AFME's Response to ESMA Consultation Paper: ESMA's Opinion on the Trading Venue Perimeter

28 April 2022

1. Executive Summary

- Members of AFME support the EU and ESMA objectives of markets operating:
    - with increased transparency and investor protection;
    - in a fair and orderly manner;
    - with resilience and integrity;
    - as a level playing field; and
    - without stifling innovation
- Members understand a concern that there may be a perceived gap in how some vendors are interpreting the regulatory framework that this Opinion seeks to address. This could be achieved by regulating some of the providers as receivers and transmitters of orders where they are not operated by regulated entities (who are already subject to oversight).
- However, members believe that this proposed Opinion
    - deviates from the original MiFiD2 and MiFIR text; and
    - goes beyond what is needed to address any perceived regulatory gap.
- Members believe that if the Opinion were published as is, it will inadvertently harm the market in a number of areas set out herein and will create more uncertainty (contrary to its aim).
- Members also want to highlight that systems designed to facilitate cost efficient trading can and do exist with all the protections otherwise afforded to market participants by obligations placed on MTFs (including as to transparency).
- However, if there were any genuinely multilateral systems existing as 'de-facto MTFs', but not registered as such, we would suggest that these can be brought into scope by evaluating the existence, role and involvement of the system as an 'organiser'. The organiser would have to operate a system which involves multilateral interaction between at least three users interacting amongst themselves to require an OTF or MTF registration.

2. Background on the Functioning of Secondary Markets

- This response has been prepared by AFME's Fixed Income and Equities Divisions ("**AFME**", for the purposes of this response). AFME is concerned that a fundamental (but unnecessary) shift in market structure may be required if the Opinion was finalised in its current form.
- Banks, trading venues and other financial service providers all play a critical role in the EU financial services ecosystem. Trading in different sizes may warrant features not akin to those provided by central order books to ensure immediacy and minimise market impacts, which otherwise could and would not be achieved. The nature of the capital markets varies

between asset classes and can vary within each asset class depending on the depth of liquidity of each instrument.

- European fixed income markets play a critical role in providing funding for corporates and governments[1]. The differences between fixed income and equity market practices, types of fixed income investors and ways of transacting trades need to be considered in any Opinion in this area, and especially any changes to the multilateral concept.

- As markets become more automated, how and where trading takes place is changing. According to Trax, fixed income electronic trading rose from c 27% in 2017 to c 36% in March 2021. That said, there is a danger in assuming that electronic functionality or trading is synonymous with multilateral platforms. It isn't.

- Several fixed income market structures have evolved to accommodate the interests of a diverse array of corporate and sovereign issuers. Due to this heterogeneity, many different ways of trading (also called protocols) have developed. These include Request For Quote ("RFQ") and Request For Stream ("RFS"), RFQ to all, all-to-all and process trades. This heathy diversity of trading methods need to be preserved.

- While access to risk capital remains essential for active management of order flow, for illiquid instruments and larger trade sizes, it is particularly important for regulators and policymakers to maintain a market structure which provides the right balance of optionality for all types of order flow and market participants – large or small orders, executed electronically or by voice.

- Pursuing best execution on behalf of end investors is a key investor protection principle that should be protected. Restricting alternative trading methods means limiting the ways in which market impacts can be managed, which would result in higher implied trading costs (i.e., wider spreads) for end investors, reducing the value of their pensions and savings; higher volatility and, ultimately, reduced liquidity and inevitably higher funding costs, including for sovereigns.

3. **<u>Departure from Level 1</u>**

- The draft Opinion is a material change to the concepts of "multilateral system" and "multi-dealer platform" which are defined and referred to in the Level 1 texts in Article 4(19) MiFID2 and in Recital 20 MiFIR respectively (and validated by ESMA's own Market Structure Q&A). The draft proposal creates less certainty by departing from the purpose of a trading venue, which is to facilitate interaction by multiple parties leading to price formation, as referred to in

  - Article 18(7) MiFID2 which requires an MTF or OTF operator to have "at least three materially active members or users, each having the opportunity to interact with all the others in respect to price formation"; and

  - the definitions of MTF and OTF in Article 4(1)(22) MiFID2 both of which include as an essential element "interaction in a system in a way that results in a contract".

