European Securities and Markets Authority

Reply form for the ESMA MiFID II/MiFIR Discussion Paper

QUESTION 10

Should the data publication obligation apply to every financial instrument traded on the execution venue? Alternatively, should there be a minimum threshold of activity and, if so, how should it be defined (for example, frequency of trades, number of trades, turnover etc.)?

We are in favour of comprehensiveness in data publication across financial instruments and execution venues. Execution quality needs to be judged with reference to the liquidity characteristics of the financial instrument, which should form part of the data publication.
We do agree with ESMA that a development schedule that prioritizes some instruments over others (driven by total trading volume rank, for example) is appropriate.

QUESTION 11

How often should all execution data be published by trading venues? Is the minimum requirement specified in MiFID II sufficient, or should this frequency be increased? Is it reasonable or beneficial to require publication on a monthly basis and is it possible to reliably estimate the marginal cost of increased frequency?

We believe that execution data should be published more frequently than the annual minimum requirement specified by MiFID II. We are particularly interested in monitoring the execution quality of trading venues following changes in the trading venues' business logic. We believe that the marginal cost of increased publication frequency would be limited, assuming a standardized reporting format.

QUESTION 13

Do you agree that trading venues should publish the data relating to the quality of execution with regard to a uniform reference period, with a minimum of specific reporting details and in a compatible format of data based on a homogeneous calculation method? If not, please state why.

We agree that parameters should be consistent and uniform across trading venues. However, as noted in par 2.3.16, if the uniform reference period is infrequent, there may be potential issues with data reliability and manipulation. We therefore favour a more frequent reporting cycle, even if data may not always be directly comparable across trading venues due to lumpy liquidity.

QUESTION 14

Is the volume of orders received and executed a good indicator for investment firms to compare execution venues? Would the VBBO in a single stock published at the same time also be a good indicator by facilitating the creation of a periodic European price benchmark? Are there other indicators to be considered?

Post-trade reports of order and execution volumes are useful market share metrics to consider, and should enter into the order routing logic as one of the variables determining fill probability. We agree with 2.3.17 that by itself this would be insufficient to evaluate market quality. In conjunction with some of the metrics in Annex 2.3.1 Section C, particularly around order book depth, however, market share is a useful indicator.

We would consider the synchronous publication of a VBBO across trading venues to be an inferior alternative to a full consolidated tape. We would be concerned that synchronous publication of VBBO might achieve lock-in as a 'good enough' solution, leading to further delay in the development of a full consolidated tape.

QUESTION 15

The venue execution quality reporting obligation is intended to apply to all MiFID instruments. Is this feasible and what differences in approach will be required for different instrument types?

We believe that the benefits of having a standardized approach is preferable, even at the expense of potential data interpretation issues for certain instrument types, particularly less liquid instruments. We believe that market participants will be able to interpret results taking appropriate note of the trading characteristics of different instruments.

QUESTION 17

If available liquidity and execution quality are a function of order size, is it appropriate to split trades into ranges so that they are comparable? How should they be defined (for example, as a percentage of the average trading size of the financial instrument on the execution venue; fixed ranges by volume or value; or in another manner)?

If the data is to be aggregated, it would be appropriate to split trades into similar buckets. We would view percentage of trading value as the simplest useful discriminant, using a non-linear range (for example, 0-0.1% ADV, 0.1-0.25%, 0.25-0.5%, 0.5-1%, 1-5% etc).

QUESTION 18

Do you agree that a benchmark price is needed to evaluate execution quality? Would a depth-weighted benchmark that relates in size to the executed order be appropriate or, if not, could you provide alternative suggestions together with justification?

Depth-weighted spreads and prices are useful indicators of available liquidity. However, we question the accuracy of such measures in the presence of undisplayed liquidity.

We would lean towards simpler benchmarks to evaluate execution prices, such as a VBBO. This might lead to changes in the shape of the trading venue's limit order book. However, we believe that interested market participants will be able to identify and interpret systematic changes in the spread across a trading venue.

QUESTION 20

What would be the most appropriate way to measure the likelihood of execution in order to get useful data? Would it be a good indicator for likelihood of execution to measure the percentage of orders not executed at the end of the applicable trading period (for example the end of each trading day)? Should the modification of an order be taken into consideration?

The percentage of orders not executed at the end of the trading period is one extreme measure. We would also recommend statistics on order duration (time to get to the top of the book) as indicators of the likelihood of execution, as well as cancellation ratios.

QUESTION 21

What would be the most appropriate way to measure the speed of execution in order to get useful data?

