

# EFAMA RESPONSE TO ESMA'S CONSULTATION PAPER ON MIFIR REPORT ON SYSTEMATIC INTERNALISERS IN NON-EQUITY INSTRUMENTS

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## I. Introduction

### A. Consolidated Tape.

EFAMA<sup>1</sup> understands that both the EU Commission DG FISMA (EC) as well as ESMA plan to mandate a Consolidated Tape ("CT") as a catalyst for handling the market data issues besides resolving in general the lack of pre- and post-trade price transparency.

EFAMA is supportive of a voluntary use based consolidated tape to the extent that:

- it is properly constructed and governed
- cover all financial instruments,
- built upon existing data to reduce its cost, and
- operated by ESMA.

### B. Role of the Systematic Internalisers.

Systematic Internalisers ("SIs") play a role in providing liquidity and price improvement within this ecosystem and act as a 'shock absorber' for end-users by limiting price impacts of buy-side positions.

There is no evidence to indicate that SIs have had any negative impact on liquidity or price discovery. As sources of liquidity, they add much needed diversity and competition which only stands to benefit investors. Should SI activity be restricted in any way, the only beneficiaries would be primary markets which risks establishing an oligopoly in European markets.

### C. Timing.

We consider that the time between the application of the rule and its assessment is too short to propose strong improvement as requested by this consultation.

In addition, the timeline imposed to reply to the current consultation and the ESMA consultation paper MIFIR report on the review of the transparency regime for equity, ETFs and other related instruments is hardly compatible with the time required to collect and compile adequately the data needed.

Lastly, we urge ESMA to bear in mind that any change to regulatory reporting is a cost for the industry that should be requested only after a cost/benefit analysis.

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<sup>1</sup> EFAMA is the voice of the European investment management industry, representing 28 member associations, 59 corporate members and 22 associate members. At end Q3 2019, total net assets of European investment funds reached EUR 17.2 trillion. These assets were managed by more than 62,500 investment funds, of which almost 34,000 were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining funds composed of AIFs (Alternative Investment Funds).

## II. Reply to questionnaire

**Q 1: Do you consider that there is a need to clarify what a “firm quote” is? If so, in your view, what are the characteristics to be met by such quote?**

We do not see a need to clarify what a “firm quote” is.

We believe that a “firm quote” shall meet the following characteristics:

- the offered priced shall be executable,
- for the required size of the instrument, and
- for a requestor.

**Q 2: (For SI clients) As a SI client, do you have easy access to the quotes published, i.e. can you potentially trade against those quotes when you are not the requestor? Do you happen to trade against SIs quotes when you are not the initial requestor? How often? If it varies across asset classes, please explain.**

We disagree with ESMA's proposal.

It is important to distinguish between two situations:

- If the client is not a direct client of the SI, we understand that a SI does not offer to open its trading books. It is the prerogative of a SI to choose its counterparties, as in any commercial relationship.
- If the client is a direct client of the SI, we would see benefits in gaining access to those data and trading opportunities. We also consider that the access to this information is controlled by the SI themselves and that access to this information has a cost which cannot be monitored by the SI's clients and is reflected in the price of the instruments. However, imposing such mechanism in the current legal framework would force the SI to enter in a transaction that might breach the counterparty risk limits, which should be avoided.

Regarding the availability of quotes, we consider that available quotes are always indicative quotes as per the criteria mentioned in Q1.

Quotes can only be executable taking into account the size of the instruments and the identity of the requestor thus we do not believe that this is something that should be changed as SI would therefore reflect their obligation to trade against the price quote in the price.

Also, we do see three potential negative consequences rendering published quotes executable:

- firstly, we believe that it would somehow affect the liquidity as SI would not publish executable price if they do not already own the instrument in their book.
- secondly this would lead to some kind of competition between the clients if for a requested instrument, a client does not consider that the price is good enough and do not trade against the quote but one or several other clients trade against at that price, the original requestor could be left without any option to trade with that SI.
- finally, the SI could potentially and on a discretionary basis arbitrate between the clients and decide to trade with a client which was not the original requestor.

Therefore, we would recommend ESMA to develop a consolidated tape for all financial instruments<sup>2</sup>, for post-trade data. This would provide the required transparent information, as post-trade data are the core pre-trade information.

**Q 3: What is your overall assessment of the pre-trade transparency provided by SIs in liquid non-equity instruments? Do you have any suggestion to amend the existing pre-trade transparency obligations? If so, please explain which ones and why.**

We consider that the current regime works relatively well.

We observe that SI pre-trade transparency for OTC derivatives remains limited to instruments classified as “traded on a trading venue” (ToTV) reflecting the fact that SIs have generally opted-in for ToTV instruments only. Technically speaking, there is very little trading that qualifies as SI trading activity in certain asset classes due to the overly granular approach to assessing ToTV. This may be an underlying cause explaining why virtually all volumes have been reported as ToTV in certain asset classes. For instance, regarding interest rate derivatives, data indicates that only ~5% of off-venue trading activity qualifies as ToTV. For SI pre-trade transparency to be reliable the concept of ToTV should be refined. Moreover, in its assessment of the SI transparency regime, ESMA should attempt to determine total ToTV trading volumes relative to total off-venue trading volumes on an asset class by asset class basis.