[1] • Further information on the Fixed Income is available at: https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_FixedIncome2021_08.pdf

- The platform needs to have all three of the following criteria: (i) a system; (ii) multiple buying and selling interests; and (iii) an interaction between those interests (as well as involving MiFID financial instruments).

- Single dealer platforms are already regulated as SIs (as contemplated in the Recital 20 MiFIR) or are routing trades to an SI.

- If ESMA does consider it necessary to re-open the concept of a trading venue, we respectfully suggest that it should be clarifying the concepts of the Level 1 text rather than departing from them.

4. **Departure from ESMA Q&As on market structure and place of execution (and reporting) determination guidance**

- The proposed Opinion also departs from ESMA's Market Structure Q&A (questions 7 and 10)[2] and paragraph 76 of its previous consultation paper.

- ESMA's Q&A 7 states:

"…the fundamental characteristic of a trading venue is to **execute transactions**. As defined under Article 4(1)(21), (22) and (23) of MiFID2, trading venues under all its possible forms as regulated market, multilateral trading facility and organised trading facility are multilateral systems "which bring together multiple third-party buying and selling interests in financial instruments […] *in a way that results in a contract*". Therefore, a *trading venue should not be allowed to arrange transactions without formalising the execution of those transactions under its rules and systems.* ESMA has also already clarified that a transaction cannot be concluded on more than one trading venue at the same time". [emphasis added]

- ESMA's Q&A 10(c) additionally acknowledges:

"If an investment firm arranges a transaction between two clients and the clients decide to formalise the trade on a regulated market or an MTF, the transaction would not be considered as taking place under the rules of the system because a transaction cannot be concluded on more than one venue."

- ESMA's previous consultation response states that:

"a trading venue cannot use its trading system and platform to arrange transactions that are then reported and executed on another trading venue."

- So, in instances where the transactions ultimately take place on a trading venue (rather than OTC including on SIs), requiring these software providers to become trading venues would be in direct contradiction with this Q&A. Should these software providers be required to become trading venues, the place of execution will be blurred and the consequent reporting obligations of the transaction will be confusing.

[2] https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-38_qas_markets_structures_issues.pdf, answer 7 page 41

5. **General recommendation**

- The Opinion needs refocus on:
    - what the "operating" (or "organising") service is that is being provided;
    - the "interaction" element of the test;
    - whether the provider has any involvement in terms being set and/ or visibility of that transaction; and
    - who maintains the execution "time stamp" and if so, how are they regulated.

6. **Other Considerations**

- ESMA relies too heavily on the CJEU *Robeco* judgment which is based on the concepts and text of MiFID1, which would have been decided differently under MiFID2. It also misinterprets the judgment. *Robeco* can be distinguished on the facts: it considered a market for the issuance and redemption of shares in UCITS overseen by Euronext's trading venue rules so it was very fact specific.

- There are appropriate protections for market participants trading on systems which do not qualify as trading venues: no further benefit will accrue by expanding the concept of trading venue as suggested in the Opinion:

    - First, market transparency requirements apply – trades will be published to an APA;
    - Secondly, market surveillance requirements apply regardless: all entities and market participants are subject to MAR (regardless of their form and authorisations) and compliance does not rely on the trade being concluded on a a trading venue. Investment firms and SIs are subject to extensive surveillance and controls.

- If an overly restrictive regulatory regime is enforced in the EU, this will drive innovation and more efficient markets to develop elsewhere in more favourable jurisdictions. Liquidity might be driven away: this is especially important in the context of fixed income markets, as the current MiFID package does not include a bond trading obligation. In summary, firms offering comparable innovative services in non-EU markets, for example, may not be subject to the same requirements.

- The proposed Opinion will deal with topics already being considered elsewhere by the European Commission as part of the MiFID review package. We suggest that it is premature to publish an Opinion until those negotiations are completed. Indeed, there is arguably no longer a case for the publication of an Opinion by ESMA given the November 2021 EC Proposal (as advocated by ESMA in its OTF Final Report) to move Article 1(7) MiFID2 to MiFIR. The publication of an Opinion at this juncture risks divergence between the Opinion and legislative amendments which may decrease legal certainty, contrary to ESMA's aim. The original basis for an Opinion was a short term measure until a legislative amendment was proposed, and proposals were released in November 2021.