Time from receipt of order, with a sufficient granularity (eg nanoseconds) to allow a direct comparison of latency in trading venues

QUESTION 45

What in your view would be the minimum content of information that would make an indication of interest actionable? Please provide arguments with your answer.

We agree that price, volume and side are the minimum content necessary for an actionable IOI.

QUESTION 53

What comments do you have in respect of the new large in scale transparency thresholds for shares proposed by ESMA?

We support a segmentation of large in scale thresholds for different liquidity categories, particularly for illiquid equities vs others. We see ADT as a reasonable and simple proxy for liquidity for this purpose. However, we believe that changes in trading technology over the last few years have meant that the definition of 'large in scale' orders has changed as well. In our experience, the overwhelming majority of orders are the output of algorithmic execution strategies, with only a relatively small residual (in terms of number of orders) coming from large-in-scale orders. Outside of the most illiquid segment of the market, we would expect the threshold trade size separating large-in-scale orders from others to be quite similar across liquidity categories. The low coefficient of change in minimum size and ADT in both current and proposed regulations reflects this.

As a result, we are not convinced of the merits of segmenting equities into too many different ADT buckets, with separate large-in-scale thresholds for each. We believe an appropriate balance between transparency and adverse selection protection can be struck with a common threshold level for most stocks. We acknowledge that setting different, lower thresholds for the most illiquid segment of the market (ADT<100,000) would make sense.

We would like to suggest creating a table for equities similar to that shown under 3.1.46 for ETFs, for different turnover thresholds (10, 20, and 30%, for example). This would allow the evaluation of what the large in scale thresholds would be on an empirical basis. We suspect that the thresholds will be quite similar across different ADT buckets, supporting the setting of a common threshold level for most stocks.

QUESTION 59

How frequently do you think the calculation per financial instrument should be performed to determine within which large in scale class it falls? Which combination of frequency and period would you recommend?

We believe that a review after no earlier than 2 years is appropriate. An annual calculation of ADT strikes us as sufficient, in particular since we are of the view that fewer ADT segments are better than more.

QUESTION 60

Do you agree with ESMA's opinion that stubs should become transparent once they are a certain percentage below the large in scale thresholds? If yes, at what percentage would you set the transparency threshold for large in scale stubs? Please provide reasons to support your answer.

We believe that stubs should become transparent once they are a certain percentage below the large in scale thresholds. We are concerned about the potential for abuse in the form of inflating order size to reach the LIS threshold, executing part of the order without pre-trade transparency, and then cancelling the remainder before the stub would become transparent. From that perspective, we are in favour of setting the point where stubs become transparent quite aggressively – even less than the 25% suggested by ESMA.

We believe that the potential for abuse outweighs the potential greater execution costs for large in scale traders.

QUESTION 61

Do you agree with ESMA's view that the most relevant market in terms of liquidity should be the trading venue with the highest turnover in the relevant financial instrument? Do you agree with an annual review of the most relevant market in terms of liquidity? Please give reasons for your answer.

In the absence of a consolidated BBO, it is reasonable to use the venue with the highest turnover as the most relevant market. In practice, we believe an annual review is sufficient.

QUESTION 76

Do you think that the current post-trade regime should be retained or that the identity of the systematic internaliser is relevant information which should be published? Please provide reasons for your response, distinguishing between liquid shares and illiquid shares.

We are concerned that post-trade transparency on the identity of the systematic internaliser would lead to less liquidity being available from these market participants. Pre-trade transparency in quotes would provide investors with a sufficient overview of available liquidity pools, in our mind. We do support the publication of aggregate data with a lag, however we believe that one calendar year is too much of a delay. We would suggest considering monthly or at least quarterly reports.

QUESTION 79

Do you support the proposal to introduce a flag for trades that benefit from the large in scale deferral? Please provide reasons for your response.

Yes that is useful – both because of the reference price exemption and because of the possibly deferral in publication. In many cases, such trades would be excluded from the benchmark price and volume calculations that are used to evaluate execution strategies. Not having a flag for those trades would make the construction of an appropriate trade price history more difficult.

QUESTION 80

What is your view on requiring post-trade reports to identify the market mechanism, the trading mode and the publication mode in addition to the flags for the different types of transactions proposed in the table above? Please provide reasons for your answer.

We support the MMT initiative and the increased transparency it can provide. We believe it to be beneficial both from a post trade transaction cost analysis perspective and from a regulatory oversight perspective. We appreciate the increased granularity, in particular around the trading mode and the publication mode. We view the MMT initiative as providing a comprehensive set of trade reporting flags, which would enable market participants to analyse trading dynamics in greater detail.