Also, ESMA does not appear to account for or assess the level of pre-trade transparency of package transactions involving SIs. Specifically, as per Section 4, Question 4(c) of ESMA’s Q&A on MiFID II MiFIR transparency topics, ESMA specifies that – “Where an investment firm is prompted for a quote for a package order for which it is a systematic internaliser only for some components, the investment firm can decide either to provide a firm quote for the whole package or only for the components for which it is a systematic internaliser.” Certain SIs are interpreting this as meaning that quoting requirements about package transactions are entirely discretionary even where it is a systematic internaliser for components of the package.

Accordingly, we recommend that ESMA amend the wording of the Q&A from “can decide either to” to “must either”. This would render the pre-trade transparency regime applicable to SIs more robust and guarantee that firms provide quotes for instruments even where those instruments are executed as part of a package.

We also encourage ESMA to keep in mind that SI are important liquidity providers and that they have a role of support to entrepreneurship that venues do not provide.

From our perspective, the most immediate tool to foster pre-trade transparency for all type of instruments is to develop and implement a consolidated tape.

**Q 4: (For SI clients) do you have access to quotes in illiquid instruments? If so, how often do you request access to those quotes? What is your assessment of the pre-trade transparency provided by SIs in illiquid instruments?**

Funds and asset managers are frequently trading above the large in scale waivers thresholds.

Therefore, we tend to receive information on assets that are liquid but under LIS and illiquid instruments.

See also our replies to Q2 and Q3 for further details.

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<sup>2</sup> See [EFAMA work on data costs and consolidated tape](#).

**Q 6: Do you consider that there is an unlevel playing field between SIs and multilateral trading venues active in non-equity instruments, in particular with respect to pre-trade transparency? If so, please explain why and suggest potential remedies.**

We disagree with ESMA's proposal.

Their respective role explains the different regimes, especially due to the risk that SI are taking and covering as well as their support to entrepreneurship. It is important to bear in mind that SI are also

- securities syndicators in case of IPO
- advisors in many M&As process.

Despite not being the ultimate remedy to all transparency issues, we insist on the need to implement well thought-through consolidated tape.

We would also encourage ESMA to enforce more strictly the rules related to the access and payment of data. We consider that the absence of enforcement of the "reasonable commercial costs" principle constitute a barrier to transparency as the cost of data may refrain some market participants to seek quotes for some instruments or some quotes.

**Q 8: What is your view on the proposal to simplify the requirements in relation to SI quotes in liquid non-equity instruments under Article 16(6) and 18(7)?**

As per our previous answers, we do not think that it would be beneficial to the clients, as the SIs could be required to trade on the published quote for a client and would have discretion to trade with other clients on a case by case basis,.

In practice, the prices are tailor-made for a specific client and for a specific size.

Requiring SI to trade against the quotes published could lead to:

- a decrease in the transactions offered by the SI, if they do not own the instruments, or
- arbitration between clients instead of reinforcing liquidity.

**Q 9: Do you consider that the requirements in relation to SI quotes in illiquid non-equity instruments (Article 18(2)) are appropriate? What is your preference between the options presented in paragraph 52 (please justify)?**

The use of waivers is beneficial to the industry which often trade under waiver (i.e. LIS waiver).

Funds and asset managers are investing for and on behalf of their clients.

To efficiently do so and to reduce costs of transactions, our members are frequently using waivers separately or in combination with each other since they interact to safeguard and facilitate institutional investors' ability to efficiently implement substantial investment decisions.

Therefore, we don't believe a change to the requirements applicable is necessary (option 1) and we consider that all waivers should remain, at least until a full-fledged Consolidated Tape for all financial instruments is in place.

**Q 14: What is your view on the best way for ESMA to fulfil the mandate related to whether quoted and traded prices reflect prevailing market conditions and in particular: (1) the source of data for the SI quotes/trades (RTS 27, APA); (2) the source of market data prices; and (3) the methodology to compare the two and formulate an assessment?**

See also our reply to question 2.

As first step, EFAMA suggests increasing supervision and enforcement of existing market data cost regulation by ESMA and NCAs in the near term.

Additionally, EFAMA argues for changes to applicable supervisory laws during the mandate of the new EC that are needed to:

- close gaps between existing legislations,
- achieve a coherent regulation of financial market data cost,
- impose cost transparency rules across the different data providers, and
- impose the creation of a consolidated tape operated by ESMA.

However, EFAMA cautions that it could actually worsen the market data problems considerably if the Consolidated Tape Providers' (CTP) governance and operations requirements are not calibrated adequately, as data consumers would use inadequate CTP data and therefore may be forced to continue to use the other market data sources as well. In addition, European authorities should keep in mind that a Consolidated Tape (CT) as such would not solve the market data's market failure – as is obvious when looking at the current problems in the US.

Finally, the impact of the “rebalancing” of trades post Brexit might be taken into consideration, since the volume might be significantly influenced by removing the de facto largest place of trade, that will inevitably have an impact on the LIS and SSTI. Therefore, we ask ESMA to freeze the different thresholds for at least 12 months or at least until a macro economic study is performed on the expected trading levels.

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