- Additionally and importantly, it is noteworthy that the publication of an Opinion was not supported by the majority of respondents to ESMA's OTF Public Consultation, as conceded

by ESMA in its OTF Final Report.

7. Potential unintended (negative) consequences:

Members highlight the following:

- **Stifling of competition and loss of diversity:** The ESMA Opinion if adopted in its current form, will limit options for execution, which in turn will increase the cost of data and costs for end investors. It is likely to stifle competition and risks creating further EU restrictions, costs and frictions without investor benefits. This runs counter to the Capital Markets Union ambitions and the focus on end investor participation in markets. The CMU package was intended to focus on facilitating the raising of capital.

- **Overreach and fundamental market structure impact:** ESMA's current clarifications of the definition, and 'multilateral systems' scenarios go beyond the steps required to close any perceived regulatory gap. As a consequence, systems that serve to improve the overall functioning of the market, will either have to:

    - operate and register the system as a trading venue. This would lead to incurring disproportionate additional costs to end investors for no additional regulatory benefit; or

    - connect to a trading venue for execution. This would limit flexibility on how to execute, stifling innovation, and reducing the opportunity for cost efficient execution.

- **Stifling of innovation:** As noted above, the industry has increasingly adopted electronic methods to manage the information and process requirements placed on it by regulation and demand for efficiency. The proposed restrictions could lead to market participants choosing voice brokerage instead, leading to operational inefficiency consequences and less transparency.

- **Data ownership and costs:** Currently firms own their own data when trading as an SI. There are questions around loss of ownership; if EMSs require a trading venue licence it is likely that many will not provide the service. Members also note there are already widespread concerns with escalating market data costs (which are payable in addition to membership and execution fees)[3], and which would be likely to increase as the trading venues gain market power. Members urge ESMA to consider the risk that its proposals might further exacerbate this trend, when weighed up against any perceived benefits, before proceeding.

8. Consultation questions

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

No. AFME members are concerned that ESMA's interpretation of 'multilateral' is too wide. We set out below our fundamental questions and proposals around how ESMA needs to re-frame its positions. Members do not agree with many of the concepts ESMA is proposing.

[3] AFME_CostFixedIncome2021_09-1.pdf

The conditions in paragraph 11 of the draft Opinion should be cumulative requirements (with 'and' in between each requirement) as follows:

"four key aspects should be identified in a system or facility to be considered as a

multilateral system:

a) It is a system or facility; ***and***

b) there are multiple third-party buying and selling interests**; *and***

c) those trading interests are able to interact; and,

d) trading interests need to be in financial instruments.

We discuss the first three criteria below with an emphasis on the 'interaction' limb (c) which is the key differentiator (and was discussed in the CJEU *Robeco* judgement, albeit under different regulatory criteria and MiFID1).

- **System or facility**

Electronic trading is not synonymous with on venue trading There is a need to protect the OTC market, which should continue to exist in a digitalised world, and for regulators and regulation to support the ongoing digitalisation of trading workflows, for the reasons set out in the introduction. The current proposal seeks to characterise most electronic methods as a trading venue, when MiFID2 is technology agnostic (see ESMA's Market Structure Q&A).

There should be a clear distinction between:

  - systems where key parameters or rules which influence the interaction of trading interests are determined or applied centrally by an organising or operating entity in common to all users who may interact; and

  - systems which provide such capabilities but allow for each user of the system to apply, disapply or customise the parameters or rules independently such that the system cannot be said to operate under a single rulebook, or to be under the control of a single party responsible for the integrity of the system, meaning the way in which the trading interests interact.

- **Multiple third party concept**

AFME members do not agree with ESMA's interpretation of the definition of multilateral systems, which will lead to unintended and undesirable consequences.

Under Article 18(7) MiFID2, MTFs and OTFs 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*."