QUESTION 83

Do you agree with the proposed shortening of the maximum permissible delay to 1 minute? Do you see any reason to have a different maximum permissible deferral of publication for any equity-like instrument? Please provide reasons for your answer

We believe shortening the maximum permissible deferral to 1 minute is reasonable; and do not see any reasons to have different maximum permissible deferrals for different classes of equity-like instruments. We support a regular review of what 'as close to real-time as technically possible' should mean, and would expect to see further reductions in the maximum permissible delay in future.

QUESTION 84

Should the deferred publication regime be subject to the condition that the transaction is between an investment firm dealing on own account and a client of the firm? Please provide reasons for your answer.

We believe that the deferred publication regime reflects the realities of trading in Europe, in particular the reliance on OTC liquidity provisioning by investment firms. Having said that, deferrals do hinder the price discovery process. In our mind, they should be applied as sparingly as possible. In particular, there has to be a reasonable expectation that one side to the trade will be trading out of the position in a short period of time, and be deserving of some reporting deferral. From this perspective, we support that deferred publication should be subject to the counterparties being an investment firm and one of its clients.

QUESTION 85

Which of the two options do you prefer in relation to the deferral periods for large in scale transactions (or do you prefer another option that has not been proposed)? Please provide reasons for your answer

We appreciate the argument for Option B, giving the liquidity provider some time to hedge or unwind.

QUESTION 86

Do you see merit in adding more ADT classes and adjusting the large in scale thresholds as proposed? Please provide alternatives if you disagree with ESMA's proposal

We see merit in synchronizing the ADT classes for pre- and post-trade transparency. However, as we pointed out in the questions on pre-trade transparency, we favour simpler to more complex structures. . We view market as driven either by algorithmic execution characterized by many small transactions, or by large block-type transactions. While there is some differentiation in block size based on the trading volume of the stock, we believe that block size is considerably more driven by the position sizing in portfolios. Therefore, we are in favour of fewer classes (one for illiquid SME shares, another for megacaps/super-liquid stocks, and one for everything else). In our experience, setting the threshold for delayed publication at around 30% of ADV seems appropriate. We do favour fixed thresholds over relative thresholds, and would thus recommend calculating the median 30% of ADV for each bucket, and then setting the threshold at a round number closest to this median.

QUESTION 140

Do you agree that for the initial application of the new transparency regime the information should be made public within five minutes after the relevant non-equity transaction? Please provide reasons for your answer.

We think a maximum 5 minute delay is a good starting point, but would recommend revisiting this once the new regulations have been in force for a couple of years, with a view to bringing the maximum delay for non-equity instruments in line with equity instruments. We are aware of the potential technology challenges within voice markets of complying with this time limit, but believe these are surmountable.

QUESTION 141

Do you agree with the proposed text or would you propose an alternative option? Please provide reasons for your answer.

There is a distinction between large-in-scale deferrals and illiquidity deferrals. The former has a counterpart in equity-like instruments. We support a similar treatment for large-in-scale deferrals for liquid non-equity instruments and equity-like instruments. In particular, we do not see much merit in publishing transaction details with the volume masked for this deferral duration. Instead, the complete details should be published following the deferral period.

QUESTION 142

Do you agree that the intra-day deferral periods should range between 60 minutes and 120 minutes?

We support a similar treatment for large-in-scale deferrals for liquid non-equity instruments and equity-like instruments.

QUESTION 145

Do you support the proposal that the deferral for non-equity instruments which do not have a liquid market should be until the end of day + 1? Please provide reasons for your answer.

We support a longer deferral period for illiquid non-equity instruments, given the potentially greater difficulty in obtaining a reasonable hedge. We do believe that the actual time to build a hedge will be highly dependent on the situation; however, we do not think that a more granular approach based on asset class, for example, would be helpful to characterize the situation ex ante. Therefore, having a simple, uniform deferral horizon (eg. EOD t+1, as suggested) seems reasonable.

QUESTION 147

Do you agree with the proposal that during the deferred period for non-equity instruments which do not have a liquid market, the volume of the transaction should be omitted but all the other details of individual transactions must be published? Please provide reasons for your answer.

We believe that for illiquid instruments, price discovery is particularly important. We would therefore support the publication of transaction details with masked volume during the deferral period.

QUESTION 151

Do you agree with the proposed option? Which option would be more suitable for the calibration of the large in scale requirements within an asset class?

We agree with the preference for Option 2. Given that the volume distribution in non-equity instruments is highly skewed towards the liquid segment, and given that large-in-scale thresholds are only relevant for the liquid portion of non-equity instruments, we believe that setting thresholds for asset classes is appropriate.

QUESTION 154

Do you agree with the proposed approach? If no, which indicator would you consider more appropriate for the determination of large in scale thresholds for orders and transactions?

