allow ESMA to formulate any changes based purely on hard evidence.

<ESMA_QUESTION_CP_MIFID_EQT_35>

[9] See AFME/IA response to the LSE Consultation Paper on market structure and trading hours – link here