Many of the elements of the proposed Opinion appear to disregard this MiFID2 interaction and three materially active member/user requirement set out in the legislation. Put another way, the *Robeco* judgement held that, under MiFID1, "one to many" interactions (e.g. the ability of one party to trade with multiple parties) amounted to multilateral trading. However, post-MiFID2, it is not the

case that one-to-many interactions qualify because Art 18(7) requires “many to many” interactions. This is because the requirement states that there are at least three active users “*each* having the opportunity to interact with *all the others*” [emphasis added]

Members suggest that ESMA reconsiders its approach because it does not only misinterpret the *Robeco* judgment, but takes the concepts further. At paragraph 17 of the Consultation Paper, ESMA states that “In scope are also systems where only two trading interests interact, provided such trading interests are brought together under the rules of a third-party operator”. In other words, ESMA suggests that “one to one” interactions are also in scope if facilitated under a system operated by a third party. However, paragraph 35 of the *Robeco* judgment states: … the fact that there is no trading between the various brokers or between the various investment fund agents is irrelevant in so far as, within that system, *the agents can conclude transactions with multiple brokers and vice versa**.”*** [emphasis added]. This makes it clear that the court’s judgment related to one-to-many interactions (and not to one-to-one interactions as ESMA suggests). In any event, as set out in the paragraph above, we believe that any suggestion that one to one interactions can make a venue multilateral is inconsistent with MiFID2 that makes it clear it is only “many to many” interactions that are in scope of the definition post-MIFID2.

The proposed Opinion drafting in paragraph 17 specifically references two or more participants and needs to be amended, as suggested in Appendix 1, given this departs from the Level 1.

The ability to interact with at least two other participants is important. For example, an EMS that is connected to two SIs would not be within scope, if the SIs cannot interact with each other. Figure 5 on page 21 of the consultation does not clarify this and it is therefore misleading.

- **Ability of trading interests to interact and negotiate in a way that results in the conclusion of a contract**

This is the critical criteria in differentiating a trading venue. The interaction needs to be purposeful and result in the *negotiation and conclusion* of a contract (Art.4(1)(22) MiFID2). This is part of the MTF and OTF definitions. The platform needs to provide an execution service. It is not merely a service of putting at least three parties together; it requires three parties to be connected all together for the purpose of the negotiation and conclusion of trades in general, for the purpose (as noted above) of price formation.

The MiFID2 definitions of MTF and OTF are the following under Article 4(1) MiFID2 (our emphasis added):

  - **MTF: “**A “multilateral trading facility’ or ‘MTF’ means a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – *in a way that results in a contract* in accordance with Title II of this Directive”

  - **OTF:** An ‘organised trading facility’ or ‘OTF’ means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system *in a way that results in a contract* in accordance with Title II of this Directive;”

- The MiFID2 text has an existing concept of multilateral in Article 20(6) in the context of OTFs: it states that a platform may "facilitate *negotiation* between clients so as bringing together two or more potentially compatible trading interest in a transaction"[4]

- The text also discusses multiple dealers "interacting" in the same financial instrument not being a Single Dealer Platform.

- To ensure legal certainty, we recommend avoiding different interpretations of the multiple third-party concept and would welcome further clarity on how the proposals in this consultation could interact with the existing framework defined in MiFID2.

- **Practical Criteria**

Once the criteria in paragraph 11 of the Opinion (see p.6 above) are satisfied, ESMA could have regard to the following features when deciding whether a system is operating as a multilateral venue in practice. The satisfaction of a majority of these features could indicate that the system is operating as a multilateral venue, where a system operator (or organiser):

- Is a provider of the trading protocol; and

- Has provisions governing the execution protocol (which within our response we will refer to as the "execution organiser"); and

- Has full control of rules (business and software); and

- Has visibility over the trade, pricing and execution data; and

- Has the ability to reject a trade, for example, in specified situations under its Rulebook; and

- Provides the trade execution timestamp (which indicates where the trade is matched and executed); and

- Is not already subject to venue like regulatory oversight e.g. Systematic Internalisers.

And within such system most of the following features exist:

- Trades are formed when the trading venue executes them i.e., on acceptance of the AIOI (a firm offer to buy or sell or enter into an instrument);

- The trading venue has the power to cancel a trade/ orders/ RFQs in pre-determined situation;

- The system determines the exchange methodology protocols;

[4] MiFID2 Article 20(6) confirms that (i) systems that **cross client orders** and (ii) systems that arrange transactions in non-equities where the operator of the OTF may **facilitate negotiations** between clients so as to bring together two or more potentially compatible trading interests in a transaction are OTFs.