Yes, we agree with a measure that is comparable to that used for equity instruments.

QUESTION 156

In your view, which option would be more suitable for the determination of the large in scale thresholds? Please provide arguments.

Similar to our argument in the section on the determination of large-in-scale thresholds for equity instruments, we would suggest the definition of large-in-scale thresholds for non-equity instruments be based on a ‘coverage ratio’. We would suggest a target coverage for large-in-scale thresholds of between 20-30% of trading volume.

QUESTION 160

Do you think that the condition for deferred publication of large in scale transactions currently applying to shares (transaction is between an investment firm that deals on own account and a client of the investment firm) is applicable to non-equity instruments? Please provide reasons for your answer.

Yes, we believe the same condition should apply to non-equity instruments

QUESTION 190

Do you agree with the definition of ‘real time’ in relation to market monitoring of algorithmic trading activity by investment firms?

We believe it is important to include pre-trade monitoring as well. This may take the form of risk limits on a per-position basis, or statistical measures based on historically observed order flow frequency, characteristics of limit order posting etc. The purpose of this monitoring would be to prevent potential market abuse and maintain orderly markets.

QUESTION 194

Do you agree with the above approach?

We are concerned that a large part of the list, particularly the items relating to ‘complexity’, reflects current issues being discussed. The list may not be general enough to capture potential future market microstructure issues. We would prefer an analysis in terms of the ‘nature’ of the trading venue – the key question is which market participants are favoured or incentivized by a given structure. The aim of the regulation should be to correct imbalances between the advantages of different market participants when these become too large. This is likely to be both more robust and more relevant.

QUESTION 209

To what extent do you consider it appropriate to request having all the pre-trade controls in place? In which cases would it not be appropriate? Please elaborate.

The list is a fairly comprehensive starting point. We wonder whether an outcomes-based approach (i.e. have systems in place that prevent client harming themselves, prevent client from disrupting the market, and prevents market abuse) is sufficient and simpler.

QUESTION 259

Do you agree with the preliminary assessments above? What practical consequences would it have if firms would also be captured by Article 17(4) MiFID II when posting only one-way quotes, but doing so in different trading venues on different sides of the order book (i.e. posting buy quotes in venue A and sell quotes in venue B for the same instrument)?

Market making agreements are contracts between investment firms and trading venues. Even if the aggregate effect of posting one-way quotes across multiple trading venues is that of being a market maker, it might be difficult for a trading venue to determine whether an investment firm has met its obligation under the agreement. From this perspective, we favour limiting the definition of market making for market making agreement purposes to two-way quotes on a single trading venue.

QUESTION 264

Do you agree with the above assessment? If not, please elaborate.

In contrast to Q259, here we are looking at one-sided quotes in multiple related instruments (e.g. equity vs option, index vs constituents) in a single trading venue. We agree that this is market-making under the definition, since it could be verified by a single trading venue.

QUESTION 275

Do you disagree with any of the events that would qualify as 'exceptional circumstances'? Please elaborate.

We believe that the set of exceptional circumstances should be as narrow as possible, and be limited to technological issues with either the trading venue or connections to the trading venue. In particular, we do not believe that technological issues with investment firm systems or with internal risk management issues should be an automatic exceptional circumstance. Instead, they should be reported along with proposals for remedy.

We also do not believe that new information should constitute an exceptional circumstance – in these situations the role of the market maker as the liquidity provider is particularly important. We believe that the privilege of earning a market maker spread during 'normal' market conditions leads to obligations during other times (such as news releases).

QUESTION 305

What factors should ESMA be considering in ensuring that co-location services are provided in a 'transparent', 'fair' and 'non-discriminatory' manner?

We believe that there are two potential benefits to co-location. The first is the speed with which messages can reach the trading venue (e.g. new quotes, quote cancellations etc). We believe that this is a valid reason for co-location, and should be allowed subject to the payment of a fee. We remark that if this form of co-location were not allowed, there would be a business model for setting up an unaffiliated data centre 'across the road' which would provide substantially the same speed advantages, but without any regulatory oversight.

The second potential benefit to co-location is the speed in which messages from the trading venue are received. We are of the view that price and trade information (except for own trades) should not be available on a preferred basis to co-located entities. Instead, they should be available at a central, common location. Our experience with trading in the US tells us that arbitrage between the SIP feed and direct feeds is a significant contributor to the sense of US equity markets not being a level playing field. We recommend that these factors are taken into consideration when evaluating co-location services.

