EFAMA
European Fund and Asset Management Association

CONSULTATION RESPONSE

Brussels, 29 April 2022

EFAMA's REPLY TO ESMA's CONSULTATION PAPER ON THE OPINION ON TRADING VENUE PERIMETER

We welcome this opportunity to comment on a review of the TV perimeter, and support ESMA's objective of clarifying when systems and facilities qualify as multilateral.

We believe that the proposed definition of multilateral systems is problematic as it risks bringing into scope some OMS and EMS tools which are utilized by investment managers to facilitate order and execution flow. Fundamentally, these systems are not designed to aggregate third-party bilateral indications or allow multilateral interactions. A distinguishing feature of a multilateral system is that it allows multiple banks to quote at the same time. With the OMS and EMS used by asset managers, the use-cases are limited to receiving market data to assist with best execution or sending a request directly to a single broker.

Definition of Multilateral System

The 4 criteria associated with a multilateral system should in theory exclude OMS and EMS, but as we describe below, we can see how all 4 criteria could be considered as fulfilled for some OMS/EMS utilized by some asset managers depending on broader definitions of 'third-party', system/facility and interaction between trading parties. In addition, ESMA's proposed definition of which systems should be considered 'multilateral' does not sufficiently differentiate between bilateral systems and multilateral systems and could therefore capture a number of EMS/OMS systems. It could also capture buy-side systems that have been developed to connect directly to counterparties of their choosing.

Certain Buy side participants have developed their own technology to execute with liquidity providers (e.g., SIs) directly. This is done with appropriate transparency and ultimately leads to a better and more efficient outcomes for the end investor. In effect, these systems would stop being a viable option under the ESMA's opinion. In addition, a dealer's ability to offer direct execution services to their clients will also be affected.

Forcing all these systems, that do not conduct trading, to become authorised as trading venues under MiFID II and subjecting them to complex and costly regulatory requirements would likely prevent them from existing in their current form and limit their ability to grow while reinforcing the monopolistic position of the already well-established trading venues. This would limit competition in the market, stifle innovation and will ultimately lead to increased costs for end-investors (as operational/regulatory costs are directly or indirectly passed along).

EMS/OMS

With respect to EMS, there should be a distinction between the 'pass-thru' and the 'governance' of a trade. The EMS is not making a decision to execute. That decision is taken by the trader at the investment management firm, the EMS is only a decision support tool. The investment firm ultimately controls the rules and parameters for execution, again disqualifying the EMS itself as a trading venue. Once the EMS makes available the best trading options, the actual trade will be executed on an MTF or SI. Again, what sets the OMS/EMS apart is that they provide an alert to execute, but the actual execution occurs away from the OMS/EMS on a separate protocol.

Therefore, for a system to be deemed multilateral, there should be a system operator (or organiser) that:

- Is a provider of the trading protocol; and
- Has provisions governing the execution protocol
- Has full control of rules (business and software); and
- Has visibility over the data; and
- Provides the trade execution timestamp (which indicates where the trade is matched and executed); and
- Oversees the facilitation of negotiation or the crossing of orders which is the concept used for OTFs in MiFID2 Article 20(6).

If OMS and EMS are allowed to fall in scope of the trading venue authorization, we would see an unlevel playing field emerge whereby only the larger asset managers would have the resources to build internal systems. Smaller investment managers would be forced to restrict their use of third-party systems which today provide necessary functions like facilitating order flows on large trades to mitigate against information leaks.

Q1: Do you agree with the interpretation of the definition of multilateral systems?

We do not agree with the proposed definition of multilateral systems and are concerned by this broad approach, which tends to bring all investment/asset managers in scope of the trading venue regulation. In general, all four criteria are likely to be fulfilled by investment/asset managers, e.g.:

- Multiple third-party buying and selling trading interests: an investment/asset manager trades on behalf of its clients and funds with counterparties and never on its own account. The systems and/or infrastructure used are usually operated by a third-party. In conclusion, the criterion would be fulfilled.
- It is a system or facility: as the definition is broad an includes non-automated procedures, the daily trading desk interaction with the market is caught and the criterion fulfilled.
- Interaction between trading interests: arranging, negotiating and/or "matching" of essential trading terms are key elements in any order-routing system of an investment/asset manager. Hence, this criterion is fulfilled.
- Financial instruments: trading interests typically occurs in financial instruments within the meaning of Article 4(15) of MiFID II, the criterion is therefore fulfilled.