- The system has access to the pricing and trade data and offers facilities to report the trade;
- The system may charge fees to enable trading activity (e.g., connectivity and transaction fees);
- The system has at least three materially active members or users, each having the opportunity to interact with all the others in respect to price formation;
- The system maintains records and centrally authenticates all members/participants that are involved in the arrangement of the trade in the system;
- The service is generally standardized, so that the capabilities on offer are the same for all members;
- The operation of the system is subject to a rulebook which forms part of a contract between member/ participants and the operator of the venue and which sets out how trades are formed on the venue; and
- There are allocation, confirmation and settlement requirements to comply with CSDR.

- Critical questions to determine the execution "organiser"
  - Who is providing the terms around how execution is done, and the execution time stamp: is it the dealer or aggregator? Who is the counterparty?
  - Is the operator of the platform or provider of the software tool aware of the transaction?
  - Who is organising that execution?

- **Asset Management Example**

For example, an asset manager develops their own software (using their own or leased infrastructure) that connects to multiple venues and SIs. They own and operate it themselves. Based on ESMA's proposals it would appear that it would be in scope. If it was a trading venue it would not be accessing liquidity from multiple sources; it is an aggregator ultimately.

- **Buy Side Software Provider Example:**
  - 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 it 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;

- The software provider has no visibility of the system data. It therefore cannot be responsible for market surveillance as it has need to know access only;

- 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.;

- While the software may offer capabilities to influence how trades interact the software provider has no power over how those capabilities are deployed.

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

The criteria for assessing whether a system is determined as multilateral, and therefore classified as a trading venue depend on very limited but crucial characteristics in practice. In members' experience it requires:

- a provider of the exchange methodology (trading protocol); and

- the trade execution timestamp (which indicates where the trade is matched and executed); and

- the provisions governing the execution protocol (which within our response we will refer to as the "execution organiser", which could be demonstrated by a rulebook, as with Euronext and its rulebook in the *Robeco* judgement); and

- the facilitation of negotiation or the crossing of orders which is the concept used for OTFs in MiFID2 Article 20(6).

The scope is technology neutral (as ESMA acknowledges in paragraph 29 of its draft Opinion and its Market Structure Q&A 11). AFME members would like to emphasise that the technology deployed must *not be a determinant* in the assessment. This is because of:

- its evolution; and

- the fact evolution is in investors' interests (better price discovery and reduced transaction costs).

Single Dealer Platforms operated by third party software/ IT providers should not be captured (on the basis that the CJEU *Robeco* judgment was based on MiFID1 and not the MiFID2 text or concepts) (see our question 6 answer).

The legal and compliance burden of operating a trading venue is material and only required where there is a genuine market place resulting in negotiations and executions of transactions.

Q3: In your experience, is there any communication tool service that goes beyond providing information and allows trading to take place? If so, please describe the systems' characteristics.

No, AFME members are not aware of the full range of communication tools that are in use as some may be specific to certain regions, limited participants and limited products.

However, as outlined in our answer to question 1, if there is a communication tool that is "organising the execution" between multiple counterparties interacting with each other, including, publishing/outlining the trading protocols and providing a timestamp, then that tool should require trading venue authorisation. Furthermore, if that tool is charging fees and dictating the product scope, that lends further weight to the assessment.

Conversely, systems that only provide general connectivity for persons to communicate without protocols, such as utilities or electronic web chat tools, these should not require trading venue authorisation because these systems (i) are not specifically designed to bring together buyers and sellers of financial instruments; and/ or (ii) do not provide procedures or parameters for buyers and sellers of financial instruments to interact in a way that results in the negotiation and conclusion of a contract. For example, the following should ***not*** fall within the scope of these requirements:

- systems that do not match or dictate protocols;
- structured and unstructured bilateral chats (e.g., chat bots) and electronic multilateral unstructured chat providers (used to reach out simultaneously to multiple dealers, on the basis it is non structured, does not provide a protocol or organise the products it can trade);
- bulletin boards with communication tools (on the basis they may not be aware of the execution and are not 'organising' the execution);
- telephone lines;
- notification of matches and systems with Straight Through Processing (STP) affirmation via Markitwire and/ or post trade notifications (e.g. in some affirmation communication terminology); and
- APIs

As highlighted by the Advocate General in his Opinion in *Robeco* (paragraph 88), "mere information channels for the transmission of orders" must be appropriately differentiated from "systems in which financial instruments … are traded and its activity is carried out in accordance with the rules established by the system operator (Euronext) in a trading manual".