Note that we view the receipt of price and volume information for own trades as a valid purpose of co-location, since in this case, the co-located market participant provided a service to the rest of the market. We are aware of the potential latency arbitrage opportunities inherent in this approach, but view the benefit of that service as counterbalancing the cost of potential latency arbitrage.

QUESTION 605

What are your views generally on (1) the systems, procedures, arrangements supporting the flow of information to the CCP, (2) the operational process that should be in place to perform the transfer of margins, (3) the relevant parties involved these processes and the time required for each of the steps?

(1) **the systems, procedures, arrangements supporting the flow of information to the CCP**:

All of these should be standardised (format of messages and timing of deliveries) and automated where possible. The information should be easily accessible and transparent for the investor. Clearing members and clearing houses need to have flexible automated systems to be able to communicate with the investors' systems. The agreements between investors, clearing members and clearing houses should as far as possible be balanced standard documents with the ability for the parties to negotiate deviations.

(2) **the operational process that should be in place to perform the transfer of margins**: (1) Valuation issues need to have a quick resolution process or one that requires all adhering parties to accept a standard valuation source. (2) Clear and strict rules that define which transactions can be included in the daily valuation taking into consideration start and end dates. (3) The timing for when to agree margin calls and settle them is also important to have standardised for all parties. A T+1 settlement cycle for cash and bond margin trades would be our preferred option where "T" represents the day a margin call is being determined. Same day margin calls and settlement may be too challenging depending on volume and investigations that may need to be carried out.

(3) **the relevant parties involved these processes and the time required for each of the steps?** The clearing processes involve various different parties and a considerable number of steps from beginning to end (reference is made to the various flow diagrams that have been made available by market participants). Ideally the number of steps and the time required for those should be limited as much as possible in order to make the whole process as quick and efficient as possible, whilst still maintaining reliability and accuracy. See also our response to Q606.

QUESTION 606

In particular, who are currently responsible, in the ETD and OTC context, for obtaining the information required for clearing and for submitting the transaction to a CCP for clearing? Do you consider that anything should be changed in this respect? What are the current timeframes, in the ETD and OTC context, between the conclusion of the contract and the exchange of information required for clearing on one hand and on the other hand between the exchange of information and the submission of the transaction to the CPP?

Do you consider that anything should be changed in this respect? All information required for clearing should be standardised as much as possible in order for investors to know in advance what is required from them. If any additional information is required then it is the CMs responsibility to request this from the investor before a transaction is submitted to a CCP for clearing. For investors it is probably more attractive to use a broker which forms part of the same entity as the CM, as this reduces the number of parties involved in the clearing process. See also our response to Q608.

QUESTION 608

When does the CM assume the responsibility of the transactions? At the time when the CCP accepts the transaction or at a different moment in time?

At the time when the CCP accepts the transaction or at a different moment in time? During the trade matching process the CCP and the CM need to validate the transaction (confirm that it is eligible for clearing) in order for them to accept responsibility. It should be possible for the CM to validate the transaction before its submission to the CCP provided that specific standard criteria are met, so that the identification of trades as centrally clearable can happen sooner in the process. Such validation should take place in the step-by-step process following confirmation of the trade by the investor on the matching platform, for instance MarkitSERV. This would also support STP.

QUESTION 611

What are your views on the systems, procedures, arrangements and timeframe for (1) the submission of a transaction to the CCP and (2) the acceptance or rejection of a transaction by the CCP in view of the operational process required for a strong product validation in the context of ETD and OTC? How should it compare with the current process and timeframe? Does the current practice envisage a product validation?

See comments in Q608.

QUESTION 612

What should be the degree of flexibility for CM, its timeframe, and the characteristics of the systems, procedures and arrangements required to supporting that flexibility? How should it compare to the current practices and timeframe?

A market standard should be established for the settlement cycle for cash and bond collateral margin trades that allows enough time to handle collateral margin calls, disputes and settlement. A T+1 settlement cycle for cash and bond margin trades would be our preferred option where "T" represents the day a margin call is being determined. Same day margin calls and settlement may be too challenging depending on volume and investigations that may need to be carried out.

QUESTION 613

What are your views on the treatment of rejected transactions for transactions subject to the clearing requirement and those cleared on a voluntary basis? Do you agree that the framework should be set in advance?

We suggest that a trade rejected by either the CCP or the CB is sent back to the originators (traders from both parties) informing them of the rejection. This should then prompt the traders to action this rejection and decide whether to resubmit their trades for matching as bilateral (non-cleared) transactions or if they will agree on a new framework in place for a new clearable trade. Such rejections can be avoided if there is a framework is in place prior to execution to determine if a trade is clearable or not. This should apply to both categories, both transactions subject to the clearing requirement and those cleared on a voluntary basis