We strongly encourage a review of this definition to ensure that trading activities by investment/asset managers on behalf of clients and funds do not qualify for trading venue authorisation. Investment/asset managers are not and do not operate trading venues in the understanding of the market.

Q2: Are there any other relevant characteristics to a multilateral system that should be taken into consideration when assessing the trading venue authorisation perimeter?

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- Provides the trade execution timestamp (which indicates where the trade is matched and executed); and
- Oversees the facilitation of negotiation or the crossing of orders which is the concept used for OTFs in MiFID2 Article 20(6).

An additional point we believe worth highlighting is that, under Article 18(7) MiFID2, multilateral trading facilities (MTFs) and organised trading facilities (OTF)s must "*have at least three materially active members or users, each having the opportunity to interact with all the others in respect to price formation.*" In our view, it appears that many of the elements of the proposed ESMA Opinion do not sufficiently consider the MiFID II "interaction" and "three materially active members/users" requirement as set out in the legislation.

Q4: Are you aware of any EMS or OMS that, considering their functioning, should be subject to trading venue authorisation? If yes, please provide a description.

We disagree with the conclusion in Figure 2. Independent of the functionality of the EMS, complying with regulatory obligations in relation to Best Execution and Market Conformity whereby trading interests are routed to different parties and venues to find best prices would bring the EMS in scope of the trading venue authorisation. We are struggling to understand, why an EMS should be considered as trading venue, as in simple terms the EMS will only look for the best prices of trading interests of investment/asset management clients and funds. The resulting trading activity would then be concluded on a MTF or with a SI, hence we fail to understand the added value to qualify the EMS as trading venue, as market critical activities and necessary reporting are fulfilled by the MTF or SI. In contrast to a trading venue, the EMS does not match trading interests of any party but is limited to clients/funds of the investment/asset manager on the one side and the authorised trading counterparts of the investment/asset manager on the other side.

Considering MiFIR requirements, associated obligations for trading venues such as e.g., transaction reporting and contribution to the consolidated tape cannot be met by investment/asset managers as infrastructure is not set-up for nano-second communication. Further, as the transactions are concluded on MTFs or SIs, respective obligations would be conducted by these trading venues and would lead to a duplication of information. If an EMS would be considered a trading venue, then practically the trade

would be concluded twice, once on the trading venue (e.g. MTF, SI) and once in the EMS, which from our perspective would be an incorrect result and also trigger double regulatory reporting of the same transaction and cause false inflation of volume.

Example to illustrate why an EMS in the ESMA Figure 2 scenario does not qualify as a trading venue:

- One software provider in the market allows clients to connect to sell side brokers and the terms on which they do so;
- The software replaces what would otherwise be done by phone so is merely a more efficient way of a buy side client seeking quotes;
- It is sold as software only, which clients can (1) install on their own servers, or (2) can be provided on servers as an additional service;
- For (1), the client installs, maintains and manages the software, and connectivity to brokers / liquidity provider themselves;
- For (2), the software provider supports staff installations, maintains and manages the software, and connectivity to brokers / liquidity providers, as a service for clients not wanting to take on the IT burden of hosting servers themselves;
- In both cases, the software provider has no visibility into what the client is doing, except for support purposes. The provider doesn't see what they're trading or the prices they're seeing.
- In some cases for (1), the software provider has no access to servers, even for support purposes. The client maintains and manages the software;
- It is noteworthy that the software provider should not have visibility of the system data for many reasons (day to day) including market abuse control (need to know access only) and for data confidentiality and trading sensitivity reasons;
- The software provider has no self-initiated powers, other than to ensure the software works. It does not have power to intervene in trades by suspending trading for reasons other than software issues, or to request specific information from users, such as information on positions, clients, etc.

We strongly recommend a review of the definition to ensure that trading activities by investment/asset managers on behalf of clients and funds do not qualify for trading venue authorisation. Investment/asset managers are not and do not operate trading venues in the understanding of the market. Further, proprietary systems (e.g. OMS, EMS) of investment/asset managers not sold or made available to third parties should be out-of-scope.

Q5: Do you agree that Figure 4 as described illustrates the operation of a bilateral system operated by an investment firm that should not require authorisation as a trading venue?

Yes, we agree that Figure 4 represents a bilateral interaction and should not require TV authorisation.

ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages over EUR 30 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors. More information available at www.efama.org.

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Contact

Susan Yavari
Senior Regulatory Policy Advisor – *Capital Markets*
Susan.yavari@efama.org | +32 2 548 26 55