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.

Whether or not these systems are captured is fact specific. Members are not aware of EMS examples that "organise execution". The expertise of an EMS is their ability to provide technological connection and/ or aggregate liquidity only. An EMS is not generally an 'organiser' of markets. An EMS should be regulated as a receiver and transmitter of orders, if applicable, where the activity of such EMS falls within that regulated activity scope.

Following the multilateral 'interaction' criteria set out in question 1, an NCA needs to apply a case by case assessment and:

- Understand the offer framework and how the trade is "done" or not done (whether it is subject to the dealer's / SI's final agreement and framework and/ or whether the system is merely passing messages to a dealer or SI);
- Who owns the execution protocol (if it is the dealer, or a trading venue);
- Whether the timestamp is generated by the service provider and shown to the client (unlike a trading venue which assigns its timestamp to the trade); and
- Whose terms and surveillance applies to the transaction (for example, the dealer terms may apply).

The majority of liquidity providers will be SIs, but even if not, all relevant MiFID2 /MiFIR transparency requirements are met and reported through the waterfall assessment.

Many services are focussed on the technology only. Single Dealer Platforms have evolved faster than trading venues. Dealers often connect to Trading Venues via APIs which are not provided by the trading venues. For the avoidance of doubt, members do not consider that ESMA's Figure 2 constitutes a multilateral system with the criteria described above.

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, AFME members agree that Figure 4 within this Consultation Paper illustrates the operation of a bilateral system operated by an investment firm and should not require authorisation as a trading venue. This assessment should be independent of any technology deployed (for the reasons set out in question 2).

Such a restrictive approach towards the use of technology can also hinder innovation and reduce market participants' incentives to increase electronification. Indeed, should third party platforms be considered multilateral systems based on the technology they use, firms might not invest in such technology as they do not have the capital to comply with the requirement to register as a trading venue.

Q6: Do you agree that a "single-dealer" system operator by a third party, as described in Figure 5, should be considered as a multilateral system? If not, please explain.

No, AFME members do not agree with the ESMA interpretation that "single-dealer" systems operated by a third party should be considered as a multilateral system. Indeed, members are concerned that some 1-to-1 Request for Quote (RFQ) systems which aggregate quotes may also be captured by the definition. Those systems do not match trading interests and do not facilitate

the conclusion of a contract; therefore, we would welcome clarity on their exclusion from the scope of the definition of multilateral systems. This interpretation appears to disregard MiFIR Recital 20 and MiFID 2 Article 18(7):

- Under Article 18(7) MiFID2. MTFs and OTFs 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."-

- Under Recital 20: "a so-called single-dealer platform, where trading always takes place against a single investment firm, should be considered a systematic internaliser, were it to comply with the requirements included in this Regulation."

The organisation of the execution is the pivotal factor.

AFME members note that for the trading of bonds regardless of whether the trade is formalised on a trading venue or not, the client will usually obtain quotes from multiple dealers for voice negotiated trades (to obtain the best quote), and if that trade execution process is determined to be multilateral, then all participants trading fixed income in the EU will be required to register as a trading venue.

In our members' view, the factors must be objective and technology neutral such as the system's functioning and characteristics (rather than subjective factors such as whether the software is provided by third parties).

Members do not support the idea that two trading systems with exactly the same functionality and characteristics may be bilateral or multilateral depending on subjective factors, such as whether the technology used is developed by the sell-side or buy-side entity or by a third provider.

Operating the platform must be appropriately differentiated from the simple provision of a software or any other technology, as outlined in Figure 5, as MiFID2 should be technology neutral (as acknowledged in ESMA's Q&A and draft Opinion).

In addition:

- the text in paragraph 29 of the draft ESMA Opinion appears to contradict applying a differing approach between Figure 4 and 5;

- the Advocate General in *Robeco* distinguishes a technology provider that is not a market operator, who sells the same software or communication technology to many users as a product (see paragraph 81);

- Figure 5 could lead to misinterpretation, and lead to third party phone systems or the FIX messaging protocol being brought within scope under ESMA's proposals.

AFME strongly recommends that technology is removed from the assessment as this is not a criteria in the MiFID2 text. For this reason, a Single Dealer Platform with third party software does not fulfil the multilateral criteria set out above. It is a service to provide better price discovery and liquidity, which ultimately benefits end investors, provided there is a regulated counterparty with whom an investor or client can ultimately trade.

Such a restrictive approach towards the use of technology can also hinder innovation and reduce market participants' incentives to increase electronification. Indeed, should third party platforms be considered multilateral systems based on the technology they use, firms might not invest in such technology as they do not have the capital to comply with the requirement to register as a trading venue.

Members also note that the ECJ *Robeco* judgement is fact specific, relates to the MiFID 1 text and does not translate into other markets

Of particular note are the following elements. Members caution over-reliance outside its specific context:

- It was an interpretation of MiFID1;
- OTFs did not exist at the time of the judgement and AG Opinion (although the AG opinion notes the MiFID2 requirements);
- It was a distribution channel for fund units in open investment funds (for primarily retail investors as institutional investors can trade directly)- so it was a very different market. It involved interacting with fund agents on redemptions/ purchases rather than in the brokerage area;
- It was operating under the Euronext member non-discretionary rules set out in the Trading Manual (EFS Trading Manual' and 'TCS-web user Guide) to the EFS to which all members adhered;
- It was about retail market protections and transparency and notes: 'Large investors have the necessary knowledge to protect themselves' so very specific to the client base;
- It operated by Euronext "under the 'umbrella' of the administrative licence to act as a regulated market granted to Euronext by the AFM ";
- It found the 'interaction' (or intersection point) to be important (as we note above);
- Buying and selling interests are each brought together within the EFS system, by Euronext, giving rise to contracts and its operation is subject to the non-discretionary rules contained in the Trading Manual;
- The judgment did focus on whether contracts were formed in the system or not (and differentiating communication channels);
- The judgment focusses on the system organiser acting in a proprietary risk taking capacity (or not); and
- It was based on multiple trading parties (not just two).

Unlike Euronext EFS, many Single Dealer Platforms:

- are simple technology providers, that do not have the capacity to (and do not) make any decision on how or when transactions are closed;
- do not intervene in any decision that affects the execution of the transactions, as they act as mere transmitters of information between users;
- use standardised messaging protocols provided by other associations, such as the FIX Protocol to communicate between users; and
- use technology as a mere communication channel and do not usually cover how or when transactions in financial instruments can be executed between the parties.

For these purposes it is important to differentiate a "market operator" from "operating a market" based on:

- The nature and capacities of the provider (i.e., whether it is a market operator with the capacity and the level of knowledge to arrange transactions in financial instruments in the system or it is just a simple technology provider);
- Whether the provider has provided a common set of rules for all its users, that establishes how the negotiation of the financial instruments shall be conducted, or whether such rules are bilaterally agreed by its users; and
- The role that the provider carries out in the platform (i.e., whether it intervenes or makes any decision in the formation of a transaction using discretion or oversight or it acts a simple transmitter of information between two parties).

Q7: Do you agree that systems pre-arranging transactions that are formalised on a trading venue, even when arranged in a multilateral way, should not be required to be authorised as trading venues? Do you agree with the justification for such approach?

Yes, AFME members agree that systems pre-arranging transactions that are formalised on a trading venue should not require trading venue authorisation.

Q8: Are there any other conditions that should apply to these pre-arranged systems?

No, there are no other conditions that could apply to these pre-arranged systems.

Q9: Are there in your views any circumstances where it would not be possible for an executing trading venue to sign contractual arrangements with the pre-arranging platforms? If yes, please elaborate.

AFME members are not aware of any such circumstances

Appendix 1- Drafting Proposals or Changes

Our bold and italics and strike through are added below to suggest changes:

Paragraph 11:

"four key aspects should be identified in a system or facility to be considered as a multilateral system:
a) It is a system or facility; ***and***
b) There are multiple third-party buying and selling interests**;** ***and***
c) those trading interests are able to interact; and,
d) trading interests need to be in financial instruments.

Paragraph 14:

"Under MiFID II, the definitional scope of multilateral system should include those non-automated arrangements that achieve a similar outcome as a computerised system~~, including those where a firm reaches out to other clients to find a potential match when receiving an initial buying or selling interest~~"

Note: this muddies the water and does not define a multilateral system so question the value of this text as it is creating greater uncertainty. Members suggest all of the multilateral criteria are cumulative conditions under paragraph 11 above to fix this.

Paragraphs 17-18:

"17. In scope are also systems where only ***three or more active*** ~~two~~ trading interests interact ***with each other,*** provided such trading interests are brought together under the rules [of a third-party operator]. [This interpretation is supported by a legal analysis of the Court of Justice of the European Union. This analysis refutes the argument that a system is deemed to be bilateral even where there is always the same participant on the one side of a trade which executes the order from an investor. Considering such system as bilateral would negate the involvement of the system operator where they ~~**which**~~ run~~**s**~~ the system as an independent operator in respect of the transactions***.*** Therefore, having a single liquidity provider is not sufficient for the system to be considered bilateral.]

Note: We think this text should be removed altogether as being misleading and confusing as the Robeco judgement is fact specific, related to MiFID 1 provisions (not OTFs) and related to collective investment scheme issuance and redemptions. These redemptions and issuances were overseen by Euronext and its trading manual and rules.

18. ~~On the contrary, t~~Those systems where the interaction occurs between two counterparties only, with no actual or potential third-party involvement operating the system, should not be considered multilateral. In general, those bilateral systems operate according to the rules and/or commercial policy of the dealer (the systematic internaliser (SI)) without the intervention of any third party. The SI trades on own account on every transaction in the bilateral system and is required to take on market risk. ***"***

Paragraphs 20-21

AFME members would suggest a change to paragraph 20 that it does require the conclusion of a contract in accordance with the Level 1 text requirements:

"20. The definition of multilateral systems does not require the conclusion of a contract ***in the system*** as a condition, but simply that trading interests can interact within the system ***in way that results in a contract that is subject to the systems rules, protocols and oversight***. ~~Hence, the conclusion of a contract is not a prerequisite for a firm to be required to request authorisation as a trading venue for the system or facility it operates. Systems or facilities where trading interests can interact, where there is confirmation of a trade or where the essential terms have been (or can be) negotiated (for example buy/sell, price, quantity), would still require authorisation as a trading venue, even if some further contractual details are arranged outside of the system as is the case with many derivative contracts. In such instances it cannot be argued that there is no interaction in between trading interests only~~ because the final terms of the contractual agreement are concluded outside of the system or facility

21. The interaction can be the result of automated mechanisms, for example, where there is an automated match on an order book system; or it can be the result of a concrete action by the member or participant, as it is the case on some RFQ or quote driven systems. In both circumstances there is interaction between trading interests within the system ***where it results in a contract that is subject to the systems rules, protocols and oversight.***

…..

Paragraphs 29

29. It should also be noted that it is not the form of the arrangement nor the technology used that determines the need for authorisation. Rather it is the functioning of the arrangement that is key to assess whether the activity should require authorisation. That is to say that, for example, systems which facilitate the interaction of third-party trading interests related to financial instruments should require authorisation ~~**as a trading venue,**~~ whether it is by using in-house facilities or by employing third-party systems.

Note: suggest ESMA strikes this out as this is not the only way software providers would be regulated, as ESMA acknowledges itself in its feedback on its previous consultation

Paragraph 36

36. RFQ systems as described in RTS 1 and 2, are defined as systems where quotes are provided in response to a request submitted by one firm. This is the case of systems that allow for the interaction of multiple members or participants (Client A, Client B) with multiple liquidity providers (Dealer A, Dealer B, … Dealer n). Each Client has the possibility of interacting with multiple Dealers who will act as counterparties to deal in a specific financial instrument. The Client may request a quote to N Dealers and the responses are sent individually to the Client. The responses are referring to one single request on which the client requested quotes in a multilateral way. ~~In light of the above consideration, ESMA deems such systems as multilateral in nature and hence requiring authorisation as a trading venue.~~

Note: paragraphs 37 -44 require material adaptation or removal